Inside First Trust ETFs

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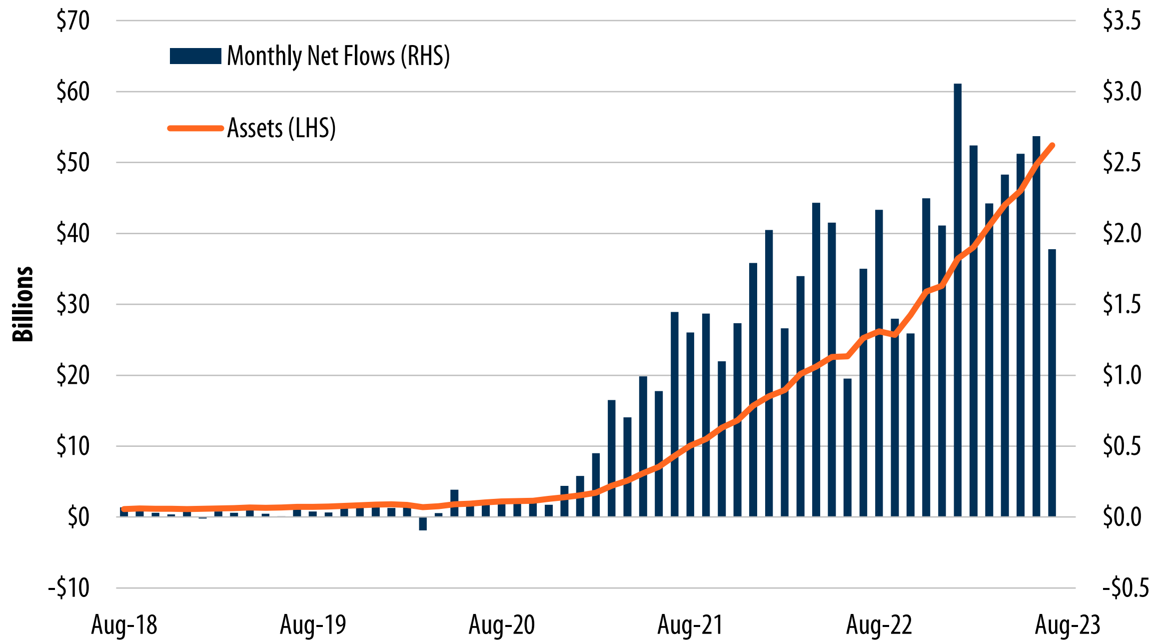
Monetizing Risk with Call-Writing ETFs

Call-writing ETFs have been one of the fastest growing segments of the ETF industry in recent years, as investment professionals have sought to capitalize on the larger options' premiums that generally correspond with increased equity volatility. Over the past two years, assets in call-writing ETFs, also known as "covered call" or "buy-write" ETFs, have grown by over 500%, and net inflows this year have totaled $17.4 billion (as of 7/31/23).[1] These ETFs typically invest in equities, while also selling call options to generate additional income. Below, we identify a few key attributes of call-writing ETFs for investment professionals to consider when sorting through this rapidly growing segment of the ETF industry. We then highlight four First Trust call-writing ETFs.

Chart 1: Investors Flock to Call-Writing ETFs



Source: Morningstar. Data from August 2018-July 2023. Includes "Derivative Income" Morningstar Category and First Trust Target Income ETFs.

Key Considerations for Call-Writing ETFs

In our opinion, one of the most consequential differences among call-writing ETFs is how each fund manages its underlying equity portfolio. As with any equity ETF, investment professionals should consider what sort of exposures the fund seeks to provide. For example:

- Does the ETF track a passive index, or is it actively managed?
- Is the strategy seeking broad equity market exposure, or is it tailored for specific factors or attributes, such as value stocks or dividend-payers?
- Does the ETF have any substantial sector or geographical biases?

By understanding how a call-writing ETF's underlying equity portfolio is managed, investment professionals may avoid undesired portfolio biases or overlap.

We believe another important consideration is how different ETFs manage their call-writing strategies. Some funds seek to maximize distributions by selling (i.e. writing) calls against a high proportion of their underlying equity holdings. Such strategies effectively forgo potential appreciation of those holdings in exchange for the income generated from call premiums. Other call-writing ETFs may sell calls against a smaller proportion of their underlying holdings, forgoing some level of call premiums in favor of more potential upside participation. Hence, the overwrite percentages and distribution levels of call-writing ETFs are key data points, in our opinion.

