FIRST Trust ADVISORS L.P.

Quarterly Market Overview

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Robert F. Carey, CFA
Senior Vice President
Chief Investment Officer

Mr. Carey has over 20 years of experience as an Equity and Fixed-Income Analyst and is a recipient of the Chartered Financial Analyst (CFA) designation. He is a graduate of the University of Illinois at Champaign-Urbana with a B.S. in Physics. He is also a member of the CFA Society of Chicago and the CFA Institute.

Mr. Carey has appeared as a guest on such programs as Bloomberg TV and CNBC and has been quoted by several publications, including *The Wall Street Journal, The Wall Street Reporter, Bloomberg News Service, and Registered Rep*.

When it comes to forecasting…the X Factor is time

So far so good

As we begin another year, we thought it might be useful to provide some insight into how we shape our views on the markets. This is the 28th edition of this newsletter and we are proud of the fact that we have been accurate more often than not with our forecasting, especially in recent years. Our primary goal is to give good guidance, particularly with respect to major market moves. We strive to provide as much of the backstory as possible. If we can catch a move early enough, we can help our investors capture more of the upside associated with that move. Sometimes our goal is simply to make investors aware of potential pitfalls. We recently were able to accomplish both of these agendas in our July 2005 and April 2006 editions.

In July 2005, we argued that foreign stocks were in the midst of supplanting foreign bonds as the top performing asset class abroad. The combination of low interest rates and robust global growth suggested to us that many investors would eventually become comfortable swapping current income for growth of capital. As it turned out, they did so in a big way. In 2006, investors poured an estimated $150 billion into international stock funds, vs. just $30 billion into U.S. stock funds, according to TrimTabs. With respect to returns, from 6/30/00-6/30/05, the Lehman Global Aggregate Index of bonds gained 7.79% per year on average, vs. an annualized gain of just 0.02% for the MSCI Daily Total Return World (Ex-USA) Index of stocks. From 6/30/05-12/29/06, however, the MSCI Index posted a cumulative gain of 45.67%, vs. a cumulative gain of 4.52% for the Lehman Aggregate Index. The baton had been passed.

In April 2006, we turned our attention to emerging market equities. We had touched on them in the July 2005 issue, but never really touted them due to their unique risk characteristics. Besides, thanks to the explosive returns posted by such countries as Brazil, Russia, India and China (BRICs), investors didn't need much coaxing to begin with. Our concern in April 2006 was that investors might be getting overzealous to the point of ignoring the inherent risks associated with emerging market stocks, much the way investors did with tech stocks in 2000. The lesson learned back then was that stock valuations matter. As we now know, some emerging markets, such as India, experienced some very sharp sell-offs in Q2'06. Thailand's stock market declined 15% in one day in December. These types of corrections are not unique.

We hope that we can be just as timely with our analysis in the future as we have been of late.

It's about time

Prior to the 1980s, the rule of thumb used to be that Americans could expect to experience a recession approximately every five years. In the 1980s, however, the U.S. enjoyed an 8-year economic expansion only to be followed by a record 10-year expansion from 3/91 through 3/01. One other notable change is that recent recessions have also gotten shallower. The last two have lasted just 9 months each. Because expansions are lasting longer, the stages of an economic cycle are lasting longer as well (see model on back page). Since cycles repeat themselves by design, we feel confident that we can have a fairly good idea of where the economy and markets are headed at any given time. What we do not know is how long it is going to take to advance from one point to another. Time is truly the X Factor.

What does "The Street" like?

It only makes sense to pay attention to the sentiments of the largest money managers. We consider their opinions when we are forecasting. After all, they control such enormous amounts of capital that they can move the markets based on where they allocate their billions of dollars. For example, in the second quarter of 1999, money managers began to liquidate positions in pricey large-cap growth stocks and reallocated some of this capital to mid- and small-cap stocks. This activity took place one-year before the bubble burst in the stock market. You can see their influence in the performance of mid- and small-caps in the many years that followed. From 3/31/99-12/29/06, the S&P 400 Index of mid-caps and the Russell 2000 Index of small-cap stocks posted cumulative returns of 139.9% and 119.8%, respectively. The S&P Citigroup Growth Index posted a cumulative return of -3.9% over that span.

