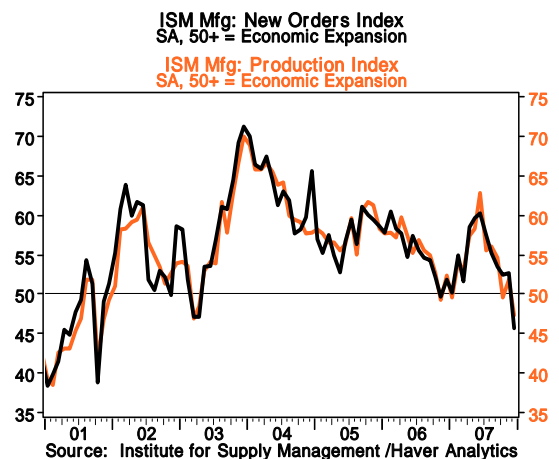
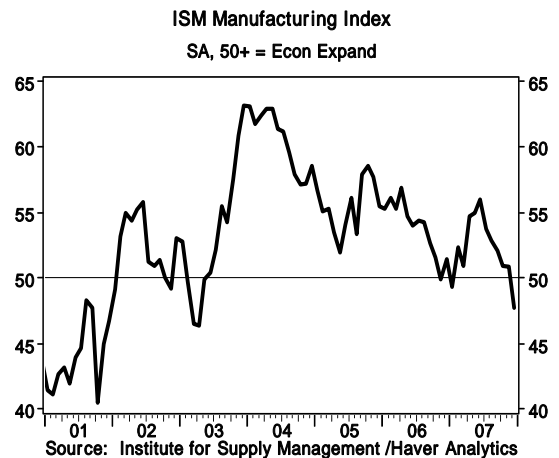


DECEMBER ISM MANUFACTURING INDEX

Chief Economist – Brian S. Wesbury
Senior Economist – Robert Stein, CFA
Economic Research Analyst – Trevor D. Scott

- The ISM Manufacturing index declined to 47.7 in December versus 50.8 in November. (Levels higher than 50 signal expansion; levels below 50 signal contraction.)
- The output-related components of the index were generally down. The production index declined to 47.3 from 51.9 and the new orders index fell to 45.7 from 52.6. The employment index increased to 48.0 from 47.8.
- The prices paid index increased to 68.0 from 67.5 last month, suggesting continued upward pressure on inflation.

Implications: Today's ISM report was weak, and hit jumpy financial markets hard. Stocks are down, bond yields are plummeting and Fed rate cut probabilities are up sharply. We think this is an over-reaction. The average ISM in Q4 was 49.8, which corresponds to a real GDP growth rate of 2.5% -- exactly our forecast for Q4. In addition, the ISM was negative early in 2007, and in mid-2003, but the economy proved resilient anyway. Nonetheless, we understand the market's reaction. Back in August 2000, when the ISM first fell below 50 and signaled the 2001 recession, most economists did not take it seriously. And just like golfing, a short putt is often followed by one that goes too long. Given the markets memory of 2000, it's not surprising to see any weak data magnified in significance. In other economic news this morning, construction increased 0.1% in November (versus a consensus expected -0.4%). Although private residential building was down 2.5%, business building was up 1.7%, and public construction was up 2.5%. The decline in home building is being offset by large increases in business and state/local building. In fact, today's data on business and public construction introduce *upside* risk to our forecast of 2.5% real GDP growth in Q4.



Institute for Supply Management Index <i>Seasonally Adjusted Unless Noted: 50+ = Econ Growth</i>	Dec-07	Nov-07	Oct-07	3-month <i>moving avg</i>	6-month <i>moving avg</i>	Year-ago <i>level</i>
Business Barometer	47.7	50.8	50.9	49.8	51.4	51.4
New Orders	45.7	52.6	52.5	50.3	52.8	51.9
Production	47.3	51.9	49.6	49.6	52.5	52.4
Inventories	45.5	46.9	47.2	46.5	45.9	48.5
Employment	48.0	47.8	52.0	49.3	50.2	49.4
Supplier Deliveries	53.3	51.7	50.6	51.9	51.6	53.3
Order Backlog (NSA)	43.0	41.5	46.0	43.5	47.3	45.0
Prices Paid (NSA)	68.0	67.5	63.0	66.2	64.3	47.5
New Export Orders	52.5	58.5	57.0	56.0	56.0	54.3

Source: National Association of Purchasing Management

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