Another aspect of an ETF's call-writing strategy that may be useful to evaluate is whether its distribution objective is relatively constant or variable. Options premiums tend to rise and fall with equity market volatility, so a strategy that seeks to maintain a relatively constant overwrite percentage may produce larger distributions as volatility increases and smaller distributions as volatility decreases. On the other hand, a strategy seeking to distribute a more stable level of income may be able to achieve this objective by selling fewer calls (i.e. with more upside potential) as volatility increases and more calls (i.e. with less upside potential) as volatility decreases.

[1]Source: Morningstar, as of 7/31/23.

Overview of First Trust Call-Writing ETFs

First Trust Cboe Vest S&P 500® Dividend Aristocrats Target Income ETF® (KNG)

Equity Strategy:

KNG invests in an equally weighted portfolio of stocks contained in the S&P 500® Dividend Aristocrats Index. To be eligible for this index, a stock must be a member of the S&P 500® Index that has increased its dividend payments for at least 25 consecutive years. Currently, less than 15% (66 stocks) of the S&P 500® Index qualifies as "dividend aristocrats," as of 7/31/23. KNG's selectivity and equally weighted methodology has resulted in a significantly different sector allocation than the S&P 500® Index (see Chart 2 below), with relative overweight allocations to the Consumer Staples (24.1% vs. 6.6%) and Industrials (23.0% vs. 8.5%) sectors and a notable underweight allocation to the Information Technology (3.1% vs. 28.1%) and Communications Services (0% vs. 8.7%) sectors, as of 7/31/23.

Call-writing strategy:

KNG seeks to generate an annualized level of income from dividends and options premiums that is approximately 8% higher than the dividend yield of the S&P 500® Index (before fees). To do so, KNG sells monthly calls on individual fund holdings. Since KNG has a target distribution rate, its option overwrite percentage is variable. Thus, as equity market volatility increases, the sale of fewer call options may be required to achieve its income objective (i.e., more upside participation). Conversely, as volatility decreases, the sale of more call options may be required (i.e., less upside participation). As of 7/31/23, KNG's option overwrite percentage was 28%, meaning 72% of the portfolio had no constraints on upside participation.

First Trust Cboe Vest Rising Dividend Achievers Target Income ETF (RDVI)

Equity Strategy:

RDVI invests in an equally weighted portfolio of 50 stocks contained in the Nasdaq US Rising Dividend Achievers™ Index. This index seeks to identify stocks that have historically raised dividends, but also emphasizes certain fundamentals that may support future dividend growth, in our opinion. To be eligible for the index, stocks must have raised dividends over the prior 3- and 5-year periods, while also increasing earnings over the prior 3-year period. Additionally, to favor companies that are still meaningfully reinvesting in future growth opportunities, stocks with dividend payout ratios above 65% are eliminated. A minimum cash-to-debt ratio of 50% is also required, to favor stocks with relatively strong balance sheets. Finally, 50 stocks with the most attractive combination of dividend growth, dividend yield, and payout ratio are selected and equally weighted, with sector exposure constrained to a maximum of 30%. RDVI's sector allocation has differed significantly from broad market indices. Compared to the S&P 500® Index, RDVI was significantly overweight the Financials (30.9% vs. 9.7%) and Basic Materials (12.4% vs. 1.8%) sectors and underweight the Technology sector (11.8% vs. 31.9%), as of 7/31/23.[2]

Call-writing strategy:

RDVI seeks to generate an annualized level of income from dividends and options premiums that is approximately 8% higher than the dividend yield of the S&P 500® Index (before fees). To do so, RDVI sells weekly call options on the S&P 500® Index (or S&P 500® Index-tracking ETFs). Because RDVI has a target distribution rate—like KNG—its option overwrite percentage is variable, meaning potential upside participation in its equity portfolio is also variable. As of 7/31/23, RDVI's option overwrite percentage was 22.5%, meaning 77.5% of the portfolio had no constraints on upside participation.

