First Trust

Quarterly Market Overview

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Mr. Carey has appeared throughout the United States and Canada as a guest on television and radio programs. These programs include: Bloomberg TV, CNBC and Canada's Business News Network and on Chicago's WBBM Newsradio 780's Noon Business Hour. He has been quoted by several publications, including *The Wall Street Journal, The Wall Street Reporter, Bloomberg News Service, and Registered Rep.*

Earning back the trust of the retail investor

Weighted Average Annual EBITDA Growth (Earnings before deduction of Interest, Tax, Depreciation & Amortization expenses)

	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Telecommunication Services	Utilities	S&P 500 Index
1994	18.93%	11.72%	1.97%	14.07%	13.78%	5.31%	32.59%	28.94%	13.97%	-0.61%	10.86%
1995	9.11%	16.68%	21.91%	25.67%	16.49%	21.46%	17.38%	16.99%	12.09%	4.72%	15.53%
1996	6.24%	8.80%	9.44%	13.55%	16.60%	15.83%	10.89%	6.15%	-13.99%	-2.73%	7.03%
1997	16.46%	7.96%	1.59%	26.93%	8.56%	22.94%	18.58%	15.93%	19.73%	13.82%	14.87%
1998	-18.09%	6.52%	-22.25%	41.49%	11.60%	41.20%	6.45%	-24.28%	11.29%	6.51%	9.79%
1999	-4.68%	20.07%	61.90%	31.63%	14.20%	37.53%	7.62%	7.58%	32.58%	2.17%	22.30%
2000	0.43%	4.05%	59.31%	34.12%	22.92%	9.46%	-2.68%	18.23%	42.88%	7.61%	23.03%
2001	-16.18%	15.97%	-2.46%	2.98%	5.36%	-6.21%	-5.95%	-26.37%	-7.65%	23.10%	-0.45%
2002	-6.31%	6.19%	-18.66%	-20.81%	5.87%	-28.46%	3.50%	-2.66%	8.82%	-9.10%	-10.98%
2003	23.79%	5.32%	48.66%	12.39%	5.80%	7.16%	16.81%	4.06%	-15.66%	7.54%	11.45%
2004	3.82%	6.88%	18.76%	5.14%	10.68%	15.42%	-0.39%	25.99%	3.02%	4.63%	11.08%
2005	-4.34%	5.01%	14.44%	22.28%	-4.87%	10.88%	10.03%	10.61%	-0.41%	12.07%	16.07%
2006	5.30%	7.48%	25.87%	31.77%	8.33%	9.93%	-1.51%	5.80%	28.72%	11.58%	21.07%
2007	6.88%	-0.28%	-6.31%	-21.41%	3.96%	6.20%	16.88%	5.27%	63.96%	-6.29%	0.62%
2008	-11.92%	9.32%	43.21%	-73.77%	6.27%	-22.06%	20.55%	-29.12%	7.20%	3.54%	1.00%
Avg. Annual ('94 - '08)	1.96%	8.78%	17.16%	9.74%	9.70%	9.77%	10.05%	4.21%	13.77%	5.24%	10.22%
Average Total Return ('94 - '08)	4.15%	9.01%	12.10%	5.61%	10.30%	6.58%	7.48%	4.74%	3.21%	5.73%	6.45%

Source: CompuStat & Bloomberg

Framing expectations

I was speaking with a financial representative not long ago and he dropped the following gem on me: *"The problem with bull markets is they never let you in."* Brilliant! How many investors today are wondering if it is too late to commit their capital to stocks? After all, the S&P 500 just posted a gain of 67.8% from its March 9th low through December 31. Shouldn't that conjure up the image of a red stoplight? Anyone who purchased a house in the latter part of 2005 would cringe at a stat like that one. But a single stat simply isn't enough. Investors need to know the bigger picture. Here is how we frame that picture:

1. The S&P 500 declined 57% in the bear market that began at the close of trading on 10/9/07 and ended at the close of trading on 3/9/09.
2. Even though the index roared back 67.8% from its low on 3/9/09, it was still sitting well below its all-time high of 1565.15 (10/9/07) on 12/31/09. It will need to rally another 40.36% to reach 1565.15.
3. The S&P 500 has never failed to recover from its bear market lows. It takes 39 months, on average, for investors to recoup losses from a bear market, according to InvesTech. Since 1926, the S&P 500 has returned 9.81%, on average, according to Ibbotson Associates.
4. We are about 10 months into the new bull market. InvesTech's research says it could take another 29 months to make up the next 40.36%. The 9.81% average from Ibbotson would equate to a gain of 23.71% over 29 months. Either way, history sides with the investor.

