First Trust — Quarterly Market Overview

Issue 63, October 2015

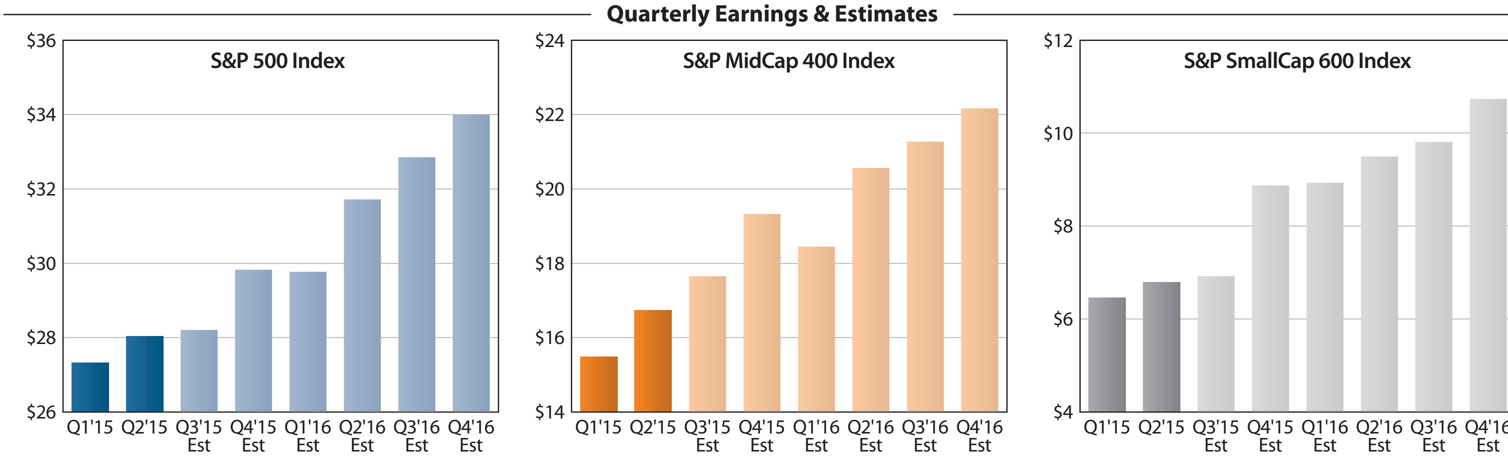
Robert F. Carey, CFA
Chief Market Strategist

Mr. Carey has nearly 30 years 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. Bob is the Chief Market Strategist at First Trust Advisors L.P., which manages or supervises approximately $106.71 billion in assets as of 9/30/15. 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.

U.S. corporate earnings comparisons look favorable through 2016

Quarterly Earnings & Estimates



Source: Bloomberg consensus estimates as of 10/13/15. There can be no assurance that any of the projections cited will occur.

As we have noted many times, we believe that corporate earnings determine the direction of stock prices over time. Of course, earnings are a moving target. Equity analysts refine their forecasts throughout the year. One of the economic challenges that U.S. companies have had to contend with over the past 15 months was the strengthening of the U.S. dollar relative to other major foreign currencies. Large-capitalization (cap), multinational companies that earn a substantial percentage of their revenues from foreign sales have communicated to shareholders in recent quarters that the strong U.S. dollar has put downward pressure on earnings.

In June 2015, S&P 500 companies reported that 47.8% of their sales came from outside the U.S. in 2014, according to S&P Dow Jones Indices. The sectors that reported foreign sales in excess of 50% of total sales were Information Technology (59.4% vs. 56.6% in '13), Energy (56.2% vs. 54.6% in '13), Materials (54.5% vs. 54.5% in '13) and Health Care (50.3% vs. 51.3% in '13). Small and medium-sized companies tend to generate much less of their revenue streams from foreign sales, so their well-being is more closely tied to the strength of the U.S. economy.

While the U.S. Dollar Index (DXY), which measures the relative value of the U.S. dollar against a basket of major currencies, posted a 20.77% gain for the 15-month period ended 9/30/15, it actually closed Q3'15 down 3.97% from its 15-month high set on 3/13. Over the past six months, the U.S. dollar has traded in a fairly tight range, in our opinion. The rally, at least of late, has stalled.

The charts above provide investors with a snapshot comparison of the projected 2015 and 2016 earnings for large-, mid- and small-cap stocks. As of 10/13/15, the takeaway from those charts is that equity investors have reason to be optimistic heading into 2016, in our opinion.

Rounding out the picture...

