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 $98 billion in assets as of 6/30/14. 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.*

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

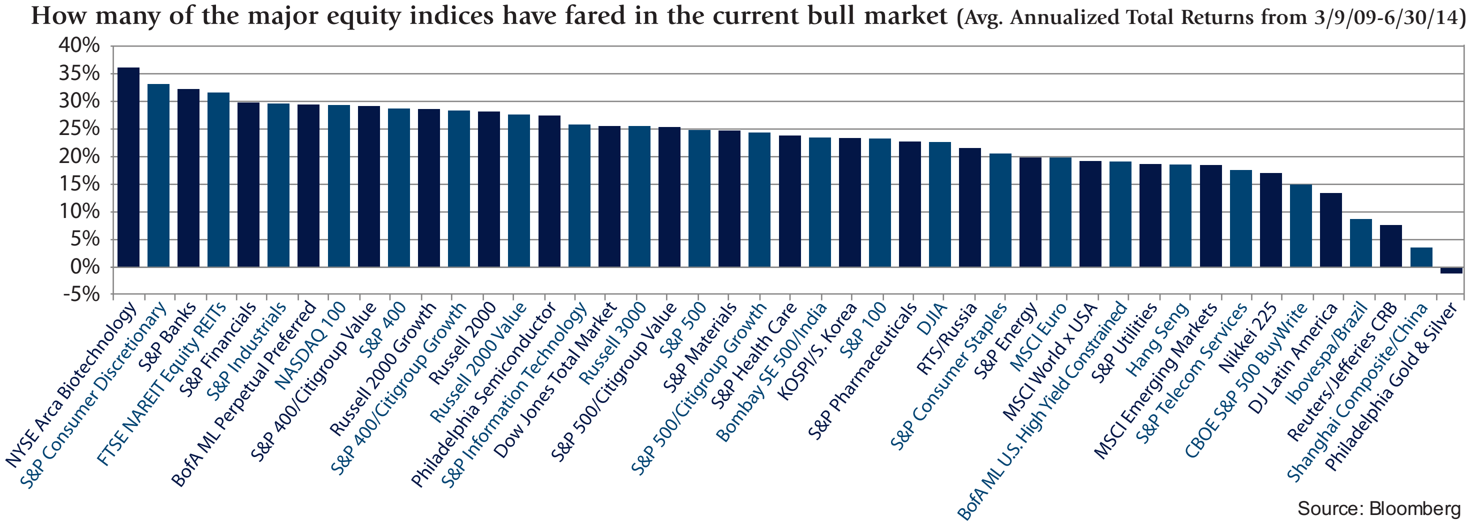
It's Harder To Move Forward When You're Looking Over Your Shoulder

For the better part of the past six years, we have been steadfast in encouraging investors to assume more risk in the markets in an effort to potentially capture higher investment returns, and we made it known that we favored equities over bonds. Brian Wesbury, Chief Economist at First Trust Advisors L.P., has been equally as steadfast in arguing that the recession that accompanied the financial crisis in 2008 was not a garden variety contraction, but rather something closer to a systemic-induced "panic." Wesbury has always contended that, while the panic was difficult to endure, the underlying fundamentals in the economy were actually better than people were led to believe by the media and politicians. While opinions can certainly vary on this issue, one statistic really lends support to Wesbury's perspective: corporate cash holdings. The cash and equivalent levels of the so-called S&P 500 Old Industrials (excludes Financial, Utility and Transportation companies) rose from approximately $610 billion at the close of 2007 to around $831 billion in 2009, or an increase of about 36.2%, according to data from Standard & Poor's. That is a notable accomplishment considering that some pundits and politicians characterized the recession (12/07-6/09) as perhaps the worst since the Great Depression. In doing so, they conveniently passed over a relatively nasty recession in 1980-1982. The unemployment rate in the U.S. rose from 6.0% in December 1979 to a recessionary peak of 10.8% in November 1982. The cash and equivalent holdings of the S&P 500 Old Industrials rose from approximately $76 billion at the close of 1980 to around $77 billion in 1982, or an increase of about 1.3%. That result is much closer to what one would expect in a traditional recessionary climate, in our opinion. As of December 2013, the cash and equivalent holdings of the S&P 500 Old Industrials stood at a record $1.29 trillion, according to S&P. Not too bad for an economic recovery deemed by some as one of the weakest on record.

The U.S. economic recovery turned five years old in June 2014. The bull market in stocks began around four months before the recession ended in June 2009. From 3/9/09-6/30/14, the S&P 500 posted a cumulative total return of 224.4%, or an average annualized gain of 24.80%. The U.S.'s share of the world's total equity market capitalization rose from 31.7% on 3/9/09 to 36.2% on 6/30/14, according to data from Bloomberg. If you recall, there was some concern around the 2008 Summer Olympics in Beijing that China, considering the pace it was growing at, was perhaps on the verge of supplanting the U.S. as the world's most dominant economic force. A similar discussion was held in the late 1980s when Japan's economy was booming. It hasn't happened. The 500 largest companies in the world (*Fortune 500*) generated a combined $31.1 trillion in revenues and nearly $2 trillion in profits in 2013, according to *Fortune*. The U.S. had the most companies on the list at 128 ($8.6 trillion in combined revenues), while China had 95 ($5.8 trillion in combined revenues).

