First Trust

Quarterly Market Overview

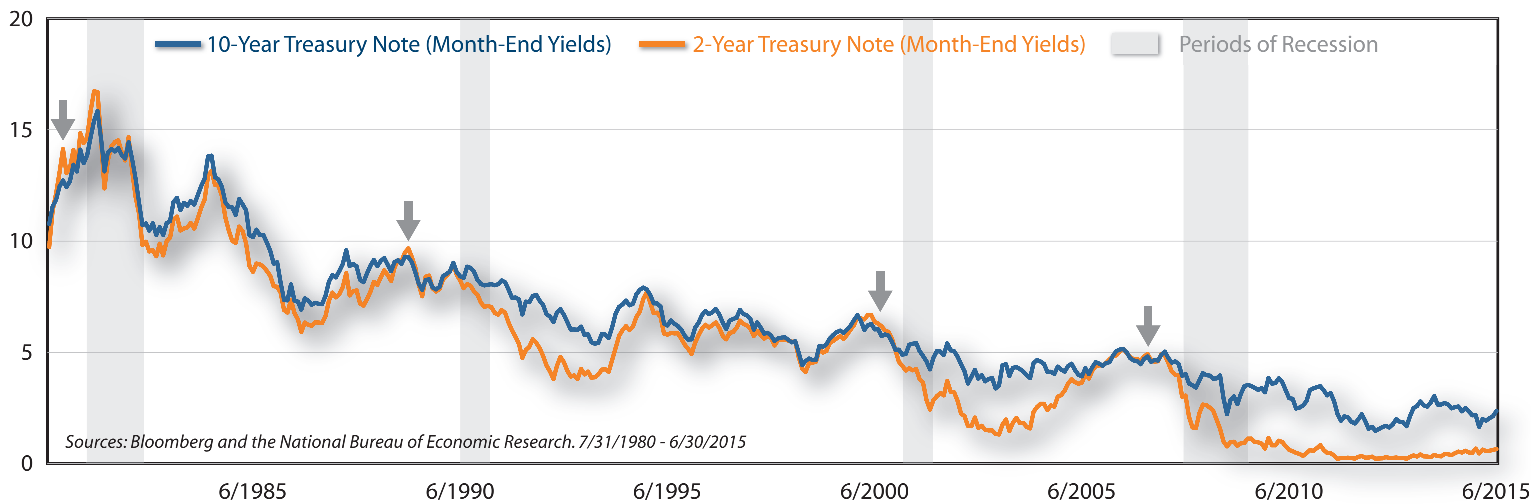
Issue 62, July 2015

Robert F. Carey, CFA
Chief Market Strategist

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. Bob is the Chief Market Strategist at First Trust Advisors L.P., which manages or supervises approximately $118.44 billion in assets as of 6/30/15. 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.

The Fed becoming less loose shouldn't kill the golden goose



The economic recovery in the U.S. turned six years old on June 30, 2015. From 6/30/09-3/31/15, the most recent data from the Bureau of Economic Analysis shows that real U.S. GDP growth has averaged 2.1% annually, according to Bloomberg. The U.S. stock market has been in bull mode since 3/9/09, or about one-quarter longer than the economic expansion. From 3/9/09-6/30/15, the S&P 500 Index posted a cumulative total return of 248.3%, according to Bloomberg.

Despite things getting better in the U.S., it still seems like enthusiasm is somewhat dampened and that more attention is given to the potential fallout from events like the Greek debt crisis and/or the sudden plunge in Chinese equities in June, in our opinion. In other words, the negative still trumps the positive. While the financial media spent little time on the huge run-up in the Shanghai Composite Index from 4/30/14 through 6/12/15, which produced a cumulative total return of 166.2% (USD), coverage seemed to ramp up quickly for the 16.9% (USD) sell-off from 6/12/15 through 6/30/15, in our opinion.

Some in the media even went so far as to speculate over whether the events in Greece and China were enough to throw the U.S. into recession. Such thinking is growing more commonplace these days due to globalization. Simply put, if you are worried about the U.S. sliding into recession and would like to follow a pretty dependable barometer, then monitor the spread between the yields on the 2- and 10-Year Treasury Notes (T-Note).

U.S. monetary policy tends to have a significant influence over U.S. economic cycles. When the Federal Reserve tightens monetary policy, other parts of the yield curve tend to react over time. As indicated in the chart, recessions have tended to occur when the yield on the 2-Year T-Note exceeds the yield on the 10-Year T-Note, which was far from the case at the close of June 2015.

Some positives to counter those negative thoughts...