- For the 5-year period ended 9/30/15, the S&P 500 Growth Index posted a cumulative total return of 103.01%, compared to 83.17% for the S&P 500 Value Index, according to Bloomberg. Year-to-date through 9/30, the S&P 500 Growth Index was down 0.97%, compared to -10.01% for the S&P 500 Value Index. Even taking the recent correction in the S&P 500 Index into account, investors have favored growth over value for an extended period.
- The VIX Index uses S&P 500 options activity to gauge investors' expectations of volatility. For the 20-year period ended 9/30/15, the VIX Index registered an average reading of 20.93, according to Bloomberg. The index level stood at 24.50 on 9/30/15. It reached as high as 40.74 during the correction in the S&P 500 Index in late August. It averaged 16.57 over the first nine months of 2015. Investors should monitor to see if it trends back below its 20-year average.
- Foreign investors held $5.9 trillion of U.S. equities as of June 2015, just below the $6.0 trillion all-time high registered in Q1'15, according to CNNMoney. Joseph Quinlan, chief market strategist at U.S. Trust, believes the U.S. has clearly emerged as the most competitive and innovative economy in the world. While foreign investors currently hold approximately 20% of U.S. stocks, Quinlan sees that share increasing to 33% over the next five to 10 years.
- Year-to-date through August 11, global M&A deal volume totaled $3.0 trillion, according to Dealogic. The 223 days represent the second fastest climb to $3.0 trillion in a calendar year, behind the 204 days needed in 2007. It took 314 days in 2014. North America was the most active region, with deals totaling a record $1.6 trillion.

Continued

For those investors who fear the bull market is over

Some investors believe that the U.S. stock market acts efficiently over time, and others think it is rigged against the "little guy." While these two perspectives may represent opposite ends of a philosophical spectrum, like most things in life, the truth likely resides somewhere in between. As we previously noted, the U.S. finally experienced the stock market correction that many pundits were calling for. We acknowledge that it was overdue. We also believe that corrections are a healthy part of any bull market. Perhaps with the exception of relatively brief spurts, markets do not go up or down in a straight line. We do, however, disagree with the notion that the recent correction is a precursor to a bear market. In addition to our front page discussion of corporate earnings, we would like investors to also consider where two select interest rates stood at the end of Q3'15 relative to where they have stood at the end of past bull markets (see chart). Today's interest rate climate does not come close to resembling the levels registered at the end of past bull markets.

The following research data was published in a *Businessweek* article on March 22, 2012 and it offers investors guidance, with respect to investing in U.S. equities, that fits the times, in our opinion: Data from Standard & Poor's revealed that, since 1953, U.S. stocks actually posted their best returns when the yield on the 10-year Treasury (T-Note) rose to around 4.00%. The S&P 500 Index gained an average of 1.7% per month during periods when 10-year yields climbed to a range of 3.00% to 4.00%. Sam Stovall, S&P's chief equity strategist, defined this "sweet spot" as a period where growth in the economy reduces unemployment, increases corporate earnings, but does not trigger growth-slowing efforts by the Federal Reserve. Stock prices usually retrench when the yield on the 10-Year T-Note tops 6.00%.

Where Interest Rates Stood At The End Of Past Bull Markets

Day Bull Market Ended (S&P 500 Index)	Fed Funds Target Rate	10-Year T-Note
9/30/15 (Ongoing)	0.25%	2.04%
10/9/07	4.75%	4.65%
3/24/00	6.00%	6.19%
8/25/87	6.75%	8.72%
11/28/80	18.00%	12.72%
1/11/73	5.75%	6.43%

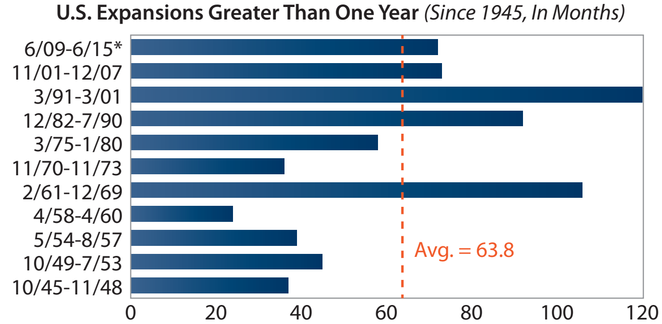
Source: Bespoke Investment Group, Bloomberg

To put this into further perspective, the 2.04% yield on the 10-Year T-Note (see chart above) as of 9/30/15 is not only roughly half the 4.00% target rate that Sam Stovall referred to as the "sweet spot" it is 454 basis points below the average yield (6.58%) on the 10-Year T-Note for the 50-year period ended 9/30/15, according to Bloomberg. The federal funds target rate is so low that even when the Fed decides to raise it we believe it is likely to remain relatively low for some time. Monetary policy won't be tight, just less loose, in our opinion.