Chart 2: Sector Allocation

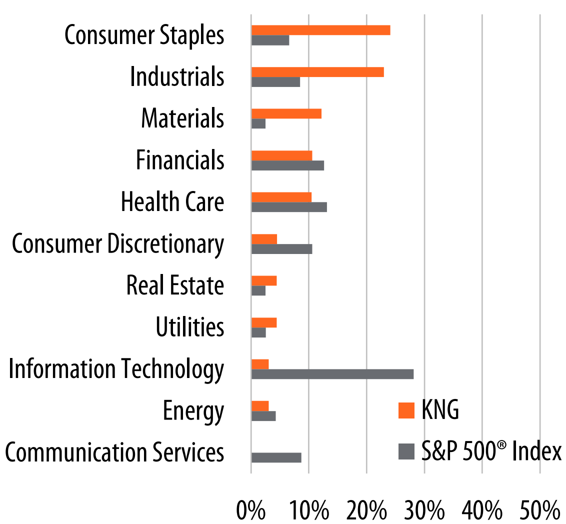
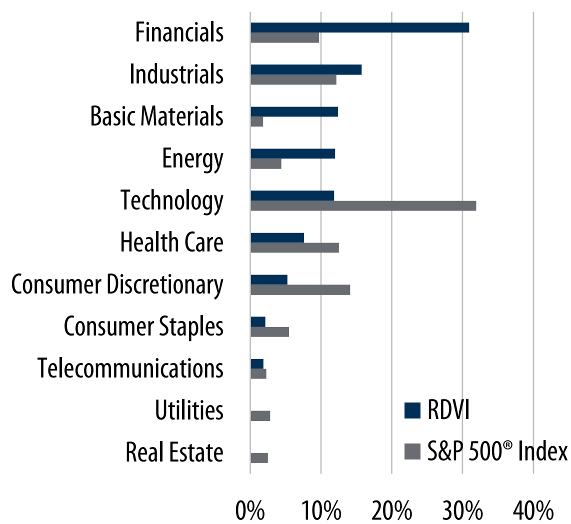


Chart 3: Sector Allocation



Source for Charts: FactSet. As of 7/31/23.

[2]Sector classifications referenced for RDVI are according to FTSE Russell's Industry Classification Benchmark (ICB), which are referenced in the index methodology to constrain maximum sector allocations. All other charts reference sector classifications from MSCI's Global Industry Classification Standard (GICS).

Overview of First Trust Call-Writing ETFs (continued)

First Trust BuyWrite Income ETF (FTHI)

Equity Strategy:

FTHI is an actively managed covered-call ETF that seeks lower beta exposure to equities via stock selection and a relatively high overwrite percentage. The fund's equity portfolio has similar attributes to the S&P 500® Index, with fewer (226) holdings, but significantly smaller sector biases than KNG or RDVI. Compared to the S&P 500® Index, two sectors had overweight/underweight allocations greater than 2 percentage points (Real Estate and Information Technology), as of 7/31/23 (see Chart 4).

Call-writing strategy:

The call-writing strategy for FTHI is designed to produce lower beta exposure to equities, with a higher overwrite percentage than KNG or RDVI, and an expected annualized level of income from dividends and options premiums between 7-9%. The fund sells S&P 500® Index call options with multiple expirations, and has a variable overwrite percentage that can fluctuate between 25-75% but has typically been greater than 50%. FTHI's overwrite percentage is determined by its income objective as well as prevailing market conditions, as the fund seeks to reduce or increase exposure to market risk in certain macroeconomic or market environments. As of 7/31/2023, FTHI's option overwrite percentage was toward the upper end of its expected range, at 70.3%.

First Trust Nasdaq BuyWrite Income ETF (FTQI)

Equity Strategy:

FTQI is an actively managed covered-call ETF that is designed to produce lower beta exposure to growth stocks. The fund's equity characteristics are similar to the Nasdaq 100® Index, selecting stocks (159 holdings, as of 7/31/23) largely from the Nasdaq Composite Index. Compared to the Nasdaq 100® Index, FTQI's sector biases tend to be relatively small. As of 7/31/23, 3 sectors (Consumer Discretionary, Information Technology, and Financials) had overweight/underweight allocations greater than 2 percentage points (see Chart 5).

Call-writing strategy:

The call-writing strategy for FTQI is designed to produce lower beta exposure to growth stocks, while targeting an expected annualized level of income from dividends and options premiums between 10-12%. The fund sells Nasdaq 100® Index call options with expirations under one year. FTQI's overwrite percentage is variable, and can fluctuate between 50-100%, but has typically been between 75-80%. Like FTHI, FTQI's overwrite percentage is determined by its income objective and an assessment of how much market risk is desirable. As of 7/31/2023, FTQI's option overwrite percentage was 84.4%.