It is and always has been about earnings

We are closing in on the 10-year anniversary of the dot-com bomb. It commenced in Q2'00 and involved the demise of thousands of Internet-related startups over about a three-year span. Most folded their tents, while the rest were bought for cents on the dollar. The ones with the solid business plans survived and prospered. At that time, Wall Street cleverly marketed Internet-related IPOs by selling investors on the notion of a new business paradigm in which revenues would be more coveted than earnings. Ideas were worth more than capital. Countless articles were written proclaiming that the Web would render the traditional brick-and-mortar model obsolete. But in the end, after the "irrational exuberance" had passed, it was discovered that the Web was always destined to be one of many tools that businesses could tap to sell more goods and services.

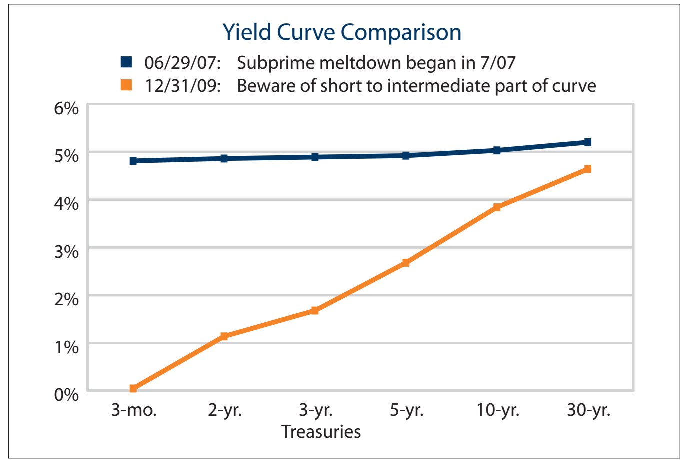
The chart above is also a tool. One of many, in our opinion, that investors can use to improve their odds of making money in the market. The data runs from '94-'08. We chose '94 because it was a year in which the Fed tightened rates. We stopped in '08 because we don't yet have the total earnings picture for '09. An example of how one can use this chart is to compare the average annual earnings with the average total return. Over time, stocks tend to go up in line with earnings. At the end of '08, Info Tech's average earnings were much higher than its average return. Since we do have returns for '09, we can report that Info Tech's average return from '94-'09 rose to 10.26%.

Fear of rising rates

First things first. When interest rates trend higher it does not mean that all maturities move in lock-step. If that were true you would never see a flat or inverted yield curve. Longer maturities would always command higher payouts to compensate for the time commitment. The chart to the right shows a flatter Treasury curve from mid-2007, just a few weeks before the meltdown began in the subprime mortgage market. The Fed had completed a three-year tightening phase (1% to 5.25%) a year earlier. So short rates rose 425 basis points during the tightening, but the yield on the 30-yr. T-Bond rose just 63 basis points – hence the flattening of the curve. The current curve is quite steep. The short end of the curve (3-mo. T-Bills) is paying only 0.05%, while the 30-yr. T-Bond is paying 4.64%.

The Fed has yet to initiate its next tightening phase. Since the art of forecasting rate changes is futile for most, it may make more sense to focus on the recent past. There is a good chance that today's curve could morph into the one from mid-2007. Why? The early phase of this recovery is expected to be more subdued in terms of GDP growth (2%-4%) than past recoveries (6%-8%). It also may be a jobless recovery for a while with modest inflation. Consider exploiting this recovery by owning riskier debt classes. Convertibles and high yield corporates still offer very generous spreads over Treasuries and stand to benefit from higher corporate profits.

Barbell Bond Strategy: To create a barbell bond portfolio, buy obligations with maturities clustered at the two extremes of the yield curve – long and very short, usually a 50-50 split to start. (Source: Forbes) Consider senior loans at the short end for more yield. Although they are speculative-grade, their floating rate feature should track the Fed's moves.

