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 $104.92 billion in assets as of 12/31/14. 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.

## The U.S. bull market is no "Nifty Fifty"

We have received some inquiries from investors wondering if the current bull market (3/9/09-12/31/14) is being driven by a small universe of stocks. Since it has happened in the past, we thought we would take this opportunity to discuss it, but the short answer is no. In support of our stance, we have provided three different charts featuring data points that clearly indicate there has been broad-based participation.

The first chart ("S&P 500 Breadth") addresses the issue head on by splitting out the influence that the top 10, 25 and 50 stocks had on the performance of the S&P 500 from 2009-2014. The S&P 500 is a capitalization-weighted index. We included both 1998 and 1999 to show what a narrow-driven, bubble climate looks like.

The second chart features cumulative total returns on the S&P 500, S&P 100 and S&P 500 Equal Weighted indices in the current bull market. The average market cap of the 500 constituents in the S&P 500 was $38.45 billion on 12/31/14, compared to $117.87 billion for the 100 constituents that comprise the S&P 100 Index, according to S&P Dow Jones Indices. As shown in the chart, the S&P 100 has lagged the broader S&P 500 to date. The strongest evidence is the disparity in the cumulative total returns between the S&P 500 and its equal weight version. Its 340.44% cumulative total return dwarfs the 244.23% return posted by the cap-weighted version – reflecting broad participation.

Our third chart supports the data in the first two charts. The number of "up" stocks in the S&P 500 in a given year has been particularly strong during this bull run. Here are the numbers: 373 (2014); 457 (2013); 390 (2012); 232 (2011); 390 (2010); and 425 (2009). With the exception of 2011, all of the remaining years were well above the 304 average from 1998-2014. Perhaps the most telling stats were the number of stocks up in 1998 and 1999: 289 and 241, respectively.

What about 2014? Equity investors enjoyed another prosperous year as the S&P 500, S&P Midcap 400 Index and the Russell 2000 Index posted total returns of 13.69%, 9.77% and 4.89%, respectively. The S&P 500 has outperformed the other two indices over the past 1- and 3-year periods. Prior to the past three years (2012-2014), the last time the S&P 500 outperformed both mid- and small-capitalization stocks for an extended period of time was in the latter half of the 1990s. Does this suggest that large-cap stocks have the edge moving forward? That is where things get a bit interesting, in our opinion. It could depend a great deal on the strength of the economy. The current U.S. economic recovery is 66 months old (6/30/09-12/31/14). From 6/30/09-9/30/14, GDP growth averaged 2.2%, according to the Bureau of Economic Analysis (BEA). The past two quarters (Q2'14 & Q3'14), however, produced annualized GDP growth rates of 4.6% and 5.0%, respectively, according to the BEA. If U.S. GDP growth can manage to exceed 3.0% in 2015, we believe it could be enough to reignite interest in mid- and small-cap stocks.

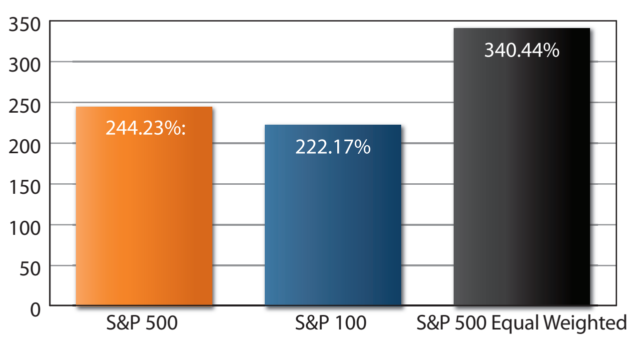
There is, however, another issue to ponder. Equity investors were a bit cautious in 2014. Three of the top four performing S&P 500 sectors (Utilities, Health Care and Consumer Staples) are characterized as defensive in nature. Investors also continued to funnel capital into bonds. The one event that some had predicted might happen in 2014, but did not, was the "great rotation" out of bond mutual funds into equities and other risk assets. While the Federal Reserve did end its monthly bond purchase program in October 2014, it did not raise rates. Perhaps 2015 will be the year.