Chart 4: Sector Allocation

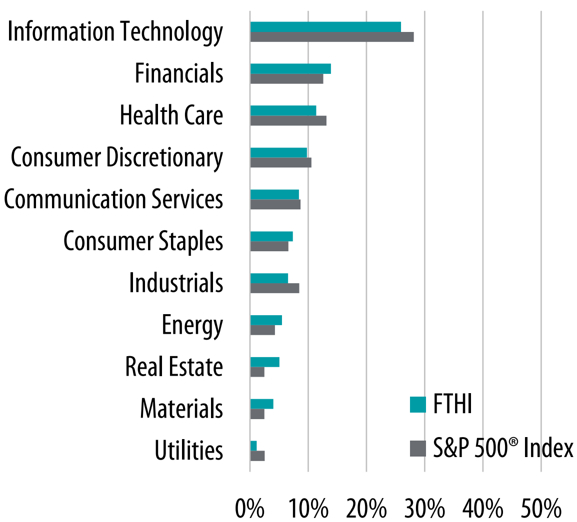
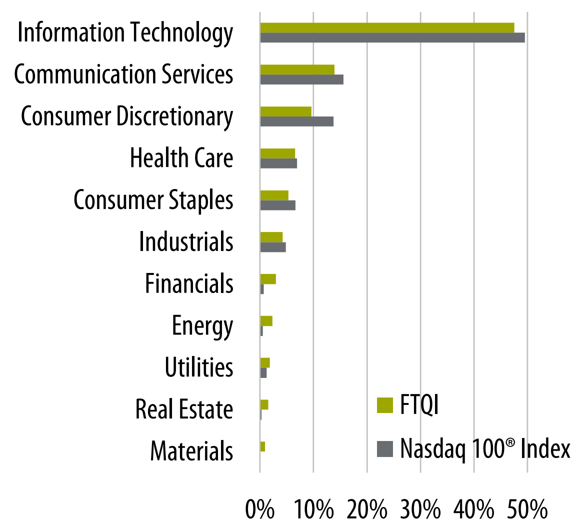


Chart 5: Sector Allocation



Source for Charts: FactSet. As of 7/31/23.

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.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Definitions

An **option** is a contractual obligation between a buyer and a seller. The buyer of a **call option** has the right, but not the obligation, to purchase an agreed upon quantity of an underlying asset from the writer (seller) of the option at a predetermined price (the strike price) within a certain window of time (until the option's expiration).

A **premium** is the income received by an investor who sells the option contract to another party

Option Overwrite is the percentage of the net asset value used for writing of call options against a long position at each monthly call selling date.

The **S&P 500® Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance.

The **S&P 500® Dividend Aristocrats Index** consists of companies from the S&P 500® Index that have increased dividends every year for at least 25 consecutive years.

The **Nasdaq 100® Index** includes 100 of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization.

The **Nasdaq Composite Index** is a large market-cap-weighted index of more than 2,500 stocks, American depositary receipts (ADRs), and real estate investment trusts (REITs), among others, listed on the Nasdaq stock exchange.

The **Nasdaq US Rising Dividend Achievers™ Index** is comprised of 50 companies with a history of raising their dividends. These companies also exhibit the characteristics to continue to do so in the future.

Risks

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 Statement of Additional Information 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.

Unlike mutual funds, shares of the fund may only be redeemed directly from a fund by authorized participants in very large creation/redemption units. If a fund's authorized participants are unable to proceed with creation/redemption orders and no other authorized participant is able to step forward to create or redeem, fund shares may trade at a premium or discount to a fund's net asset value and possibly face delisting and the bid/ask spread may widen.

A fund's use of call options involves risks different from those associated with ordinary portfolio securities transactions and depends on the ability of a fund's portfolio managers to forecast market movements correctly. As the seller (writer) of a call option, a fund will tend to lose money if the value of the reference index or security rises above the strike price. When writing a call option, a fund will have no control over the exercise of the option by the option holder and the American style options sold by a fund may be exercised at any time before the option expiration date (as opposed to the European style options which may be exercised only on the expiration date). There may be times a fund needs to sell securities in order to settle the options, which may constitute a return of capital and make a fund less tax-efficient than other ETFs. Options may also involve the use of leverage, which could result in greater price volatility than other markets.