Despite the progress that has been made since the recession ended, we are aware that some investors and some in the financial media are still waiting for the next shoe to drop that will inspire a sell-off in the stock market (see chart at top of next page). The S&P 500 has not experienced a 10% correction in 1,000 days, as of 6/30/14. Investors leery of committing capital to the stock market at current levels should know that the longest stretch without a 10% correction was 2,553 days (10/11/90-10/7/97), according to Bespoke Investment Group. That period was more than double the current stretch. The lack of volatility in the market also seems to have some on edge. The VIX Index, which uses S&P 500 options activity to gauge investors' expectations of volatility, stood at a reading of 11.57 at the end of June, well below its 10-year average of 20.05. Whether or not we experience a correction in the market in the months ahead, investors should still have a game plan for their capital. The chart below reflects how many stock indices/risk-oriented assets have performed in the bull market.

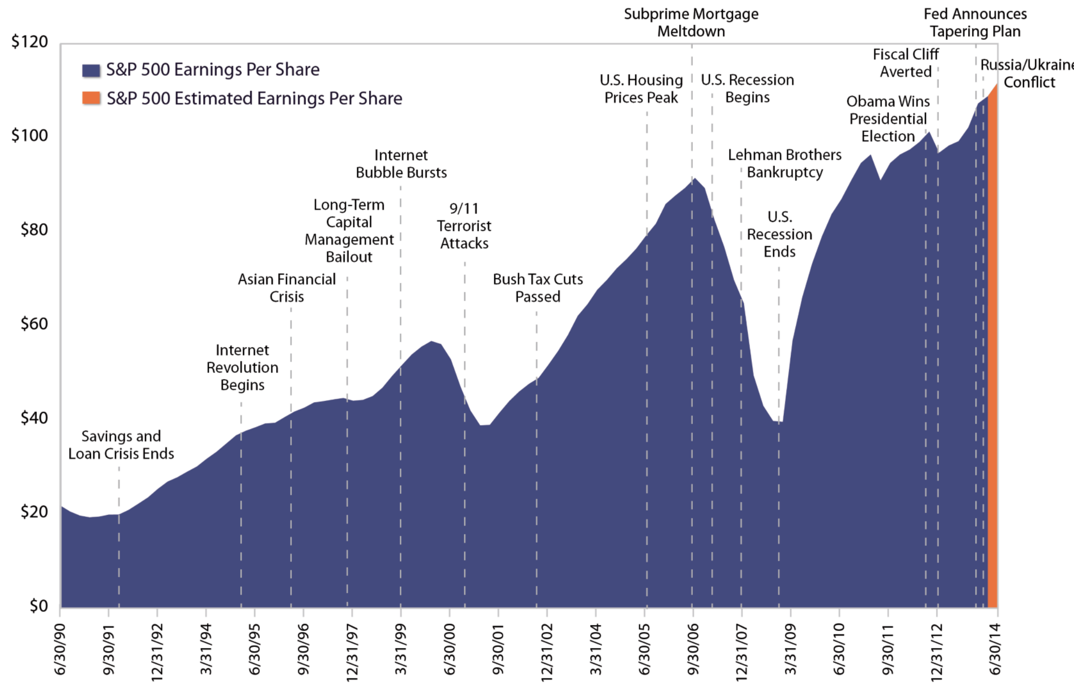
How many of the major equity indices have fared in the current bull market (Avg. Annualized Total Returns from 3/9/09-6/30/14)



Source: Bloomberg

What would you do if the market experienced a correction of 10% or more?

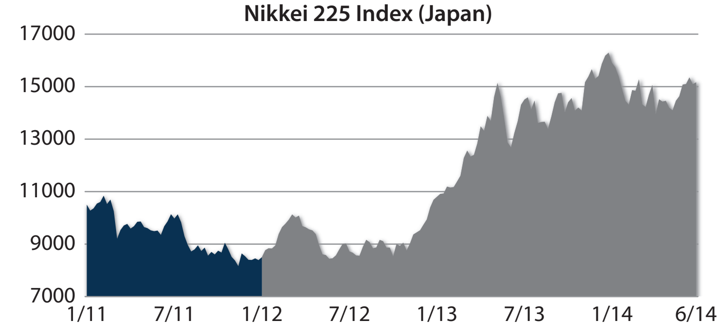
The last time the S&P 500 experienced a correction of 10% or more the sell-off concluded on October 3, 2011. We nearly had another in Q2'12, but the S&P 500 only fell 9.9%, just shy of a correction. For those investors waiting for some event to trigger a correction in the market before taking the plunge, take a moment and study the chart to the right. It captures the earnings growth of the S&P 500 Index since mid-1990, complete with 16 noteworthy events that may or may not have impacted the markets. Even after discounting these events, and those not mentioned, the S&P 500's price and earnings levels still managed to ascend to record highs. The S&P 500 has never failed to recover from a bear market (decline of 20% or more), let alone a correction. On average, the market experiences a correction every 18 months, according to S&P Capital's Sam Stovall. It's been about 33 months since the last one. Fearing a correction is one thing – being prepared to exploit one is another thing entirely.