U.S. economic expansions

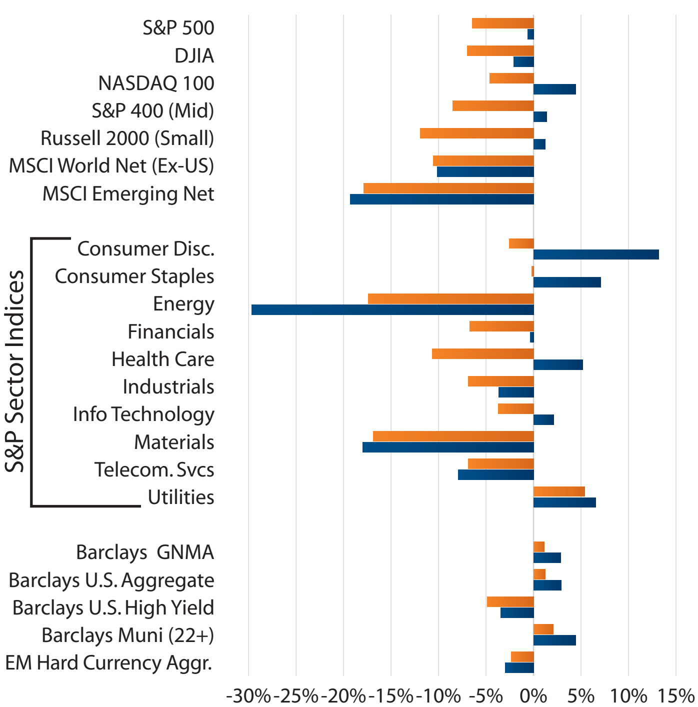
As indicated in the chart, while an average U.S. economic expansion lasts around five years, they can run considerably longer. The current expansion is at 72 months and counting as of 6/15. The expansion that ended in 3/01 lasted 120 months. The one common thread running through any U.S. expansion is consumer spending. It accounts for approximately two-thirds of U.S. economic activity. Job growth helps fuel spending. Nonfarm payrolls have expanded for 60 consecutive months through 9/15, according to Bloomberg. While 2015 has been a much more volatile year in the stock market than in recent years, the only S&P 500 Index sector to post a positive total return in the first nine months was Consumer Discretionary, up 4.08%, according to Bloomberg. We see that a positive sign moving forward, especially if gasoline prices remain at current levels. The savings at the pump can potentially lead to higher levels of discretionary spending. The J.P. Morgan Chase Institute reported that Americans have been spending about 80¢ of each dollar saved at the pump, according to MoneyTalksNews.

U.S. Expansions Greater Than One Year *(Since 1945, In Months)*



*Source: The National Bureau of Economic Research. *Current expansion is ongoing.*

Total returns for Q3 and past 12 months (9/30/15)



Past performance is no guarantee of future results.

A Look Ahead:

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

	Q4'15E	Q4'14A	**Q1'16E**	Q1'15A	**2015E**	2016E
Consumer Discretionary	**8.38**	7.70	**7.48**	6.41	**30.11**	34.84
Consumer Staples	**6.28**	5.85	**6.10**	5.71	**24.60**	26.65
Energy	**3.13**	6.74	**3.54**	-0.48	**6.25**	18.36
Financials	**5.64**	4.92	**6.01**	6.18	**22.95**	24.97
Health Care	**11.76**	8.65	**12.51**	10.15	**43.08**	52.26
Industrials	**7.72**	6.77	**6.60**	6.21	**28.23**	30.94
Information Technology	**12.24**	11.59	**10.69**	9.15	**39.70**	45.86
Materials	**3.52**	3.02	**4.79**	3.09	**13.71**	18.87
Telecom. Services	**2.72**	-1.28	**3.09**	2.90	**11.62**	12.07
Utilities	**2.66**	2.74	**3.83**	3.84	**13.76**	14.62
S&P 500 Index	**30.21**	26.75	**29.71**	25.81	**110.60**	128.48
S&P 400 Index (Mid-Cap)	**19.79**	15.36	**17.94**	14.34	**67.25**	82.74
S&P 600 Index (Small-Cap)	**9.08**	7.20	**8.71**	4.93	**27.47**	38.88

Source: Standard & Poor's (10/8/15)