Prepping for a Potential Recession with Mid-Cap ETFs

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Mid-cap equity ETFs are among our favorite ETF allocation ideas for 2023. In our view, mid-cap stocks are not only attractive from a valuation and momentum standpoint, but they have also tended to provide compelling relative returns during—and often leading up to—past economic recessions. Time will tell whether a recession occurs this year, but for those preparing portfolio allocations for a potential economic downturn, we think the merits of mid-caps are often overlooked. Below, we compare the performance of large-, mid-, and small-cap US stocks leading up to and during recessions since 1970.[1] We then highlight two of our favorite mid-cap ETF ideas.

6 Months Before US Recessions

Recessions often begin—and end—sooner (or later) than expected. Since stock prices often reflect recessionary expectations ahead of time, we believe the 6-month period leading up to US recessions may be relevant. During these pre-recession periods, US equity returns were sometimes positive and sometimes negative, but there were notable differences between the performance of large-, mid-, and small-cap stocks (Chart 1).[2]

- Large-caps had the best performance more frequently than small- and mid-caps (43% of the time) but had the worst performance during an equivalent number of pre-recession periods (Chart 2).
- Small-caps had the best performance in 29% of pre-recession periods, but the worst performance in 57% of pre-recession periods.
- Mid-caps had the best performance in 29% of pre-recession periods, and never had the worst performance.[3]

Chart 1: Equity Returns 6 Months Before US Recessions

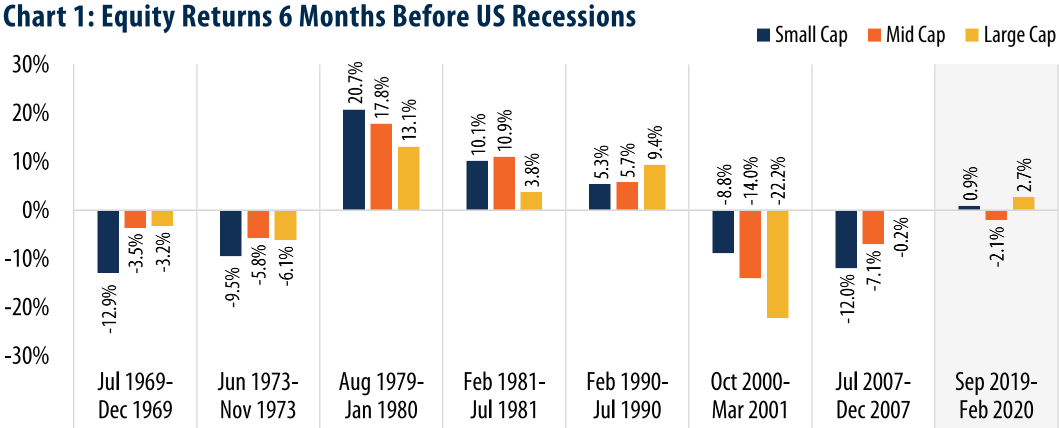
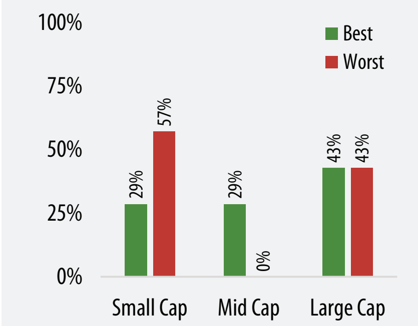


Chart 2: Best or Worst Performer 6 Months Before US Recessions



First Half of US Recessions

During the first half of US economic recessions since 1970, returns for stocks tended to be negative (Chart 3).

- Large-cap stocks most frequently had the best performance in early recession periods (57% of the time), but also had the worst performance in a large number (43%) of these intervals (Chart 4).
- Small-caps had the best performance during 29% of early recession periods, but the worst performance during 57% of these periods.
- Mid-caps had the best performance during 14% of early recession periods, but never had the worst performance.

