First Trust
Quarterly Market Overview
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Mr. Carey has over a quarter century 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. As CIO, Bob and his staff supervise over $43 billion in assets.

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 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.*

The collateral damage that can come from procrastination

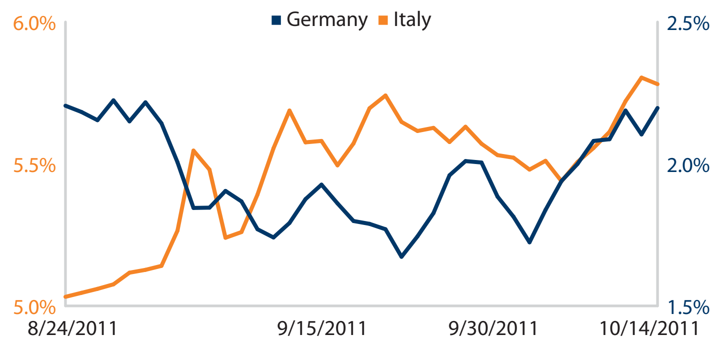
The securities markets, both domestic and abroad, have been held hostage by governmental policy makers over the past 3-4 months, in our opinion. Equities, if you recall, had performed quite well over the first four months of 2011. The European Union's delay in finalizing a debt stabilization package to backstop Greece's sovereign debt obligations sits right at the top. Next up is the U.S. The mere fact that Standard & Poor's (S&P) offered an unprecedented editorial comment in its downgrade of the U.S. from AAA to AA+ as to how dysfunctional the U.S. Congress looked in dealing with the debt ceiling issue only added fuel to the fire. We commented in our July 2010 issue that Corporate America looked lean and mean, while the U.S. government looked tired and bloated. We still feel that way today, and yet we still favor equities over bonds. It is ironic that so many investors find it comforting to commit so much capital to Treasuries when the sheer volume of outstanding sovereign debt is the epicenter of the problem here at home and in Europe.

Like the U.S., Italy's sovereign debt rating was downgraded by S&P. Italy's occurred in September. Like the U.S., one of S&P's concerns was a deadlock between political institutions and the government over a number of important issues, including structural reforms. Italy will be holding key elections in 2013. The downgrade of the U.S., however, has had a different outcome to date. Treasuries actually rallied following the announcement of its downgrade. The yield on the 10-year T-Note declined from 2.56% on 8/5 to 1.92% on 9/30. Very unusual, yet fortunate for those investors owning Treasuries. The turmoil in Europe simply trumped the mounting red ink in the U.S. But the debt situation in the U.S. has not been solved. Congress has more work to do and a hard deadline to boot. The "Gang of 12" super committee is assigned the difficult task of finding another $1.2 trillion in spending cuts by November 23rd, or else some unpopular mandated cuts will be triggered. Investors hiding out in Treasuries may want to start thinking about a potential exit strategy. After all, the rally in Treasuries has lasted nearly 30 years and commenced when yields were 15%.

Why an exit strategy? Because despite what we have witnessed so far, we can't rule out that policy makers both here and abroad will finally strike deals to avoid potential default situations, such as in Greece. With so many investors owning low-yielding Treasuries it is safe to say that when rates do begin to rise in the U.S., the issue for most won't be whether to sell, but how fast can one pull the trigger. Investors need to be as sensitive to interest rate risk as credit risk. A 100 basis point rise in rates on a 10-year T-Bond could result in a 7% or so drop in price. And we have seen in recent weeks that any positive news on reaching a debt solution, particularly in Europe, has sparked some significant rallies in the stock market. So investors, in a sense, have already demonstrated where they may direct their capital in the event any final agreements are made. Perhaps an easier way of characterizing the type of trading in the current climate is risk on one day, risk off the next. As we noted above, we favor equities over debt moving forward. So it's risk on for First Trust.

The chart below shows the yield on Italy's 10-year debt climbing over the past seven weeks or so, while Germany's has bounced some, but has not changed much on a net basis.