How we size up 2007

We have believed for quite some time that the underlying strength of the U.S. economy plus the excess liquidity still filtering through the system warrants additional tightening by the Fed. Brian Wesbury, Chief Economist at First Trust Advisors, has stood by his call for a 6.0% Fed funds rate. Brian believes his target rate would not derail the expansion, but would help quell any potential inflationary pressures that might be lurking. We favor stocks over bonds and encourage investors to overweight the following opportunities: Large-Cap Growth Stocks; Foreign Equities of Developed Countries; Technology; Biotechnology/Health Care; and Industrials.

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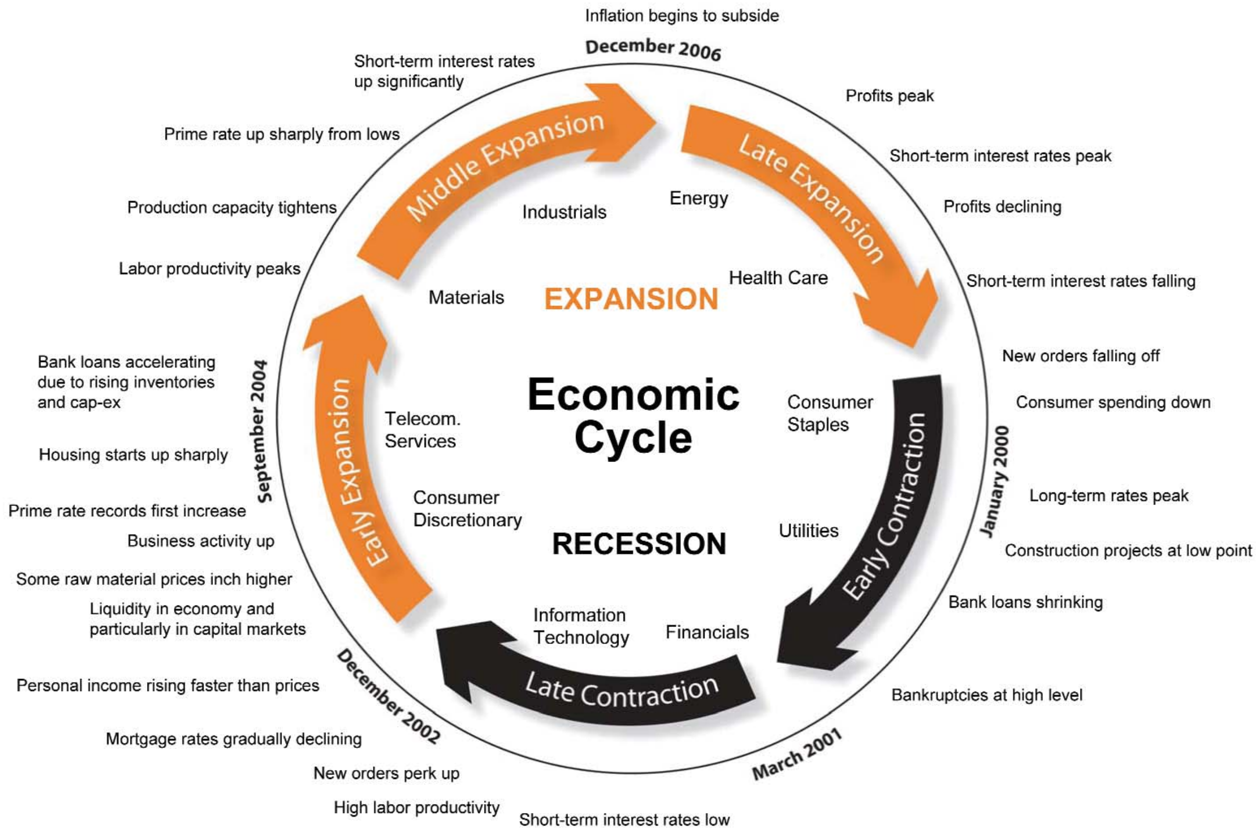
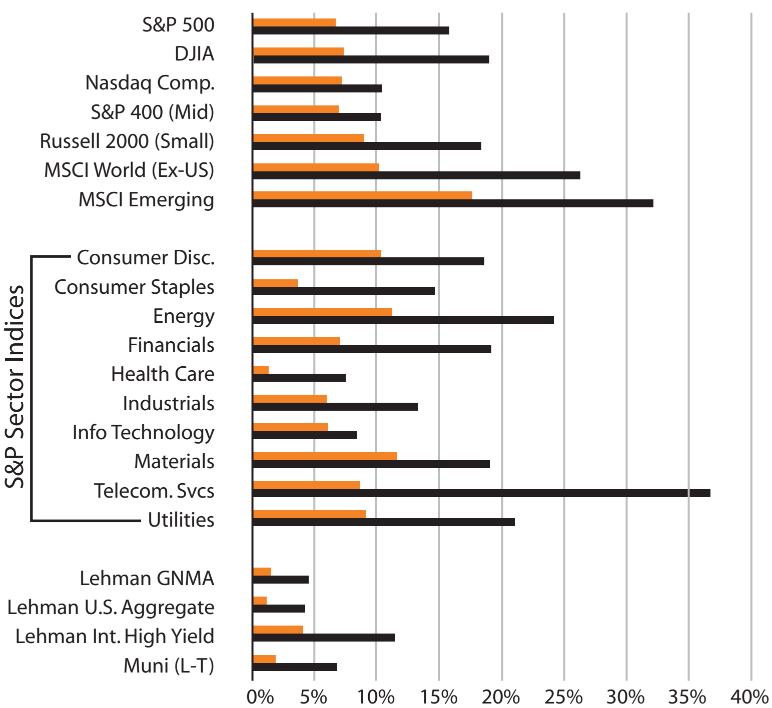
How much time does it take to complete an economic cycle?



