First Trust

Quarterly Market Overview

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

Market Turbulence Is Nothing New And This Bull Market Is About Average When It Comes To Volatility

If you include the first two weeks of October, it has been over 1,100 days since the S&P 500 experienced a correction of at least 10%, and the "natives" appear to be a bit restless. Why are they restless? Since 1945, the S&P 500 has experienced a 10% correction or worse every 18 months, on average, according to Sam Stovall, managing director of U.S. equity strategy at S&P Capital IQ. While the current streak has lasted a little more than three years (double the average since 1945), the longest period without at least a 10% correction was 82 months (1990-1997). As of 10/14/14, the S&P 500 stood 6.7% below its all-time high of 2011.36 (9/18/14). As of now, the S&P 500 has endured a pullback, not a correction. Let's see what transpires as we move through earnings season. If it happens, it happens.

Implied in the discussion above is the notion that corrections are a normal part of every bull market. We believe that corrections are healthy for the markets because they give some investors the motivation to take profits, give other investors a chance to enter the market, provide an opportunity to rebalance one's investment portfolio, and potentially keep the markets from getting too frothy or overheated.

The current bull market has lasted 2,045 calendar days, as of 10/14/14, the fourth longest streak since 1928, as measured by the S&P 500, according to Bespoke Investment Group. The three longest bull markets stretched 4,494 days, 2,607 days and 2,248 days. The average bull market has lasted 933 days. The four longest bear markets lasted 630 days, 622 days, 546 days and 543 days. The average bear market has lasted 295 days. Bull markets tend to last a lot longer than bear markets. To date, the S&P 500 has never failed to fully recover from a bear market. But for some reason, many investors have seemed tense throughout the current bull market, in our opinion.

Investors can white-knuckle the headlines all they like, but charts like the three to the right are a lot more useful, in our opinion. The financial media has been harping on the recent spike in volatility and, while noteworthy, it is not at a level that investors need to panic about. The VIX Index rose from a reading of 11.98 on 8/29/14 to 22.79 on 10/14/14. As indicated in the chart at the upper right of this page, the 22.79 level on the VIX Index is in line with the current bull market average as well as the index's 10- and 20-year averages. The data in the second chart provides another snapshot depicting the absence of any significant volatility relative to recent calendar years.

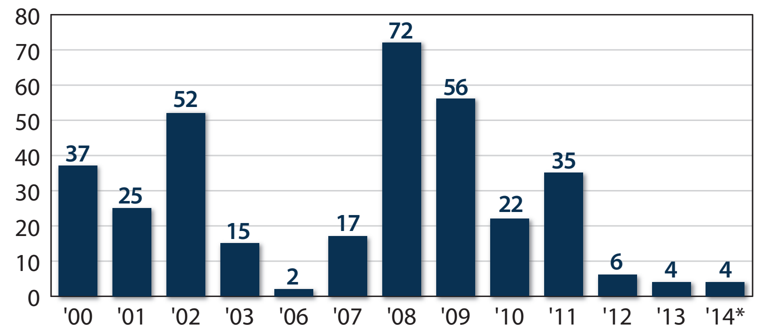
The Federal Reserve reported that U.S. household wealth rose by 1.7% in Q2'14 to $81.5 trillion. Americans' stock and mutual fund portfolios increased by $1 trillion. Data from the Fed shows that only 49% of Americans have money invested in equities, down from a peak of just over 53% in 2007, according to CNNMoney.com. We are in the midst one of the best bull markets in history and yet fewer Americans have a stake in it. Our third chart offers some useful information regarding the U.S. economy and markets.

VIX Index

Period	*Average*	*High*	*Date*	*Low*	*Date*
10 Years (9/04 - 9/14)	20.05	80.86	11/20/08	9.89	1/24/07
20 Years (9/94 - 9/14)	20.82	80.86	11/20/08	9.89	1/24/07
Bull Market (3/9/09 - 9/30/14)	20.17	49.68	3/9/09	10.32	7/3/14
Bull Market (10/9/02 - 10/9/07)	16.47	42.13	10/9/02	9.89	1/24/07
Bull Market (10/11/90 - 10/9/97)	15.88	36.20	1/14/91	9.31	12/22/93

Source: Bloomberg. 10- and 20-year averages based on monthly data points. The VIX Index (The CBOE Volatility Index®) estimates expected volatility by averaging the weighted prices of S&P 500 puts and calls over a wide range of strike prices.

Number of days S&P 500 has closed up or down by at least 2% in a year



Source: S&P Dow Jones Indices and *The Wall Street Journal.* *YTD as of 10/10/14.