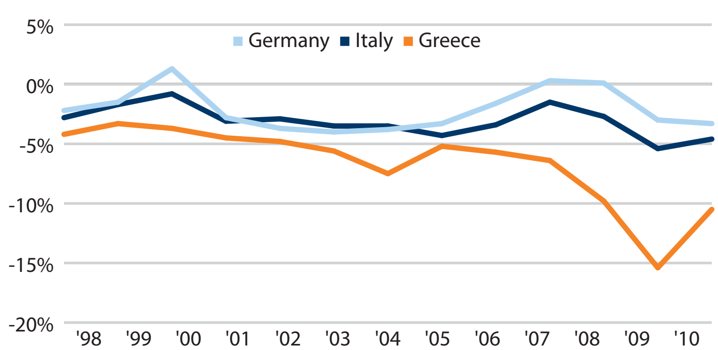
German & Italian 10-Year Government Bond Yields



Source: Bloomberg

The chart below indicates that Italy's deficit situation looks a lot more like Germany's than Greece's. As of the close of 2010, Germany's annual GDP stood at $3.3 trillion. Italy's was $2.0 trillion. Greece's was $305 billion. The entire Eurozone's annual GDP was $12.2 trillion, which means Italy is responsible for one-sixth of total output.

Budget Deficit or Surplus as a % of GDP



Source: Bloomberg/Eurostat

Special Announcement

First Trust will soon be launching a blog for Bob Carey that can be accessed by all at ftportfolios.com. The blog is intended to provide frequent observations and analysis of the securities markets.

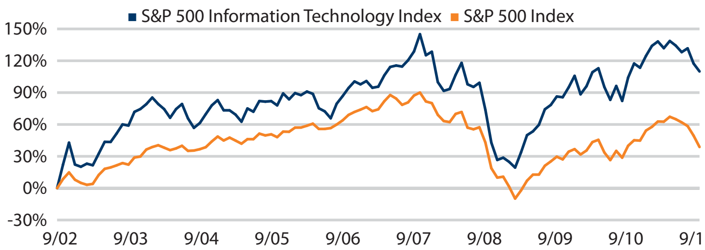
The tech sector talks the talk and walks the walk

The hype that burned investors in tech stocks a decade ago turned out to be authentic after all. Not only do we enjoy 3G cellular technology today, one can even upgrade to 4G if they are not picky about which carrier they use. Computer devices continue to shrink – yet pack more power. A decade ago, one of the biggest concerns was whether or not we could offer all U.S. households access to high-speed broadband. Today, the biggest concern for consumers is which mobile device fits their lifestyle. For some people, one device is not enough. Steve Jobs' legacy will be a reminder to us all of how the entrepreneurial spirit can foster innovation so revolutionary that it weaves its way into the fabric of daily life. And, in the case of high-tech, it appears to be generational as well.

If that sounds a bit over the top to you, consider that 82% of U.S. households have at least one computer, while 48% have multiple PCs, according to the North American Technographics Benchmark Survey conducted in 2010. The statistics go up for Generations Y (18-30) and X (31-44). Ninety-two percent of Generation Y households own at least one PC, while 58% own multiple PCs. The figures are 91% and 59%, respectively, for Generation Xers. A large percentage of these two groups have lived most of their adult lives relying on technology to make their lives easier and more productive. There is no turning back now.

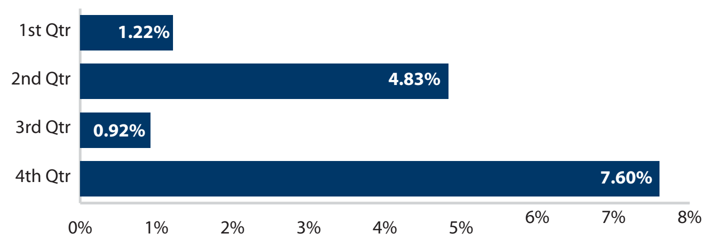
As of 9/30, the 2012 estimated P/E ratio for the S&P Information Technology Index was just 10.50, according to S&P. S&P's estimated earnings growth rate for the index for 2012 is 13.3%. When you factor in that we are in the early stages of cloud computing, we believe tech stocks are relatively inexpensive to own here.

% Change (Price-Only) Returns



Source: Bloomberg

Average Quarterly Returns for the S&P Info Tech Index (1994-2010)