Consumer staples companies provide products that are typically considered non-discretionary items based on consumer purchasing habits and their success is affected by a variety of factors, including government regulations, which may affect the permissibility of using various product components and production methods, new laws, regulations or litigation, marketing campaigns, competitive pricing, materials costs and consumer confidence.

A fund may be subject to the risk that a counterparty will not fulfill its obligations which may result in significant financial loss to a fund.

The writer of a covered call option foregoes any profit from increases in the market value of the underlying security covering the call option above the sum of the premium and the strike price of the call, but retains the risk of loss if the underlying security declines in value. The Fund will have no control over the exercise of the option by the option holder and may lose the benefit from any capital appreciation on the underlying security.

Changes in currency exchange rates and the relative value of non-US currencies may affect the value of a fund's investments and the value of a fund's shares.

Current market conditions risk is the risk that a particular investment, or shares of the fund in general, may fall in value due to current market conditions. As a means to fight inflation, the Federal Reserve and certain foreign central banks have raised interest rates and expect to continue to do so, and the Federal Reserve has announced that it intends to reverse previously implemented quantitative easing. Recent and potential future bank failures could result in disruption to the broader banking industry or markets generally and reduce confidence in financial institutions and the economy as a whole, which may also heighten market volatility and reduce liquidity. 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 have and could continue to have a significant impact on certain fund investments as well as fund performance and liquidity. The COVID-19 global pandemic, or any future public health crisis, 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, negatively impacting global growth prospects.

A fund is susceptible to operational risks through breaches in cyber security. Such events could cause a fund to incur regulatory penalties, reputational damage, additional compliance costs associated with corrective measures and/or financial loss.

Depositary receipts may be less liquid than the underlying shares in their primary trading market and distributions may be subject to a fee. Holders may have limited voting rights, and investment restrictions in certain countries may adversely impact their value.

The use of derivatives instruments involves different and possibly greater risks than investing directly in securities including counterparty risk, valuation risk, volatility risk, and liquidity risk. Further, losses because of adverse movements in the price or value of the underlying asset, index or rate may be magnified by certain features of the derivatives.

A fund normally pays its income as distributions and therefore, a fund may be required to reduce its distributions if it has insufficient income. Additionally at times, a fund may need to sell securities when it would not otherwise do so and could cause distributions from that sale to constitute return of capital. Because of this, a fund may not be an appropriate investment for investors who do not want their principal investment in a fund to decrease over time or who do not wish to receive return of capital in a given period.

Companies that issue dividend-paying securities are not required to continue to pay dividends on such securities. Therefore, there is a possibility that such companies could reduce or eliminate the payment of dividends in the future.

Equity securities may decline significantly in price over short or extended periods of time, and such declines may occur in the equity market as a whole, or they may occur in only a particular country, company, industry or sector of the market.

Financial services companies are subject to the adverse effects of economic recession, currency exchange rates, government regulation, decreases in the availability of capital, volatile interest rates, portfolio concentration in geographic markets, industries or products, and competition from new entrants in their fields of business.

An index fund will be concentrated in an industry or a group of industries to the extent that the index is so concentrated. A fund with significant exposure to a single asset class, or the securities of issuers within the same country, state, region, industry, or sector may have its value more affected by an adverse economic, business or political development than a broadly diversified fund.

A fund may be a constituent of one or more indices or models which could greatly affect a fund's trading activity, size and volatility.

There is no assurance that the index provider or its agents will compile or maintain the index accurately. Losses or costs associated with any index provider errors generally will be borne by a fund and its shareholders.

Industrials and producer durables companies are subject to certain risks, including the general state of the economy, intense competition, consolidation, domestic and international politics, excess capacity and consumer demand and spending trends. They may also be significantly affected by overall capital spending levels, economic cycles, technical obsolescence, delays in modernization, labor relations, and government regulations.

As inflation increases, the present value of a fund's assets and distributions may decline.

Information technology companies are subject to certain risks, including rapidly changing technologies, short product life cycles, fierce competition, aggressive pricing and reduced profit margins, loss of patent, copyright and trademark protections, cyclical market patterns, evolving industry standards and regulation and frequent new product introductions.