Source: Standard and Poor's. Note: 6/30/14 quarterly number is estimated.

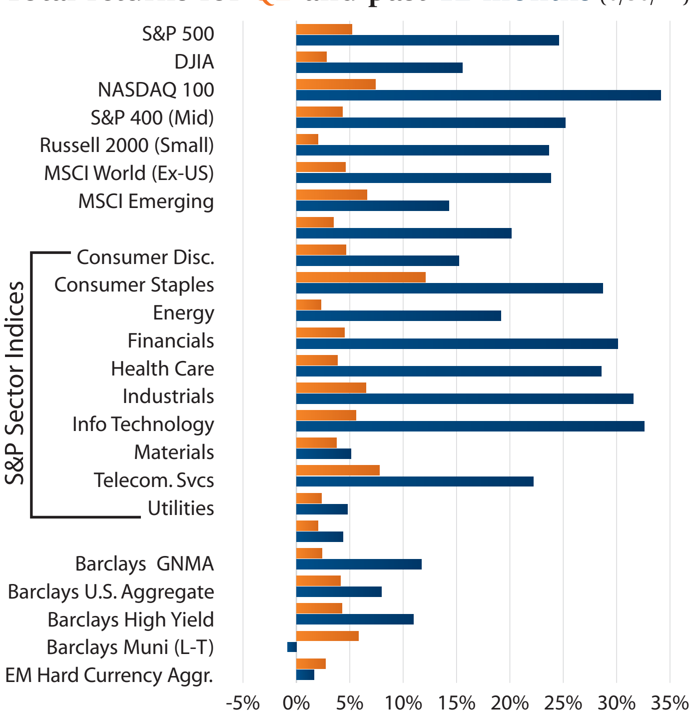
A quick take on Japan...

In our Q1'12 newsletter, we discussed the recovery underway in Japan and noted that the Nikkei 225 Index had stayed range-bound (8000 to 11000) since October 2008. As indicated in the chart to the right, the index was at the lower end of that range in January 2012, when we floated the notion that a trade could potentially be had. While the Nikkei 225 Index has managed to reach the 15000 level, we believe that this rally may have some additional legs. The index stood 16.9% below its 10-year high (7/13/07) on 6/30/14. Bloomberg's 2014 & 2015 estimated earnings growth rates for the Nikkei 225 Index were 16.25% and 12.00%, respectively, as of 7/15/14. Its 2014 P/E was 17.45, as of 7/15/14, well below its 5-year average of 21.98. Investors funneled a net $923 million into Japanese open-end stock funds in the first half of 2014, according to Morningstar.



Source: Bloomberg. Data is weekly from 1/14/11 to 6/30/14.

Total returns for Q2 and past 12 months (6/30/14)



A Look Ahead:

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

	Q3'14E	Q3'13A	**Q4'14E**	Q4'13A	**2014E**	2013E
Financials	**5.37**	5.15	**5.70**	5.27	**21.87**	21.07
Information Technology	**9.67**	8.07	**12.09**	9.81	**39.18**	33.58
Health Care	**10.19**	8.27	**10.45**	7.83	**39.15**	32.43
Consumer Staples	**6.53**	6.17	**6.86**	6.57	**25.13**	23.95
Consumer Discretionary	**7.39**	6.53	**7.82**	6.69	**28.28**	25.12
Industrials	**7.22**	6.52	**7.49**	6.63	**27.62**	24.88
Telecom. Services	**3.05**	2.49	**2.68**	5.58	**11.60**	12.31
Energy	**12.41**	10.26	**12.35**	9.42	**48.21**	42.35
Utilities	**4.42**	4.13	**2.75**	2.58	**13.41**	12.15
Materials	**4.08**	3.38	**4.18**	3.03	**17.31**	14.04
S&P 500 Index	**30.64**	26.92	**32.30**	28.25	**119.50**	107.31
S&P 400 Index (Mid-Cap)	**19.47**	15.60	**20.91**	16.11	**71.91**	60.00
S&P 600 Index (Small-Cap)	**9.03**	6.28	**9.44**	6.92	**32.46**	25.33

Source: Standard & Poor's (7/1/14)