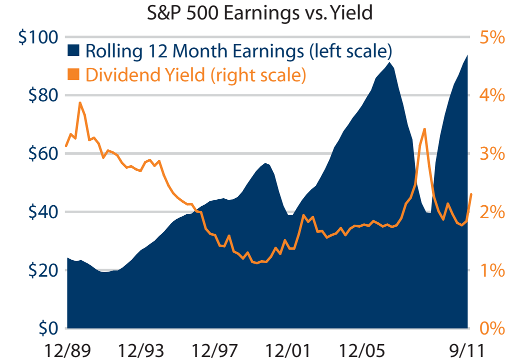


Source: Bloomberg

Companies have plenty of room to boost dividends

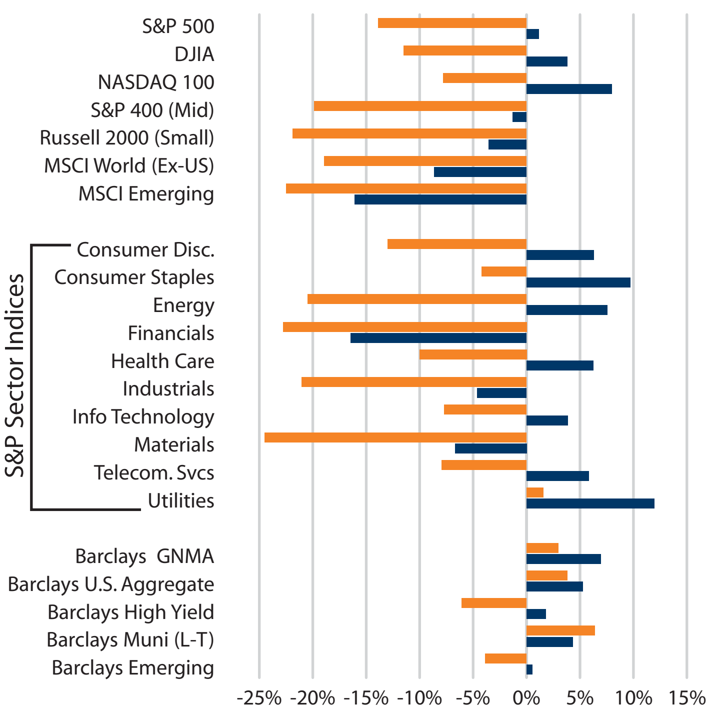
The S&P 500 appreciated 76% from 3/9/09-9/30/11. Constituents in the S&P 500 have been raising their dividend distributions just enough to keep their yields from falling. Currently, payout rates, which on a historical basis have averaged 52%, remain near their lows at less than 30%, according to Standard & Poor's. This indicates that companies are distributing about 30¢ of every dollar of earnings in the form of a dividend, rather than the 52¢ they used to. As the chart shows, the dividend yield on the index started to plunge back in the 1990s. The decline in yields was largely induced by tax policy. Investors paid a 20% rate on capital gains in the second half of the 1990s, while paying their ordinary income tax rate on stock dividends. Companies adopted growth-oriented strategies to attract investors knowing they would be sensitive to the disparity in tax rates. The yield on the S&P 500 was nearly 4% in 1990, but has leveled at 2% since 2001. The only exception was in 2008, where the yield spiked when stock prices plunged. We believe investors could be rewarded with higher dividend payouts in the years ahead. The disparity between the index's low yield and strong earnings is too great, in our opinion. Don't be surprised to see greater shareholder activism on this issue.

S&P 500 Earnings vs. Yield



Source: Standard & Poor's and Bloomberg

Total returns for *Q3* and past **12 months** (9/30/11)



A Look Ahead:

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

	Q4'11E	Q4'10A	**Q1'12E**	Q1'11A	**2012E**	2011E
Financials	**4.29**	3.43	**4.54**	3.75	**19.34**	15.74
Information Technology	**9.17**	7.90	**8.10**	7.18	**35.92**	31.68
Health Care	**8.17**	7.15	**8.75**	7.70	**35.27**	32.42
Consumer Staples	**5.62**	5.26	**5.18**	4.92	**23.24**	21.33
Consumer Discretionary	**5.58**	5.05	**5.02**	4.67	**23.04**	20.62
Industrials	**5.65**	5.24	**5.45**	4.56	**24.46**	21.08
Telecom. Services	**1.75**	1.63	**1.92**	1.91	**7.98**	7.31
Energy	**12.40**	9.10	**12.80**	10.81	**54.29**	48.68
Utilities	**2.38**	2.16	**3.15**	3.15	**12.63**	12.54
Materials	**3.87**	3.42	**5.21**	4.96	**20.35**	18.16
S&P 500 Index	**25.63**	21.93	**25.59**	22.56	**110.18**	97.33
S&P 400 Index (Mid-Cap)	**14.86**	11.94	**14.22**	10.65	**64.93**	52.24
S&P 600 Index (Small-Cap)	**6.09**	4.40	**6.27**	4.74	**27.86**	21.56

Source: Standard & Poor's (10/11/11)