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 $48 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.*

Politics aside...are we better off than we were three years ago?

Believe it or not, the 2011/2012 Republican Primary debates have been up and running since May 5, 2011. The schedule calls for 29 of them. There are seven remaining, and the field has been pared to four candidates. And while there are a number of ongoing polls that seek to measure President Obama's approval rating, the most recent (as of 1/15) from ABC News/Washington Post (48% approve & 48% disapprove) sounds about right. Ideology seems to split America down the middle on most issues these days. It isn't easy to sway public opinion one way or the other. But on some basic level, people should feel comfortable enough to stare at a set of facts and acknowledge their existence. So heading into 2012, we felt it was worth a shot at setting politics aside for a moment to put forth a list of indicators to help investors determine if the U.S. financial/economic climate is better today or better at the close of 2008. We then touch on what we expect for 2012.

Close of 2008 vs. Close of 2011

U.S. Debt Rating: AAA lowered to AA+ by S&P. *Debt ceiling debate fiasco sealed the deal.*

Federal Deficits (Fiscal Year): $459 billion rose to $1.3 trillion. *Gov't spending too high.*

Unemployment Rate: 6.9% rose to 8.7%. *Job creation has been less than stellar.*

Barrel of Crude Oil: $44.60 rose to $98.83. *Up more than double.*

Ounce of Gold Bullion: $884.30 rose to $1,566.80. *Up big but down from $1,888.70 high.*

Federal Funds Target Rate: Stayed at 0-0.25%. *No change.*

10-Year T-Note: Yield declined from 2.21% to 1.88%. *Payout is lower.*

30-Year Fixed-Rate Mortgage: Rate declined from 6.04% to 4.46%. *Loans are cheaper.*

Avg. New Home Price (Census): $263,100 down to $242,300 (10/11). *Homes are cheaper.*

S&P 500 Index Price Level: 903.25 rose to 1257.60. *Equity prices are higher.*

S&P 500 Earnings: $49.51 rose to $96.70 Est. *Earnings nearly doubled.*

S&P 500 Dividend-Payers: 372 payers rose to 394. *More companies paying dividends.*

S&P 500 Non-Financials Cash Holdings: $654.6 billion now $1.1 trillion (Q3'11). *Cash rich.*

Moody's Speculative-Grade Default Rate: 4.5% down to 1.8%. *Risk level is down.*

Capacity Utilization: 71.9% rose to 78.1%. *Plants and factories are busier.*

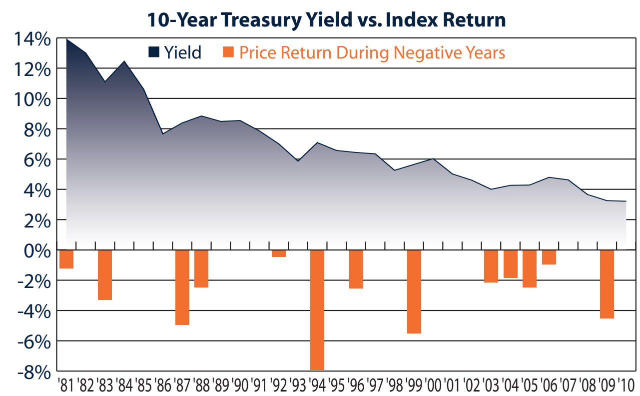
Gross Domestic Product (annualized): -8.9% (Q4'08) compared to 1.8% (Q3'11). *Obvious.*

Carey's Themes & Trends for 2012

1. Modest P/E expansion, S&P 500 earnings advance ~10%.
2. Companies investing again (Mergers & Acquisitions; Capital Expenditures).
3. Credit spreads stable, treasury yields rise.
4. Cyclical equity sectors to outperform.
5. Gridlock! No major change in Washington policies.
6. International markets remain highly correlated to US.
7. Continued economic expansion.

The piece on the right was posted on Bob Carey's Blog at ftportfolios.com on 10/28/11.

Even People Hiding in a Safe House Keep One Eye on the Exit



Source: Federal Reserve Board and Barclays Capital.
Index return is represented by the Barclays Capital U.S. Treasury: Intermediate Index
Past performance is no guarantee of future results.

