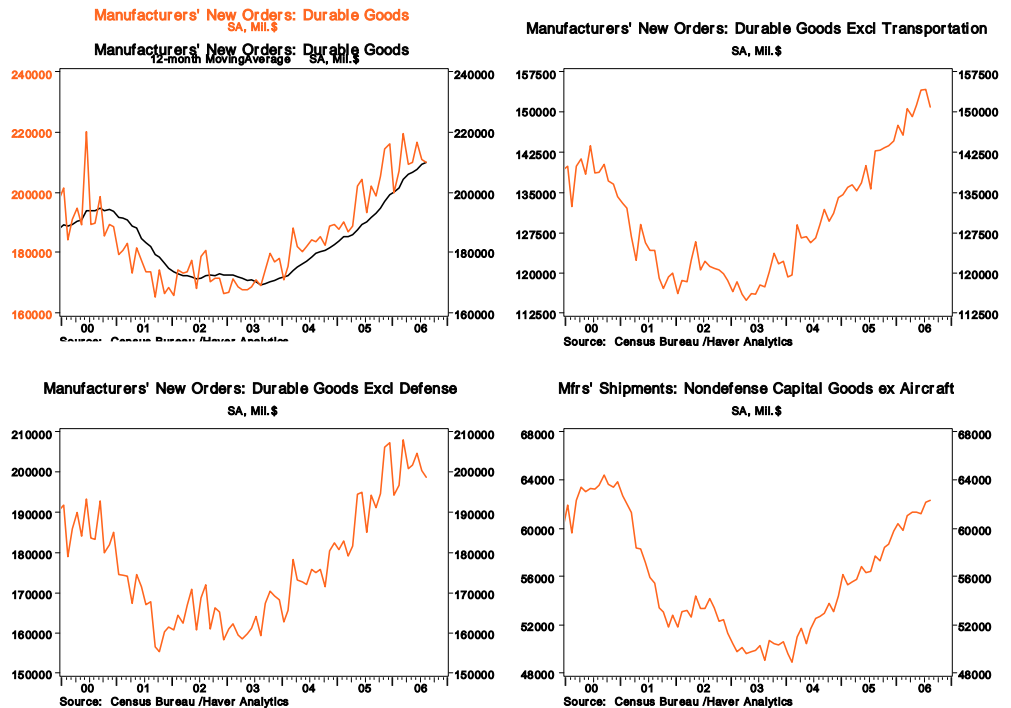


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## AUGUST DURABLE GOODS

- New orders for durable goods unexpectedly fell 0.5% in August after a downwardly revised 2.7% decline in July (originally -2.5%). New orders are up just 3.8% in the past year.
- Transportation orders rose 3.7% in August, in large part due to a 4.4% increase in motor vehicle and parts orders. Excluding transportation, new orders fell 2.0% in August and July's data was downwardly revised to show no gain (originally +0.5%). New orders excluding transportation are up 5.8% in the past year.
- Shipments of durable goods jumped 1.9% last month and are up 6.9% in the past year. Shipments of non-defense capital goods, ex aircraft (a proxy for business CAPEX) rose 0.3% in August, and are up an annualized 6.3% thus far in Q3 versus the average level of Q2.



**Implications:** At first glance, weak durable goods orders during August raise a red flag about the health of this economic expansion. Durable goods measure the supply-side of the economy and, as such, are a great leading indicator of economic activity. If this trend of weak durable goods orders were to hold, we would sharply downgrade our forecast for economic growth. Nonetheless, there are many reasons to believe this trend will not hold. Profits continue to boom, corporate balance sheets are flush with cash, and low tax rates on capital gains and dividends continue to suppress the cost of capital. These are powerful fundamentals, which should keep durable goods orders and shipments growing at a healthy rate. Durable goods data are notoriously volatile, and this volatility can last for more than one month. Moreover, a slowdown in housing has eroded electrical equipment and appliance orders. Adjusting for these factors, and looking at longer-term trends suggests that the durable goods sector of the US economy remains relatively strong. In the first two months of Q3, non-defense, capital goods new orders, excluding aircraft (a proxy for business fixed investment), are an annualized 7.7% above the Q2 average, while shipments are an annualized 6.3% higher. Both these rates of change are faster than in Q2. Despite today's weaker than expected data, investment in Q3 remains robust and we continue to forecast real GDP growth in the 3.0% to 3.5% range in Q3 and Q4.

Durable Goods Orders <i>All data seasonally adjusted</i>	Aug-06	Jul-06	Jun-06	3-mo % ch. annualized	6-mo % ch. annualized	Yr over yr % ch.
<b>Durable Goods Orders</b>	<b>-0.5%</b>	-2.7%	3.3%	-0.2%	2.6%	3.8%
<b>Ex Defense</b>	<b>-0.8%</b>	-2.2%	1.5%	-5.9%	2.1%	2.3%
<b>Ex Transportation</b>	<b>-2.0%</b>	0.0%	1.8%	-1.1%	7.4%	5.8%
<b>Primary Metals</b>	<b>-2.1%</b>	1.7%	0.1%	-1.5%	33.1%	16.5%
<b>Industrial Machinery</b>	<b>-2.1%</b>	0.5%	0.4%	-4.6%	17.9%	9.9%
<b>Computers and Electronic Products</b>	<b>-4.7%</b>	5.1%	5.7%	26.0%	6.9%	3.2%
<b>Transportation Equipment</b>	<b>3.7%</b>	-9.5%	7.0%	2.2%	-8.2%	-0.8%
<b>Shipments</b>	<b>1.9%</b>	-1.3%	0.2%	3.0%	5.7%	6.9%
<b>Unfilled Orders</b>	<b>0.4%</b>	1.2%	1.7%	13.8%	18.1%	18.4%
<b>Capital Goods Orders</b>	<b>-2.4%</b>	-2.4%	6.2%	4.7%	1.4%	4.4%
<b>Defense</b>	<b>6.1%</b>	-14.6%	51.7%	258.4%	16.2%	42.6%
<b>Nondefense Capital Goods</b>	<b>-3.5%</b>	-0.6%	1.7%	-9.3%	-0.4%	0.7%

**Source: Bureau of the Census**

*This report was prepared by First Trust Advisors, L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security*