**S&P 500 Breadth**

| *Period* | *Top 10 Avg. Change* | *Top 25 Avg. Change* | *Top 50 Avg. Change* | *S&P 500 Avg. Change* |
|---|---|---|---|---|
| **2014** | 11.37% | 10.66% | 12.23% | 11.39% |
| **2013** | 28.63% | 24.67% | 34.75% | 29.60% |
| **2012** | 8.90% | 17.34% | 18.95% | 13.41% |
| **2011** | 11.05% | 7.63% | 5.33% | 0.00% |
| **2010** | 11.21% | 10.39% | 15.34% | 12.78% |
| **2009** | 27.84% | 28.34% | 28.06% | 23.45% |
| **1999** | 58.69% | 53.61% | 105.12% | 19.53% |
| **1998** | 68.15% | 55.62% | 46.97% | 26.67% |

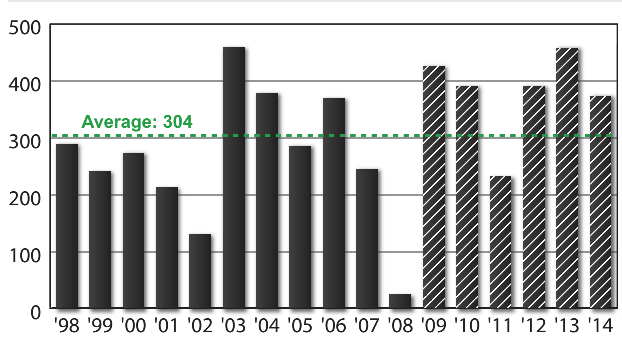
*Source: S&P Dow Jones Indices. Returns are price-only.*

**Cumulative Total Returns: 3/9/09-12/31/14**




*Source: Bloomberg*

**# of Stocks Up in S&P 500 on a Calendar Year Basis**




*Source: S&P Dow Jones Indices.*

## The income pinch in the bond market keeps getting tighter

As we mentioned on the previous page, the Federal Reserve did not raise the fed funds target rate in 2014. It has stood at 0-0.25% since December 2008. The yield on the benchmark 10-Year Treasury Note (T-Note) actually declined by 86 basis points in 2014, after having spiked 127 basis points to 3.03% in 2013. The reversal appears to be due to a combination of modest economic growth around the globe, geopolitical events with a negative bias, such as the Russia/Ukraine conflict that led to trade sanctions between the U.S./Europe and Russia, low interest rate levels on government bonds in most developed nations and the absence of any significant inflationary pressures.

We have been discussing the idea of rising interest rates in earnest since 2012. We have written numerous blog posts offering up investment ideas in preparation for when that day comes. We do live in strange times. Interest rates remain very low despite the fact that the global economy has been growing at better than a 3.0% clip since 2009, according to the International Monetary Fund (IMF). U.S. GDP forecasts from the World Bank and the IMF call for a 3.1% to 3.2% growth rate in 2015, which is stronger than the 2.2% growth rate posted so far in the current economic recovery. The last time U.S. GDP growth was 3.0% or higher was in 2005 (3.3%). Moody's expects sovereign credit ratings to stabilize in 2015 as global growth edges higher, according to Fox Business. Nearly 80% of Moody's sovereign ratings currently carry stable outlooks, up from 70% at the start of 2014. The climate for bond investors has been quite favorable since the days of the financial crisis ('08-'09), and it could extend into 2015.

**Barclays Bond Indices: Yield to Worst**

| | 12/31/14 | 12/31/11 | 12/31/09 | 12/31/07 |
|---|---|---|---|---|
| U.S. Treasury: Intermediate | 1.24% | 0.72% | 2.14% | 3.37% |
| GNMA 30 Year | 2.74% | 2.77% | 4.37% | 5.44% |
| Municipal Bond: Long Bond (22+) | 3.00% | 4.47% | 5.22% | 4.86% |
| U.S. Aggregate | 2.25% | 2.24% | 3.68% | 4.90% |
| Intermediate Corporate | 2.53% | 3.24% | 4.24% | 5.55% |
| U.S. Corporate High Yield | 6.61% | 8.36% | 9.06% | 9.64% |
| Global Aggregate | 1.62% | 2.33% | 3.07% | 4.19% |
| EM Hard Currency Aggregate | 5.27% | 6.13% | 6.40% | 6.52% |

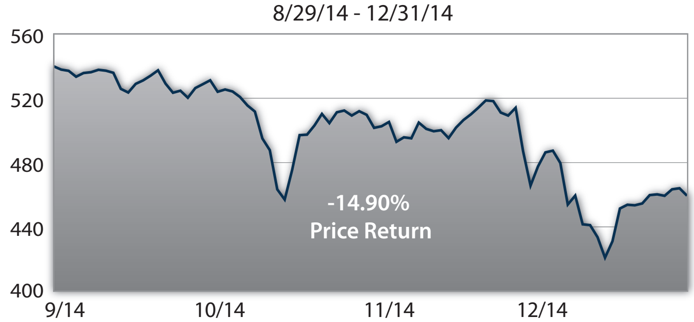
*Source: Barclays*

In September 1981, an investor could purchase a 10-Year T-Note yielding 15.80%. The bull run in the bond market, with the exception a few periods where interest rates rose, has lasted for some 33 years. The bond categories featured in the chart reflect the downward trend for yields since 2007. While there has been some discussion in the media about deflation fears, particularly in Europe, investors should know that, as of the close of 2014, inflation does exist, though it stood at just 0.80% in the U.S. in December. Based on the current climate, it looks like bond investors may get some additional grace period before interest rates head higher. We don't know for how long, but that day will come eventually.