10 Things To Keep In Mind About U.S. Equities

- Interest rates and inflation remain low.
- U.S. real GDP growth rate estimate is 3.1% for 2015. (IMF)
- Corporate cash holdings remain near record levels. (S&P)
- U.S. executives expect strong M&A activity in 2015. (EY survey)
- Speculative-grade default rates expected to stay below avg. in '15. (Moody's)
- S&P 500's consensus EPS growth rate est. > 10% for 2015. (Bloomberg)
- S&P 500's consensus top-line growth est. > 5% for 2015. (Bloomberg)
- Companies continue to buy back stock and raise stock dividends.
- Have yet to see companies bump up their capital expenditures.
- Have yet to see any major rotation out of bonds and into stocks.

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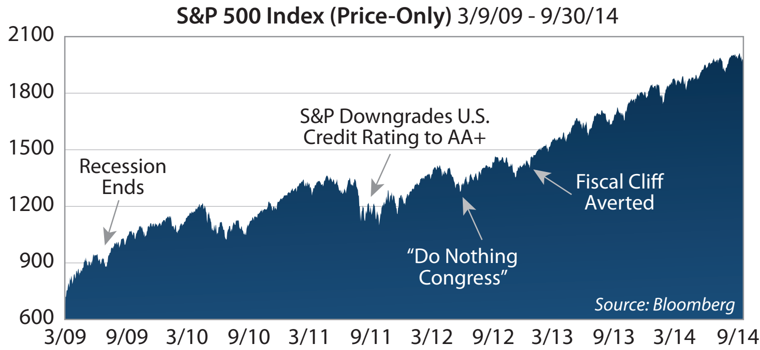
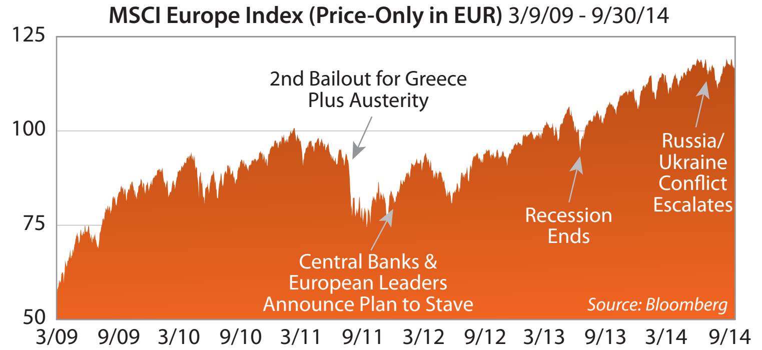
A Tale Of Two Recoveries & Two Bulls: U.S. vs. Europe