Large capitalization companies may grow at a slower rate than the overall market.

Leverage may result in losses that exceed the amount originally invested and may accelerate the rates of losses. Leverage tends to magnify, sometimes significantly, the effect of any increase or decrease in a fund's exposure to an asset or class of assets and may cause the value of a fund's shares to be volatile and sensitive to market swings.

Certain fund investments may be subject to restrictions on resale, trade over-the-counter or in limited volume, or lack an active trading market. Illiquid securities may trade at a discount and may be subject to wide fluctuations in market value.

The portfolio managers of an actively managed portfolio will apply investment techniques and risk analyses that may not have the desired result.

Market risk is the risk that a particular security, or shares of a fund in general may fall in value. Securities are subject to market fluctuations caused by such factors as general economic conditions, political events, regulatory or market developments, changes in interest rates and perceived trends in securities prices. Shares of a fund could decline in value or underperform other investments as a result. In addition, local, regional or global events such as war, acts of terrorism, spread of infectious disease or other public health issues, recessions, natural disasters or other events could have significant negative impact on a fund.

A fund faces numerous market trading risks, including the potential lack of an active market for fund shares due to a limited number of market makers. Decisions by market makers or authorized participants to reduce their role or step away in times of market stress could inhibit the effectiveness of the arbitrage process in maintaining the relationship between the underlying values of a fund's portfolio securities and a fund's market price.

Large inflows and outflows may impact a new fund's market exposure for limited periods of time.

An index fund's return may not match the return of the index for a number of reasons including operating expenses, costs of buying and selling securities to reflect changes in the index, and the fact that a fund's portfolio holdings may not exactly replicate the index.

A fund classified as "non-diversified" may invest a relatively high percentage of its assets in a limited number of issuers. As a result, a fund may be more susceptible to a single adverse economic or regulatory occurrence affecting one or more of these issuers, experience increased volatility and be highly concentrated in certain issuers.

Securities of non-U.S. issuers are subject to additional risks, including currency fluctuations, political risks, withholding, lack of liquidity, lack of adequate financial information, and exchange control restrictions impacting non-U.S. issuers.

A fund and a fund's advisor may seek to reduce various operational risks through controls and procedures, but it is not possible to completely protect against such risks. The fund also relies on third parties for a range of services, including custody, and any delay or failure related to those services may affect the fund's ability to meet its objective.

The prices of options are volatile and the effective use of options depends on a fund's ability to terminate option positions at times deemed desirable to do so. There is no assurance that a fund will be able to effect closing transactions at any particular time or at an acceptable price.

A fund that invests in securities included in or representative of an index will hold those securities regardless of investment merit and the fund generally will not take defensive positions in declining markets.

A fund's investment in equity securities and written call options are not correlated, meaning the performance is independent of one another. Market events may impact one position held by a fund more than the other position and the returns from a fund's investments in equity securities and written call options may not move in the same direction as one another.

High portfolio turnover may result in higher levels of transaction costs and may generate greater tax liabilities for shareholders.

The market price of a fund's shares will generally fluctuate in accordance with changes in the fund's net asset value ("NAV") as well as the relative supply of and demand for shares on the exchange, and a fund's investment advisor cannot predict whether shares will trade below, at or above their NAV.

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.

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

If a fund does not qualify as a RIC for any taxable year and certain relief provisions were not available, a fund's taxable income would be subject to tax at the fund level and to a further tax at the shareholder level when such income is distributed. Further, there may be other tax implications to a fund based on the type of investments in a fund.

Trading on an exchange may be halted due to market conditions or other reasons. There can be no assurance that a fund's requirements to maintain the exchange listing will continue to be met or be unchanged.

A fund may hold securities or other assets that may be valued on the basis of factors other than market quotations. This may occur because the asset or security does not trade on a centralized exchange, or in times of market turmoil or reduced liquidity. Portfolio holdings that are valued using techniques other than market quotations, including "fair valued" assets or securities, may be subject to greater fluctuation in their valuations from one day to the next than if market quotations were used. There is no assurance that a fund could sell or close out a portfolio position for the value established for it at any time.

A fund may invest in securities that exhibit more volatility than the market as a whole.

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Not FDIC Insured • Not Bank Guaranteed • May Lose Value