Sources: Standard & Poor's & First Trust Advisors L.P.

This model is just one of the tools we use when forecasting. Its purpose is to sync up stock sectors with the various stages of an economic cycle. The arrows and sectors on the inside of the circle are provided by S&P. We include dates around the outside of the circle to mark the time it takes to transition from one stage of a cycle to the next. The economic indicators around the outside help us track how a particular stage is evolving. As is the case with most models, it lends itself to interpretation. It can be impacted by outside influences. For example, the extended war in Iraq is responsible, in our opinion, for the heightened speculation in oil futures, which sent prices to record levels in 2006. Yet, the model suggests that energy is a sector that thrives during the latter part of an expansion. So we adjust our thinking accordingly. Technology, which is usually regarded as a sector to own as the economy is in the final stages of contracting, is now poised to perform well as we are about to enter the latter part of this expansion. Why? Tech is still rebounding from the slowdown in spending following Y2K (see earnings estimates below).

Total returns for *Q4* and past *12 months* (12/29/06)



A Look Ahead:

The outlook for earnings (year-over-year)...

	Q1'07E	*Q2'07E*	*2007E*
Financials	5.2%	0.7%	7.3%
Technology	**14.5%**	**21.3%**	**18.3%**
Health Care	3.6%	7.1%	11.3%
Consumer Staples	**11.5%**	**10.3%**	**11.0%**
Consumer Discretionary	-4.1%	0.7%	9.3%
Industrials	**9.4%**	**14.8%**	**12.8%**
Telecommunications Services	8.6%	1.8%	5.0%
Energy	**13.5%**	**-3.7%**	**1.6%**
Utilities	8.0%	9.0%	11.8%
Materials	**8.7%**	**2.8%**	**2.9%**
S&P 500 Index	**6.0%**	**0.8%**	**5.1%**
S&P 400 Index (Mid-Cap)	**10.2%**	**10.1%**	**14.2%**
S&P 600 Index (Small-Cap)	**6.1%**	**8.2%**	**14.3%**

Source: Thomson First Call/Baseline (1/3/07)

1001 WARRENVILLE ROAD • LISLE, ILLINOIS 60532 • 800-621-1675