1. From 1981-2010, there were 13 years in which the price-only return on Intermediate Treasuries (see chart) ended a calendar year in negative territory.
2. While Treasuries have provided investors throughout time with the optimum protection against credit risk, they have always been vulnerable to interest rate risk.
3. What makes today's climate tenuous is that interest rates are at historically low levels.
4. Our concern is that many investors have funneled a considerable amount of capital into Treasuries because they viewed them as a safe haven.
5. The turmoil surrounding the debt crisis in the European Union, particularly in Greece, certainly warranted such consideration.
6. But the news in Europe changed in a meaningful way on 10/27 due to an agreement forged by EU leaders, banks and the International Monetary Fund.
7. So the question facing investors in Treasuries is as follows: Where does my risk lie now? We believe the risk lies in the potential for rising rates.
8. Based on the 2.5% annualized GDP growth rate for Q3'11, we believe that some investors may find greater value in equities moving forward. In other words: "risk-on."
9. The forward-looking P/E on the S&P 500 is currently 12.9, according to Bloomberg. The 2012 estimated earnings growth rate for the index is 12%, according to S&P.

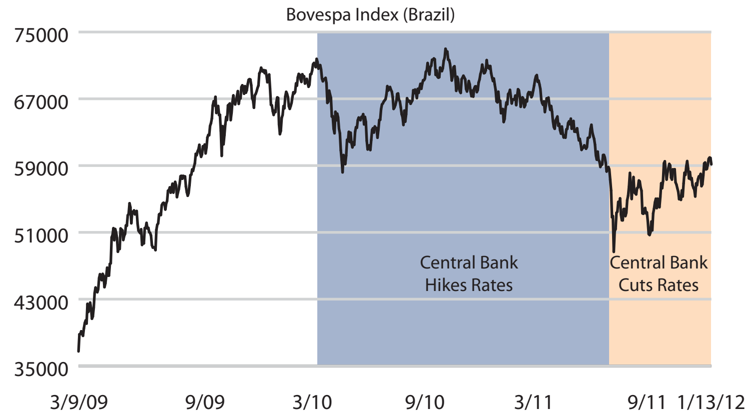
Continued

If you can find a better story looking out five years than Brazil's then buy it

This is one of those times you wonder where to begin. Perhaps with one of the hottest topics of the day: sovereign debt ratings. While many nations, including the U.S., have been downgraded in the past six months, Brazil's credit rating was actually upgraded by S&P in November. It first achieved investment-grade status in April 2008. Unlike many nations, Brazil's public debt declined from 60.6% of GDP to 36.5% over the past ten years, according to Ernst & Young (EY). EY notes that Brazil is rapidly becoming a middle class country. Of the 183 million people living in Brazil, an estimated 115 million, or 62%, are considered either rich or middle class.

Brazil's estimated real GDP growth rate for 2012 is 3.6%, according to data from the International Monetary Fund (IMF). Its average rate of growth was 4.0% from 2003-2010. The Bovespa Index posted an average annual total return of 37.9% (USD) over that 8-year period, well above the 21.4% (USD) average gain for the MSCI Emerging Markets Index. The IMF sees real GDP growth rising to 4.2% by 2016. That is the year Brazil will be hosting the Summer Olympics. It will also be hosting the 2014 World Cup. Infrastructure projects connected to the World Cup and Olympic games are expected to add 120,000 jobs annually until 2016, according to Financierworldwide.com.

Its leading trading partner is China, which supplanted the U.S. in 2009. The U.S. had been Brazil's principal trading partner for nearly 80 years. China's economy needs natural resources (agriculture, iron ore & energy) and Brazil has them.

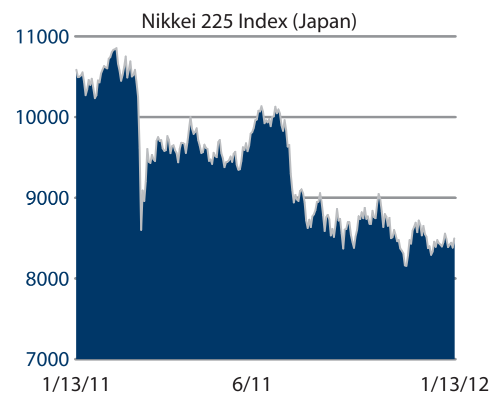


Source: Bloomberg

The central bank of Brazil (BACEN) stalled the bull market in the Bovespa Index when it began raising its SELIC target rate (similar to federal funds rate) in 4/10. In total, it raised its benchmark lending rate 375 basis points (8.75%-12.50%) in an effort to curb inflation. The good news is it reversed course in 8/11 by initiating a 50 basis point cut. It went on to cut another 100 basis points by year-end, bringing the rate down to 11.00%.