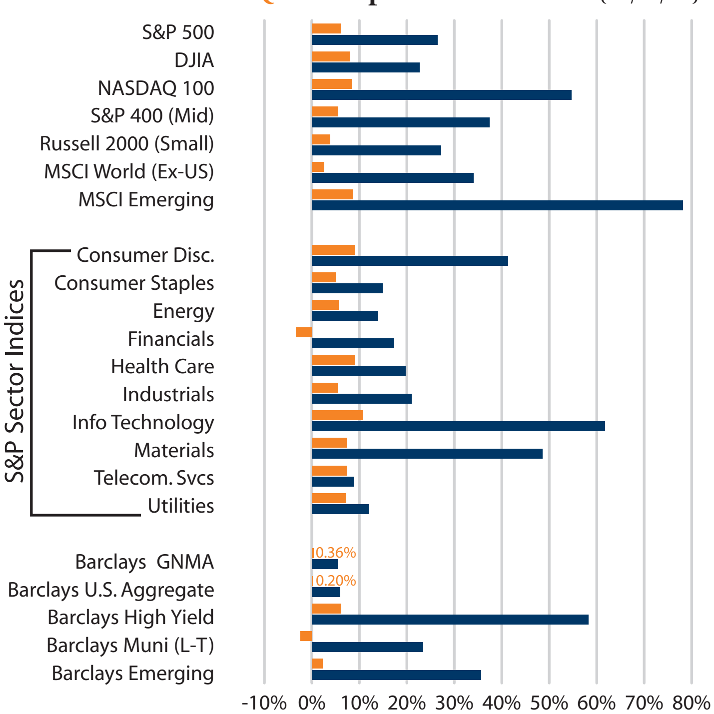


Two problems that could turn into opportunities in the second half of 2010

Commercial Real Estate (REITs): Commercial property values fell roughly 40% during the recession. The real dilemma for this sector is whether or not financing for loans due to rollover in the next few years will be there. Many projects in the last decade employed short-term financing. An estimated $300 billion in loans will need to be refinanced in each of the next three years, according to *Kiplinger*. Solid economic growth would inspire institutions to lend. Real estate research firm Reis Inc. reported that the national vacancy rate for apartments hit a 30-year high of 8.0% in Q4'09. Analysts aren't expecting improvement until mid-year, providing the economy is on solid footing. REITs and Real Estate Operating Companies raised $38 billion in 2009 to bolster their balance sheets, according to REIT.com. The FTSE NAREIT Equity Index closed '09 48.8% below its 10-yr. high.

State Budget Deficits (Municipal Bonds): This dilemma dovetails right into the sunsetting of the Bush tax cuts at the close of 2010. Due to the recession, state tax collections declined the most in 46 years in the first three quarters of 2009, according to data from the Nelson A Rockefeller Institute of Government. Revenue was down $80 billion, or 13.3%, compared to the same period in 2008. States are facing a combined deficit of $193 billion in the current fiscal year. The good news is most economists are forecasting a GDP growth rate of 2.5% to 3.0% for 2010. It took about three quarters following the end of the 2001 recession for tax collections to begin to ascend. Long maturity munis are already offering generous yields and could garner more popularity around mid-year.

Total returns for Q4 and past 12 months (12/31/09)



A Look Ahead:

The outlook for earnings (year-over-year comparison in $)...

	Q1'10E	Q1'09A	**Q2'10E**	Q2'09A	**2010E**	2009E
Financials	**2.81**	0.50	**2.86**	1.01	**12.87**	4.58
Information Technology	**4.71**	2.90	**5.05**	3.62	**21.48**	16.28
Health Care	**7.35**	6.61	**7.62**	6.60	**30.74**	26.85
Consumer Staples	**4.30**	3.90	**4.87**	4.62	**19.33**	17.96
Consumer Discretionary	**2.87**	0.38	**3.72**	2.77	**14.70**	10.02
Industrials	**3.32**	3.08	**3.78**	3.75	**15.16**	13.70
Telecom. Services	**1.92**	1.95	**1.98**	1.88	**7.85**	7.53
Energy	**7.74**	0.44	**8.35**	4.57	**33.71**	17.60
Utilities	**3.11**	2.89	**2.88**	2.52	**12.93**	11.73
Materials	**2.78**	1.04	**3.15**	1.67	**11.53**	6.70
S&P 500 Index	**17.11**	10.11	**18.54**	13.81	**76.07**	55.80
S&P 400 Index (Mid-Cap)	**8.99**	2.45	**10.03**	7.52	**41.63**	27.46
S&P 600 Index (Small-Cap)	**3.61**	0.68	**4.24**	1.83	**17.70**	8.35

Source: Standard & Poor's (1/6/10)