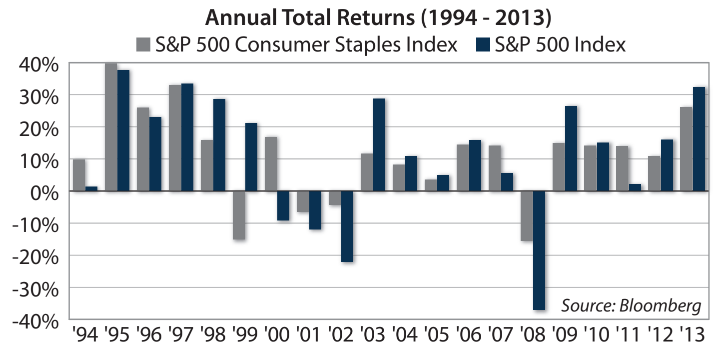




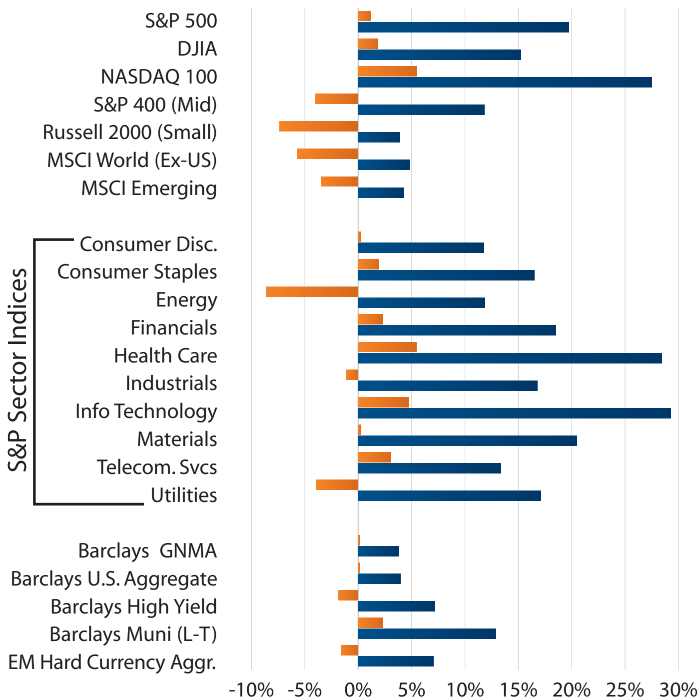
With many investors likely monitoring the economic recovery underway in Europe, we thought it might be interesting to briefly compare and contrast Europe's progress with that of the U.S. The time period captured in the charts pertains to the current bull market in stocks. Both the S&P 500 and the MSCI Europe Index commenced their respective rally's on 3/9/09. From 3/9/09-9/30/14, the S&P 500 posted a cumulative total return of 228.05%, compared to 152.83% (USD) for the MSCI Europe Index, or a difference of roughly 75 percentage points. We have also included in the charts a number of notable events that have helped shape the recoveries. One of the things that sticks out is the staggered start dates to the respective economic recoveries. The U.S. recovery commenced in Q3'09, while Europe's, due to the sovereign debt crisis in the European Union, began in Q2'13. That implies that Europe's recovery is trailing the recovery in the U.S. by more than three years. What is not represented in the charts is that real GDP growth rates in Europe have yet to even reach the 1.50% level since the start of the recovery, while the U.S. has averaged 2.1% growth from 6/30/09-6/30/14, according to data from the Bureau of Economic Analysis. The common thread between the two recoveries is the commitment from the central banks (Federal Reserve and European Central Bank) to providing whatever level of liquidity is necessary to backstop the capital markets. Our take on Europe is that investors need to be as patient there as was needed in the U.S. over the past five years.

Equity Investors Looking To Be More Defensive Might Consider Consumer Staples

The International Monetary Fund estimates that global economic growth will expand by 3.3% in 2014 (no change from '13) and then accelerate to 3.8% in 2015, according to its own release on 10/7. The rate of global growth, however, stood at 5.4% in 2010. The tempering of growth combined with a growing list of challenging geopolitical events around the globe may have some equity investors tapping their brakes with respect to risk tolerance. If so, consider investigating what Consumer Staples have to offer. From 1994-2013, the S&P 500 Consumer Staples Index posted an average annual total return of 10.7%, compared to 9.2% for the S&P 500. That is notable considering that the U.S. economy expanded, in nominal terms, from $7.0 trillion dollars on 12/31/93 to $17.1 trillion as of 12/31/13, according to data from the Bureau of Economic Analysis. Over that 20-year span, the S&P 500 Consumer Staples Index outperformed the S&P 500 in 9 of the 20 years, and with less inherent risk. The beta on the S&P 500 Consumer Staples Index stood at 0.78 on 9/30/14, according to Bloomberg.



Total returns for Q3 and past 12 months (9/30/14)



A Look Ahead:

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

	Q4'14E	Q4'13A	**Q1'15E**	Q1'14A	**2014E**	2015E
Financials	**5.57**	5.27	**6.02**	5.50	**22.15**	25.00
Information Technology	**12.03**	9.81	**10.54**	8.23	**38.27**	45.22
Health Care	**10.65**	7.83	**11.01**	8.61	**39.10**	46.67
Consumer Staples	**6.70**	6.57	**6.17**	5.55	**24.73**	27.53
Consumer Discretionary	**7.74**	6.69	**7.23**	6.15	**27.92**	32.86
Industrials	**7.51**	6.63	**6.67**	5.86	**27.71**	30.72
Telecom. Services	**2.73**	5.58	**3.13**	2.82	**11.50**	12.14
Energy	**12.10**	9.42	**12.59**	11.70	**47.54**	54.09
Utilities	**3.11**	2.58	**3.62**	3.32	**13.45**	14.61
Materials	**4.27**	3.03	**5.70**	4.43	**17.26**	21.11
S&P 500 Index	**32.24**	28.25	**31.76**	27.32	**118.95**	136.13
S&P 400 Index (Mid-Cap)	**20.78**	16.11	**18.48**	13.66	**70.12**	84.34
S&P 600 Index (Small-Cap)	**9.34**	6.92	**8.97**	5.90	**30.54**	39.86

Source: Standard & Poor's (10/2/14)