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 Chief Market Strategist, Bob and his staff supervise approximately $61 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 StreetJournal, The Wall Street Reporter, Bloomberg News Service, and Registered Rep.*

We invite you to visit Bob's Market Commentary Blog at www.ftportfolios.com for more insight.

Showdown at the "Not-O.K." Corral

Year	Asset Class	Return
1982	L-T Gov'ts	40.36%
1983	REITs	30.64%
1984	REITs	20.93%
1985	S&P 500	32.16%
1986	L-T Gov'ts	24.53%
1987	Gold oz.	20.12%
1988	S&P 500	16.81%
1989	S&P 500	31.49%
1990	L-T Gov'ts	6.18%
1991	REITs	35.70%
1992	REITs	14.59%
1993	REITs	19.65%
1994	REITs	3.17%
1995	S&P 500	37.43%
1996	REITs	35.27%

In honor of October being National Financial Planning Month (April is National Financial Literacy Month), we would like to give one more shout-out to all of the retail investors that have been collectively liquidating billions of dollars of capital from U.S. stock mutual funds in an effort to mitigate or avoid risk. You know who you are. It has been going on for most of the past six years, including 2012. While we acknowledge the emotional toll that two bear markets and one startling "flash crash" can take on a person's psyche, we do not believe that the solution is to simply walk away from one of the best avenues for building wealth the world has ever known. It's not okay, in our opinion. We'll explain.

Let's begin with last month. Since 1950, September has been the worst performing month for the S&P 500, with an average return of -0.6%, according to the Stock Trader's Almanac. In September 2012, the S&P 500 posted a total return of 2.58%. What did retail investors think of that showing? They redeemed a net $16.8 billion from U.S. stock funds, according to Morningstar. How about year-to-date? The S&P 500 posted a total return of 16.44% through the first nine months of 2012, well above its historical average of 9.77% per year since 1926, according to Ibbotson Associates/Morningstar. Retail investors were not impressed. U.S. stock funds reported net redemptions totaling $82.6 billion, according to Morningstar. For the 12-month period ended September 2012, net outflows from U.S. stock funds totaled $126.7 billion, despite the 30.18% gain by the S&P 500. Not only does this not make good financial sense, in our opinion, it is potentially damaging for some investors down the road. The latest quarterly edition of the *Financial Professional Outlook* (released 9/12), a survey of financial advisors conducted by Russell Investment Group, revealed that two of the top five topics advisors are discussing with clients are the importance of asset allocation/rebalancing and running out of money in retirement.

Interest rates are at historically low levels. And we know, thanks to three quantitative easing initiatives from the Federal Reserve, that interest rates are being kept artificially low in an effort to boost economic activity, particularly in the area of job creation. Suffice it to say, this scenario can't last forever. We believe with some better policymaking from our elected officials in Washington, D.C. that the U.S. economy can grow considerably faster. Those investors that have funneled a net $288.2 billion (Morningstar) into taxable and municipal bond funds over the past 12 months are probably pleased with the returns they have earned to date, but what will their next move be when all, or even a big share, of the Fed's stimulus gets put to work? Some investors are playing a game of chicken with interest rates. Now is not the time for a showdown, in our opinion. It is the time for realism and sound planning.

The charts bordering the left and right sides of this page feature total returns (except for gold which reflects price change) from the investment community's version of the ("four primary food groups"). They include the S&P 500 (equities), Long-Term Government Bonds (closest thing to risk-free loans), Gold Bullion (inflation-hedge) and FTSE NAREIT Equity REITs (real estate). Each calendar year shows the top performer of the four asset classes. The annual returns are from 1982 through 2011.This period was selected because it mirrors the 30-year bull market in bonds. From our perspective, there are two things that scream out when looking at this data. First, not one of the 30 calendar years has a negative return as its best return. Second, L-T Government debt was the top performer only five times.

Year	Asset Class	Return
1997	S&P 500	33.36%
1998	S&P 500	28.58%
1999	S&P 500	21.04%
2000	REITs	26.37%
2001	REITs	13.93%
2002	Gold oz.	24.80%
2003	REITs	37.13%
2004	REITs	31.58%
2005	Gold oz.	18.36%
2006	REITs	35.06%
2007	Gold oz.	31.35%
2008	L-T Gov'ts	25.87%
2009	REITs	27.99%
2010	REITs	27.96%
2011	L-T Gov'ts	28.23%

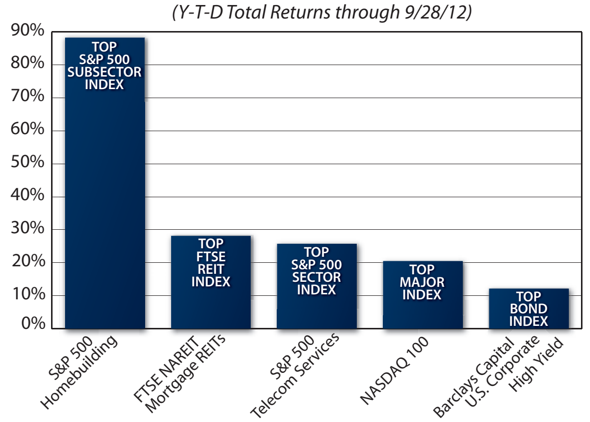
Continued

Sure Looks Like The Recovery Is Real

Watch or read enough financial news and you might catch a story about whether or not the U.S. economic recovery is real. The answer is yes. The problem is, in our opinion, not enough Americans are participating in it, and that is likely what people who discuss this topic are alluding to. This raises an even broader issue in this era of instant information: casual speak. Casual speak all too often has replaced candid conversation and it can be counterproductive at times. The U.S. economy has grown every quarter since the recession ended in June 2009. The GDP growth rate averaged 2.0% over the past 12 quarters, according to data from the Bureau of Economic Analysis. While certainly not robust, it is higher than the 1.7% average GDP growth rate posted from 6/30/02-6/30/12. Perhaps the most glaring example of financial casual speak is the phrase "lost decade in stocks." It's been thrown around a lot as an umbrella statement about equities in general, but what it really speaks to is the performance of the S&P 500 from 2000-2009. The S&P 500 posted a cumulative total return of -9.10% in that decade. The S&P 400 Index of mid-cap stocks and the Russell 2000 Index of small-caps, however, were up 85.16% and 41.85%, respectively.