## Sell-off in energy stocks creates potential opportunity in Master Limited Partnerships (MLPs)

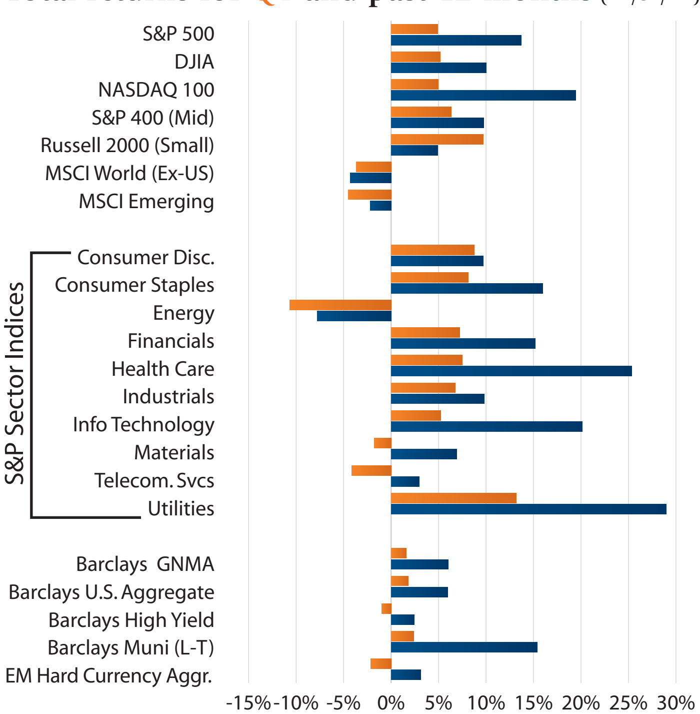
Whenever a strong theme in the stock market either runs its course or is stymied due to some unforeseen event(s) it inevitably draws the attention of some investors looking to exploit any potential opportunities that may arise. We believe that is happening now and the theme in question is energy. Crude oil, in particular, has been a theme in the market dating back to the Iraq War in 2003, in our opinion. The price of crude oil began 2003 at around $33 per barrel and reached as high as $145 in July 2008, before tumbling back to the $34 level in February 2009. The price of oil then managed to stage a second rally where it ascended to the $113 level in April 2011. The price of oil averaged approximately $96 per barrel from 2011 through mid-2014. It closed, however, at $53.27 on 12/31/14. From 8/29/14-12/31/14, the S&P 500 Energy Index declined by 18.04%, on a price-only basis, compared to a loss of 14.90% for the Alerian MLP Index. Since MLP revenues tend to be driven more by demand for energy than price, we believe that MLPs may offer the potential for greater value post sell-off.

**Alerian MLP Index**
8/29/14 - 12/31/14




*Source: Bloomberg*

## Total returns for Q4 and past 12 months (12/31/14)




## A Look Ahead:

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

| | **Q1'15E** | Q1'14A | **Q2'15E** | Q2'14A | **2015E** | 2014E |
|---|---|---|---|---|---|---|
| Financials | **6.00** | 5.50 | **6.16** | 5.84 | **24.93** | 22.50 |
| Information Technology | **10.48** | 8.23 | **10.51** | 8.52 | **45.06** | 45.22 |
| Health Care | **10.91** | 8.61 | **11.55** | 9.54 | **46.32** | 37.34 |
| Consumer Staples | **6.06** | 5.55 | **6.81** | 6.32 | **26.92** | 24.75 |
| Consumer Discretionary | **7.08** | 6.15 | **8.11** | 6.95 | **32.25** | 27.24 |
| Industrials | **6.57** | 5.86 | **7.69** | 7.12 | **30.29** | 27.48 |
| Telecom. Services | **3.01** | 2.82 | **2.88** | 2.92 | **11.53** | 10.91 |
| Energy | **9.66** | 11.70 | **10.14** | 11.94 | **41.17** | 45.17 |
| Utilities | **3.67** | 3.32 | **3.12** | 2.64 | **14.69** | 13.35 |
| Materials | **5.48** | 4.43 | **5.66** | 4.49 | **20.66** | 16.82 |
| S&P 500 Index | **30.58** | 27.32 | **32.27** | 29.34 | **131.01** | 116.77 |
| S&P 400 Index (Mid-Cap) | **18.00** | 13.66 | **20.38** | 16.76 | **82.15** | 63.30 |
| S&P 600 Index (Small-Cap) | **8.55** | 5.90 | **9.20** | 6.90 | **37.45** | 28.61 |

Source: Standard & Poor's (12/30/14)