Chart 3: Equity Returns During First Half of US Recessions

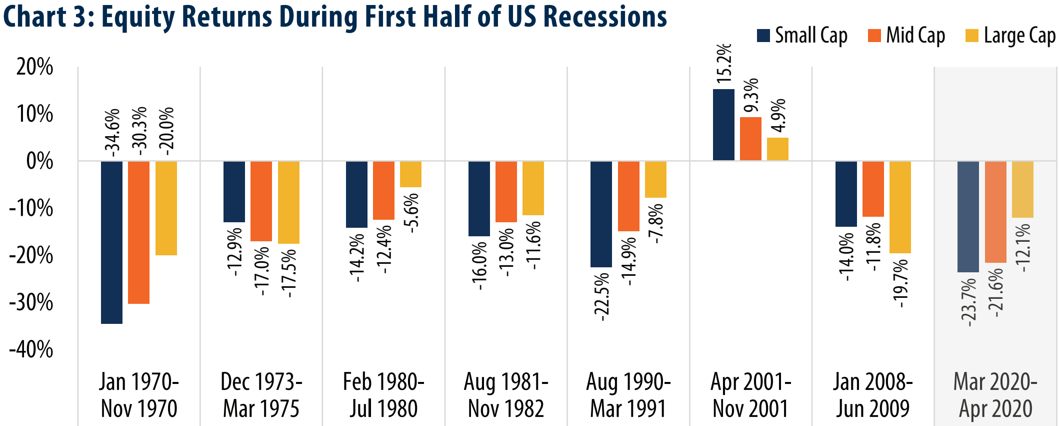
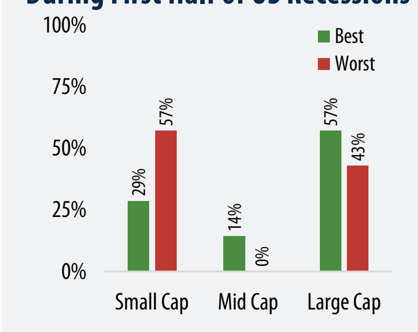


Chart 4: Best or Worst Performer During First Half of US Recessions



Source for charts: Ken French Data Library, February 2023. **Past performance is no guarantee of future results.** All charts are for illustrative purposes only and not indicative of any actual investment. Returns are cumulative total returns during US recessions, as identified by NBER. Returns are based on results from Kenneth R. French data library using the CRSP database. Universe includes all NYSE, AMEX & NASDAQ stocks. Each group is value weighted.

[1] Returns are based on results from Kenneth R. French data library using the CRSP database, as of 12/31/22. Universe includes all NYSE, AMEX & NASDAQ stocks. "Small-cap" includes the smallest 30% of stocks, "Mid-cap" includes the middle 40% of stocks, and "Large-cap" includes the largest 30% of stocks, each by market capitalization. Each group is value weighted. US recessions are defined by NBER. Returns are cumulative total returns.

[2] While charts 1, 3, 5, and 7 display data from the 2020 recession, we excluded this recession from our overall analysis (including in charts 2, 4, 6, and 8) because of the irregular nature of this recession, during which public policies related to the COVID-19 pandemic abruptly forced the shutdown of large parts of the US and global economy.

[3] The 2020 recession is an exception to this statement.

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Second Half of US Recessions

During the second half of US economic recessions since 1970, equity returns tended to be positive (Chart 5).

- Large-caps had the best performance during 14% of late recession periods, and the worst performance during 71% of these periods (Chart 6).
- Small-caps had the best performance during 14% of late recession periods, and the worst performance during 29% of these periods.
- Mid-caps had the best returns during 71% of late recession periods, and never had the worst performance.

Chart 5: Equity Returns During Second Half of US Recessions

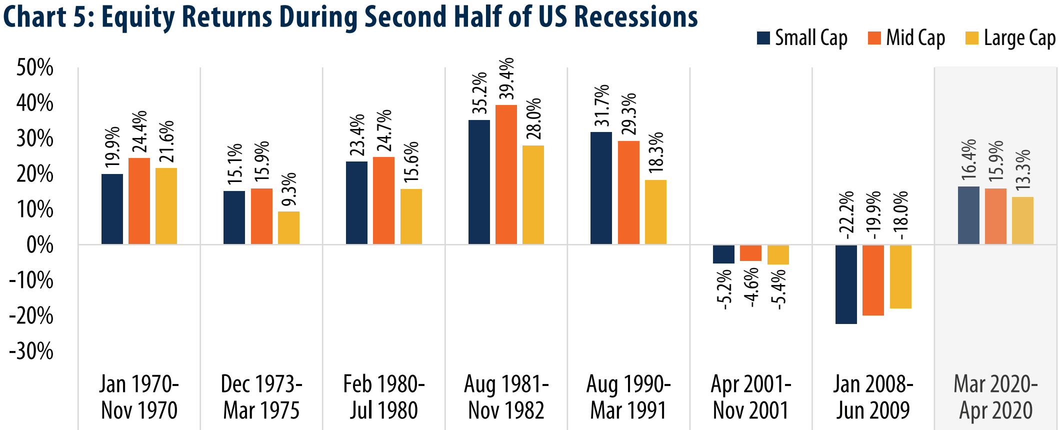
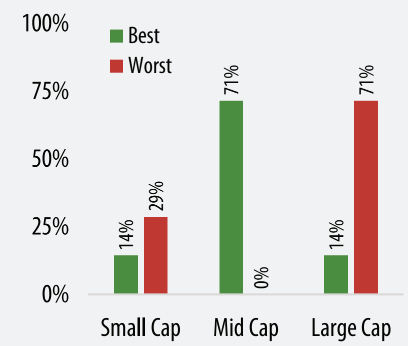


Chart 6: Best or Worst Performer During Second Half of US Recessions



Recessions Overall

Over the full course of US recessions since 1970, US equity returns were sometimes positive and sometimes negative (Chart 7).