2012's Domestic Standouts

(Y-T-D Total Returns through 9/28/12)



Source: Bloomberg

10 Reasons to be Upbeat about Stocks

The Federal Reserve continues to prime the pump. Announced a 3rd round of quantitative easing in 9/12. At this stage, more beneficial for equities than debt.

Corporations and investors are thirsting for guidance with respect to regulations, taxes and the "fiscal cliff." Election season ends Nov. 6. Then the work begins.

Homebuilders and Mortgage REITs are staging solid recoveries in 2012 (see chart at top of page). They were both at the epicenter of the financial crisis.

Stock dividend payouts have fully recovered from the recession. The $67.3 billion in S&P 500 dividend payouts in Q2'12 eclipsed the $67.1 billion in Q4'07.

S&P 500 earnings expected to be higher in 2013. S&P estimates that 2012 earnings growth for the S&P 500 will be 5.4%. It is forecasting 13.0% for 2013.

S&P 500 stock buybacks totaled $111.7 billion in Q2'12, up 32.5% from Q1'12. S&P noted that it was the second-highest total in the past 17 quarters.

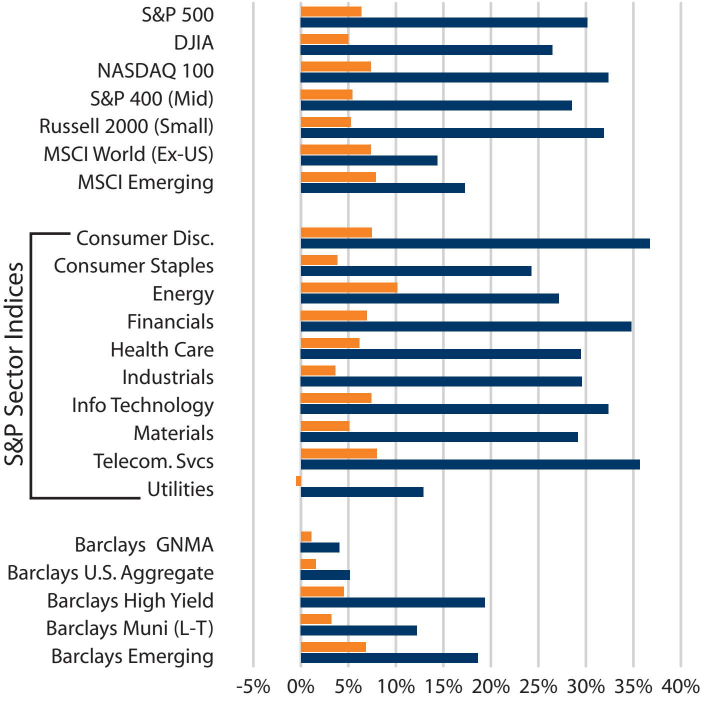
S&P's price-to-earnings (P/E) ratio on the S&P 500 was 14.10 based on '12 estimated earnings and 12.48 using '13 estimates. Its 10-year average P/E is 16.75.

Moody's reported it expects the global speculative-grade default rate to hover near 3.0% for the next 12 months, well below its 4.8% average since 1983.

Ernst & Young released the findings from its bi-annual survey of global executives. 48% of U.S. respondents intend to deploy cash toward growth initiatives.

Russell Investment Group reported that its quarterly survey of financial advisors found that 68% are optimistic about the markets looking out three years.

Total returns for *Q2* and past **12 months** (9/28/12)



A Look Ahead:

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

	Q4'12E	Q4'11A	**Q1'13E**	Q1'12A	**2013E**	2012E
Financials	**4.51**	4.05	**4.65**	3.93	**19.38**	17.10
Information Technology	**10.66**	9.26	**9.64**	8.27	**41.58**	35.29
Health Care	**8.32**	7.40	**8.92**	8.35	**36.83**	33.09
Consumer Staples	**5.88**	5.56	**5.38**	5.06	**24.21**	21.88
Consumer Discretionary	**6.32**	5.58	**5.54**	4.91	**25.56**	21.93
Industrials	**6.03**	5.42	**5.91**	5.48	**26.28**	23.45
Telecom. Services	**1.40**	1.21	**1.95**	1.90	**8.90**	7.38
Energy	**11.41**	10.04	**11.63**	11.52	**49.17**	45.87
Utilities	**2.44**	2.32	**3.16**	2.98	**12.55**	12.09
Materials	**3.41**	1.87	**5.12**	4.23	**19.24**	15.32
S&P 500 Index	**26.92**	23.73	**26.89**	24.24	**114.84**	101.61
S&P 400 Index (Mid-Cap)	**15.74**	13.36	**15.08**	12.84	**67.36**	57.33
S&P 600 Index (Small-Cap)	**6.80**	5.23	**7.22**	5.28	**30.73**	23.57

Source: Standard & Poor's (10/11/12)