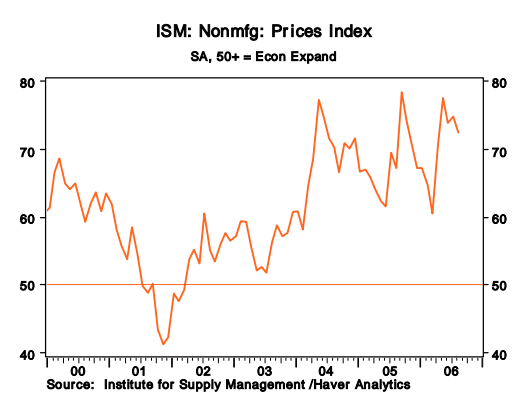
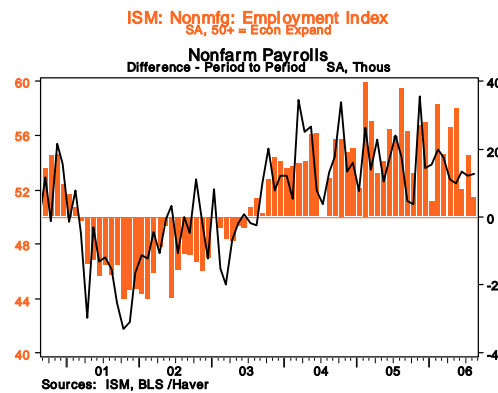
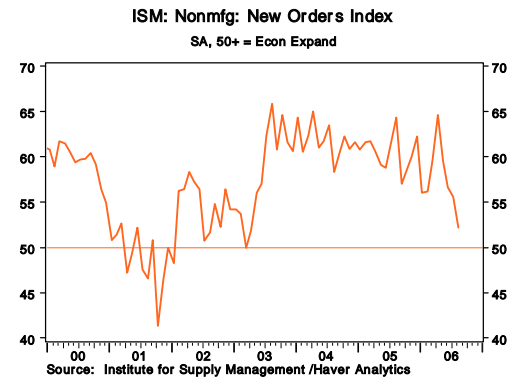
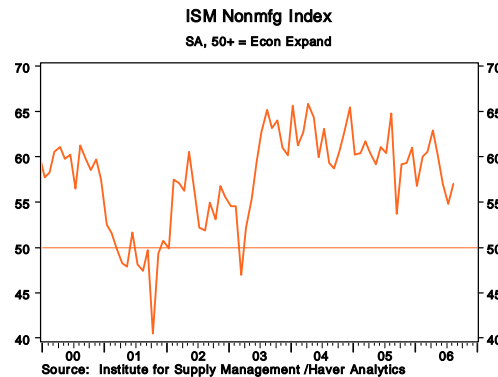


## AUG ISM NON-MANUFACTURING INDEX

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- The ISM non-manufacturing business barometer (a measure of total output in the services sector) jumped to 57.0 in August versus 54.8 in July. However, the new orders component slumped to 52.1 last month – the lowest level since April 2003.
- The employment component pulled back to 51.4 in August from 54.5 in July. Still, the employment index has been above 50 for the 38<sup>th</sup> consecutive month.
- The prices paid component fell to 72.4 in August from 74.8 in July. Nonetheless, the price component has averaged 73.6 over the past five months, the highest five-month average in the nine year history of the data.

**Implications:** While the ISM non-manufacturing business barometer strengthened in August, economic data in general this year have reflected slightly less vigorous growth in economic activity. The ISM non-manufacturing index averaged 58.7 in the first eight months of 2006, a slowdown from the 60.1 average in 2005 and the 62.5 average in 2004. Moreover, the forward-looking new orders component fell to 52.1 in August, the lowest level since the passage of the pro-growth tax cuts in May 2003. This suggests that growth has pulled back from near 4.0% real growth to a pace closer to 3.5%. Growth near this level is still fast enough to keep corporate profits strong and unemployment low. Nonetheless, history shows that a pull-back in growth does not tame inflation. In fact, rising inflation may be part of the reason that real growth is slowing. Inflation is a monetary phenomenon and the elevated price component of the ISM non-manufacturing sector (as well as the bulge in commodity prices) suggests that the Fed has been much too easy for much too long. Separately, compensation and unit labor costs were revised sharply higher in the first half of 2006. Compensation has climbed by 7.7% in the past year, while unit labor costs are up 5.0%. These data suggest that inflationary pressures are beginning to affect labor costs. Moreover, with income growth accelerating, slower consumer spending is unlikely.



<b>Non-Manufacturing ISM Index</b> <i>seasonally adjusted unless indicated</i>	<b>Aug-06</b>	<b>Jul-06</b>	<b>Jun-06</b>	<b>3-mo</b> <i>moving avga</i>	<b>6-mo</b> <i>moving avga</i>	<b>Yr ago</b> <i>level</i>
<b>Business Barometer</b>	57.0	54.8	57.0	56.3	58.7	64.8
<b>New Orders</b>	52.1	55.6	56.6	54.8	58.0	64.3
<b>Employment</b>	51.4	54.5	52.0	52.6	54.5	59.4
<b>Prices</b>	72.4	74.8	73.9	73.7	71.6	67.2
<b>Supplier Deliveries (not seasonally adjusted)</b>	53.5	54.5	56.0	54.7	54.8	55.0
<b>Inventory Change (not seasonally adjusted)</b>	51.5	53.0	51.5	52.0	54.7	53.5
<b>Orders Backlog (not seasonally adjusted)</b>	49.5	56.0	55.5	53.7	52.9	52.0
<b>Imports (not seasonally adjusted)</b>	60.0	60.5	55.5	58.7	58.7	61.5

Source: Institute for Supply Management

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