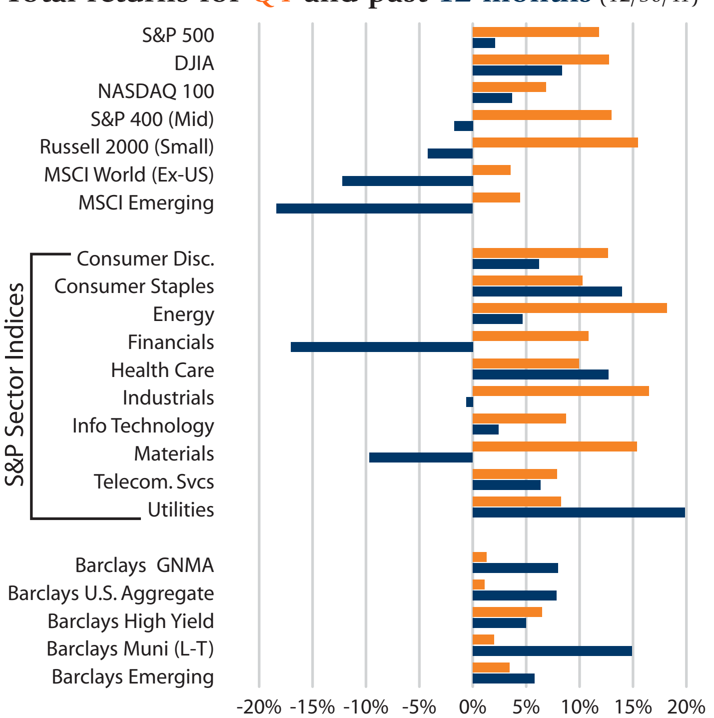
Is there a trade to be had?

At its peak, the Nikkei 225 stood at 38915.87 on 12/29/89. Today, the index's price level is closer to 8500, which is approximately 78% below its all-time high. Many of the problems that have plagued Japan over the past two decades remain today. Japan has an aging population, a shrinking workforce and low productivity. It has been stuck in a deflationary spiral despite the enormous amounts of fiscal stimulus pumped into the system. It has the highest public debt to GDP ratio of the major industrialized countries, at around 200%. The silver lining with respect to its debt load is that it has been able to finance much of it at extremely low rates. Japan's GDP growth rates have declined steadily through the years, according to data from the International Monetary Fund (IMF). From1973-1990, GDP growth averaged over 4%. Growth has averaged 1-2% since 1990. With all of its challenges, Japan does offer equity investors opportunities to make money from time to time. The Nikkei 225 has traded between 8000 and 11000 over the past four years, so it is currently at the low-end of that range. The chart to the right shows a sharp sell-off following the tsunami/earthquake disaster that struck Japan on 3/10/11. The Nikkei 225 is down about 19% since that day. Estimates put the rebuilding needs, which have yet to commence, at around $250 billion. The IMF sees GDP growth rising from -0.7% in 2011 to 2.5% in 2012.



Source: Bloomberg

Total returns for *Q4* and past 12 months (12/30/11)



A Look Ahead:

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

	Q1'12E	Q1'11A	**Q2'12E**	Q2'11A	**2012E**	2011E
Financials	**4.25**	3.75	**4.45**	3.95	**18.09**	16.05
Information Technology	**7.77**	7.18	**8.42**	7.69	**35.37**	31.06
Health Care	**8.75**	7.70	**8.82**	8.27	**35.25**	31.68
Consumer Staples	**5.16**	4.92	**5.84**	5.39	**23.08**	21.30
Consumer Discretionary	**4.89**	4.67	**5.65**	5.38	**22.64**	20.49
Industrials	**5.33**	4.56	**6.04**	5.54	**23.80**	20.95
Telecom. Services	**1.90**	1.91	**2.07**	1.78	**7.97**	7.07
Energy	**12.14**	10.81	**12.67**	12.98	**51.24**	50.07
Utilities	**3.17**	3.15	**2.73**	2.87	**12.48**	12.49
Materials	**4.77**	4.96	**5.29**	5.44	**18.78**	17.29
S&P 500 Index	**24.72**	22.56	**26.47**	24.86	**106.87**	97.02
S&P 400 Index (Mid-Cap)	**13.68**	10.65	**15.44**	13.07	**63.04**	51.01
S&P 600 Index (Small-Cap)	**6.11**	4.74	**6.73**	5.36	**27.42**	20.94

Source: Standard & Poor's (1/3/11)