- Large-caps had the best performance during 14% of recessions, and the worst performance during 57% of recessions (Chart 8).
- Small-caps had the best performance during 29% of recessions, and the worst performance during 43% of recessions.
- Mid-caps had the best performance during 57% of recessions, and never had the worst performance.

Chart 7: Equity Returns During US Recessions

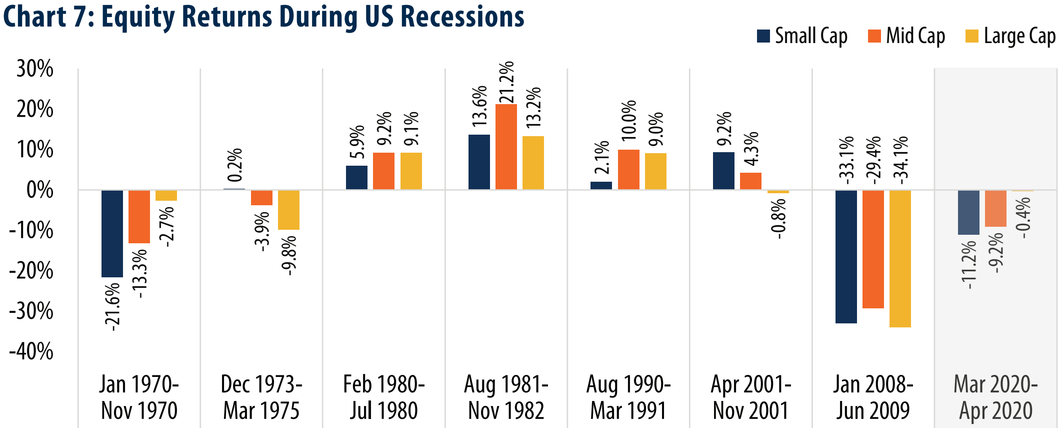
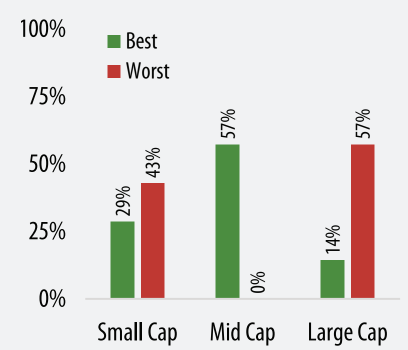


Chart 8: Best or Worst Performer During US Recessions



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Mid-Caps Had More Wins and Fewer Losses

Forecasting the beginning or end of an economic cycle is no easy task. For those seeking to position portfolios for a potential downturn, we believe performance tendencies from past US recessions make an intriguing case for mid-cap stocks. Mid-caps offered the best performance less frequently than large-caps during pre- and early recession periods, but never had the worst performance during these intervals, when avoiding losses was critical. Moreover, mid-caps had the best performance most frequently during late recession periods and recessions overall, while never posting the worst relative performance.

Mid-Cap ETF Ideas

The First Trust Mid Cap Core AlphaDEX® Fund ***(FNX)*** selects 450 stocks from the Nasdaq US 600 Mid Cap Index that have favorable factor attributes, such as cheaper valuations, better momentum, and stronger profitability. These factors are also used to determine portfolio weightings, and the strategy is reapplied/rebalanced on a quarterly basis. As of 1/31/23, FNX had a 9.7 price-to-earnings ratio, and a 1.97 price-to-book ratio.

The First Trust SMID Cap Rising Dividend Achievers ETF ***(SDVY)*** selects 100 mid- and small-cap stocks with positive earnings growth over the trailing 3 years, a cash to debt ratio greater than 25%, a trailing 12-month dividend payout ratio ≤ 65%, and a track record of dividend increases over the trailing period three and five years prior. SDVY is equally weighted and rebalanced quarterly. As of 1/31/23, SDVY had an 8.5 price-to-earnings ratio and a 1.98 price-to-book ratio.

