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FIRST Trust ADVISORS L.P.

Sep 18, 2006

Monday Morning Outlook

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-19 / 7:30 am	Aug PPI	+0.3%	+0.3%		+0.1%
	Aug "Core" PPI	0.2%	+0.3%		-0.3%
	Aug Housing Starts	1.75M	1.77M		1.80M
9-20 / 1:15pm	FOMC Meeting	5.25%	5.25%		5.25%
9-21 / 7:30 am	Initial Unemployment Claims	310K	305K		308K
9-21 / 11:00 am	Sep Philly Fed Survey	14.3	16.0		18.5

Soft, Hard, or Any Landing at All?

There is a great deal of conflicting economic opinion these days. The playing field looks like this: Roughly 20% of forecasters, pundits and analysts think there is a hard landing underway, which includes significant odds of a recession. About 20% think the economy will continue to grow at its recent pace of near 3.5% real growth. The remaining 60% (which includes the economic forecasting staff at the Federal Reserve Board) believe that a soft landing is underway, with real growth likely to fall toward 2.0% later this year and into 2007.

We find ourselves in the more optimistic 20% and believe that the economy is resilient and will retain its forward momentum. We base this forecast on three simple ideas. First, tax rates remain low. Second, productivity, profits and investment remain very strong. And third, the federal funds rate is still well below levels that have caused recessions in the past (especially when compared to nominal GDP growth). In fact, the federal funds rate would need to rise to 7% or 8% to match the tightness of monetary policy seen before the 1980, 1990 or 2001 recessions.

Despite these factors, which calm our fears about the probability of a recession or economic slowdown this year, there are some clear signs of economic weakness developing.

Data for August show that non-auto manufacturing output fell 0.1%, retail sales grew just 0.2%, and the ISM manufacturing index sat at a subdued 54.5. This comes on top of very weak data in the housing sector, rising inventories and somewhat weaker non-farm payroll statistics. In football parlance, were still ahead, but the team's not scoring on every drive.

However, this doesn't mean that the team can't get renewed vigor after an inspiring half-time speech. And, looking back at the data from recent years reveals that there have been many times when the economy has appeared to be slowing. For example, in 2004 and 2005, retail sales and industrial production each declined six times. In other words, there were many small stumbles. These stumbles were always followed by a drumbeat of pessimistic forecasts predicting that the recovery was in jeopardy.

In fact, forecasts of recession, or a significant slowdown, have been a staple of this recovery. This has been one of the least respected recoveries in history. Or, as our good friend Larry Kudlow says, "It's the greatest story never told."

Part of the problem is that the economy is becoming much harder to measure. For example, the first estimates of non-farm payroll employment and wage growth are sourced from state unemployment insurance systems. But, a growing number of independent contractors and the self-employed do not report to this system. For example, it is estimated that upwards of 600,000 people make a significant portion of their income by selling on eBay – a development that is difficult for the government to measure.

This is one reason we have relied on tax receipts as a measure of real income growth. Those data show individual income tax receipts up 12.4% so far this year – the second year of double digit year-over-year growth. This is why the government is often making large upward revisions to historical income data.

While it is true that the housing market is slowing precipitously, we view this slowdown as a return to the norm after a few years of above average growth on the back of extremely low interest rates. As a result, we do not believe that the housing market will drag the entire economy down with it.

In the end, the normal indicators of an impending slowdown – very high real interest rates, rising initial claims, a drop in investment – have not appeared. It's tough to get fearful of any landing at all.

Week of September 25, 2006

Date/Time (CDT)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-25 / 9:00 am	Aug Existing Home Sales	6.25M	6.28M		6.33M
9-27 / 7:30 am	Aug Durable Goods Orders	+0.8%	+1.0%		-2.5%
9:00 am	Aug New Home Sales	1.05M	1.05M		1.07M
9-28 / 7:30 am	Q2 Real GDP: Final	+2.9%	+3.0%		+2.9%
	Q2 GDP Price Index: Final	+3.3%	+3.3%		+3.3%
9-29 / 7:30 am	Aug Personal Income	+0.3%	+0.4%		+0.5%
	Aug Personal Outlays	+0.2%	+0.2%		+0.8%
9:00 am	Sep Chicago PMI	56.0	57.0		57.1

Brian S. Wesbury; Chief Economist **Bill Mulvihill; Senior Economist**