Performance Summary (%) as of 12/30/22

FNX Performance*	3 Month	YTD	1 Year	3 Year	5 Year	10 Year	Since Fund Inception
Net Asset Value (NAV)	9.87	-13.75	-13.75	7.79	7.15	10.15	8.06
Market Price	9.79	-13.79	-13.79	7.78	7.14	10.14	8.06
Index Performance **							
Nasdaq AlphaDEX® Mid Cap Core Index	10.05	-13.23	-13.23	8.47	7.82	N/A	N/A
Nasdaq US 600 Mid Cap Index	8.43	-18.53	-18.53	4.44	5.74	N/A	N/A
S&P MidCap 400 Index	10.78	-13.06	-13.06	7.23	6.71	10.78	8.27

SDVY Performance*	3 Month	YTD	1 Year	3 Year	5 Year	10 Year	Since Fund Inception
Net Asset Value (NAV)	13.73	-11.94	-11.94	8.17	6.34	N/A	7.12
Market Price	13.73	-12.05	-12.05	8.16	6.33	N/A	7.12
Index Performance **							
Nasdaq US Small Mid Cap Rising Dividend Achievers™ Index	13.94	-11.48	-11.48	8.80	6.98	N/A	7.76
S&P 1000 Index	10.31	-13.98	-13.98	6.80	6.46	N/A	7.06

Performance data quoted represents past performance. Past performance is not a guarantee of future results and current performance may be higher or lower than performance quoted. Investment returns and principal value will fluctuate and shares when sold or redeemed, may be worth more or less than their original cost. You can obtain performance information which is current through the most recent month-end by visiting www.ftportfolios.com.

FNX Inception: 5/8/2007. Gross expense ratio: 0.62%. Net expense ratio: 0.62%. Expenses are capped contractually at 0.70% per year, at least through November 30, 2023. SDVY Inception: 11/1/2017. SDVY Expense Ratio is 0.60%. The Investment Advisor has implemented fee breakpoints, which reduce a fund's investment management fee at certain assets levels. Please see a fund's Statement of Additional Information for full details.

*__NAV__ returns are based on the fund's net asset value which represents the fund's net assets (assets less liabilities) divided by the fund's outstanding shares. **Market Price** returns are determined by using the midpoint of the national best bid offer price ("NBBO") as of the time that the fund's NAV is calculated. FNX's performance reflects fee waivers and expense reimbursements, absent which performance would have been lower. Returns are average annualized total returns, except those for periods of less than one year, which are cumulative.

**Performance information for each listed index is for illustrative purposes only and does not represent actual fund performance. Indexes do not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Indexes are unmanaged and an investor cannot invest directly in an index.

On April 8, 2016, FNX's underlying index changed from the Defined MidCap Core Index to the Nasdaq AlphaDEX® Mid Cap Core Index. Therefore, the fund's performance and historical returns shown for the periods prior to this date are not necessarily indicative of the performance that the fund, based on its current index, would have generated.

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You should consider a fund's investment objectives, risks, and charges and expenses carefully before investing. Contact First Trust Portfolios L.P. at 1-800-621-1675 or visit www.ftportfolios.com to obtain a prospectus or summary prospectus which contains this and other information about a fund. The prospectus or summary prospectus should be read carefully before investing.

Risk Considerations

You could lose money by investing in a fund. An investment in a fund is not a deposit of a bank and is not insured or guaranteed. There can be no assurance that a fund's objective(s) will be achieved. Investors buying or selling shares on the secondary market may incur customary brokerage commissions. Please refer to each fund's prospectus and SAI for additional details on a fund's risks. The order of the below risk factors does not indicate the significance of any particular risk factor.

ETF shares may only be redeemed directly from a fund by authorized participants in very large creation/redemption units. ETF shares may trade at a discount to net asset value and possibly face delisting.

A fund's shares will change in value, and you could lose money by investing in a fund. One of the principal risks of investing in a fund is market risk. Market risk is the risk that a particular stock owned by a fund, fund shares or stocks in general may fall in value. There can be no assurance that a fund's investment objective will be achieved. In February 2022, Russia invaded Ukraine which has caused and could continue to cause significant market disruptions and volatility within the markets in Russia, Europe, and the United States. The hostilities and sanctions resulting from those hostilities could have a significant impact on certain fund investments as well as fund performance. The COVID-19 global pandemic and the ensuing policies enacted by governments and central banks have caused and may continue to cause significant volatility and uncertainty in global financial markets. While the U.S. has resumed "reasonably" normal business activity, many countries continue to impose lockdown measures. Additionally, there is no guarantee that vaccines will be effective against emerging variants of the disease.

A fund's return may not match the return of its underlying index. A fund invests in securities included in the index regardless of investment merit and the securities held by a fund will generally not be bought or sold in response to market fluctuations.

Securities of small- and mid-capitalization companies may experience greater price volatility and be less liquid than larger, more established companies.

A fund with significant exposure to a single asset class, country, region, industry, or sector may be more affected by an adverse economic or political development than a broadly diversified fund.

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