- U.S. nonfarm payrolls have increased for 57 consecutive months through June 2015. (Bureau of Labor Statistics)
- The number of job openings in the U.S. totaled 5.4 million in May 2015, the highest in the history of the JOLTS (Job Openings and Labor Turnover Survey) Index. (Bureau of Labor Statistics)
- The S&P/Experian Consumer Credit Default Composite Index stood at 0.88% in May 2015, a record low for the index. (Bloomberg)
- U.S. auto sales hit a monthly annualized pace of 17.11 million units in June 2015. Sales bottomed during the recession at 9.04 million (annualized) in May 2009. (Bloomberg)
- CoreLogic reported that, as of May 2015, home prices had reached an all-time high in 10 states and the District of Columbia. Thirty-three states were within 10% of their price peaks. (CNBC)
- In Q1'15, S&P 500 companies distributed $93.55 billion in stock dividends, a record high for a single quarter. (S&P Dow Jones Indices)
- The S&P 500 Industrials (Old) companies (excludes Financials, Utilities and Transportation issues) held $1.23 trillion in cash and equivalents on 3/31/15. (S&P Dow Jones Indices) The all-time high was $1.33 trillion on 12/31/14.
- The Federal Reserve reported that the net worth of U.S. households and nonprofit organizations stood at a record $84.9 trillion in Q1'15. (*The Wall Street Journal*)

Continued

Liquid Alternative mutual funds and ETFs becoming more mainstream

PricewaterhouseCoopers (PwC) estimates that the alternative investment industry, which includes hedge funds, private equity and real assets, will grow at least fivefold over the next five years, according to Reuters. While PwC's conservative forecast sees the industry growing from $2.5 trillion (worldwide) today to $13.6 trillion by 2020, its aggressive growth target is $15.3 trillion.

PwC estimates that total assets in liquid alternative funds (see chart), which offer daily liquidity, will increase from $260 billion at the end of 2013 to $664 billion by 2020. While demand is expected to be fueled by sovereign funds, public pension funds and wealthy investors, these funds can also be accessed by retail investors. It wasn't that long ago that professionally managed alternative investment strategies were strictly for high-net-worth individuals. Liquid alternative funds were largely born out of the 2008-2009 financial crisis, according to *Barron's*. Investors were looking for ways to curb volatility by diversifying beyond stocks and bonds. Ideally, they are designed to be integrated into a diversified investment portfolio, rather than a timing strategy, in our opinion.

Perhaps an example can lend some perspective as to why we believe alternatives are worth consideration. Morningstar defines U.S. Long/Short Equity funds as having at least 75% exposure to U.S. equities, take primarily long and short positions in U.S. equities, can gain exposure directly and/or via derivative instruments, and tend to have betas, which measure the volatility of a security or portfolio compared to the broader market, of 0.3 and higher relative to U.S. market indices, such as the S&P 500 Index. So why might an investor want exposure to a fund that allocates some of its capital to shorting stocks in the S&P 500? From 1980-2014, 316 companies in the S&P 500 posted positive returns in a given calendar year, on average, while 180 posted losses and four were unchanged, according to S&P Dow Jones Indices. The 36% of S&P 500 stocks, on average, in negative territory each year provides the incentive for shorting stocks, in our opinion.

Net Flows To Liquid Alternative Mutual Funds & ETFs

	Y-T-D (5/31/15)	12-Month (5/31/15)
Multialternative	$6.37 B	$11.64 B
Managed Futures	$3.72 B	$4.97 B
Commodities Broad Basket	-$0.35 B	$1.10 B
Long/Short Equity	-$1.60 B	-$2.76 B
Market Neutral	-$3.21 B	-$4.55 B
Nontraditional Bond	-$3.23 B	-$0.23 B

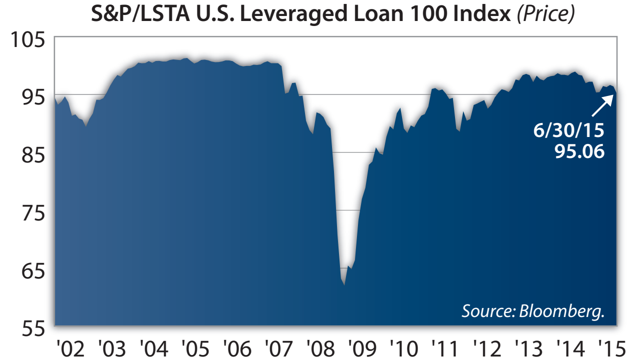
Source: Morningstar

A recent survey conducted by *Morningstar* and *Barron's* revealed that 59% of advisors and 58% of institutions say they allocate between 6% and 20% to alternative investments. Respondents said that diversification/low correlation is the primary goal. Low bond yields and fear of rising interest rates was also cited as a reason for seeking alternative investment opportunities. In terms of future allocations, both advisors and institutions said they are looking to grow their long-short equity allocations.

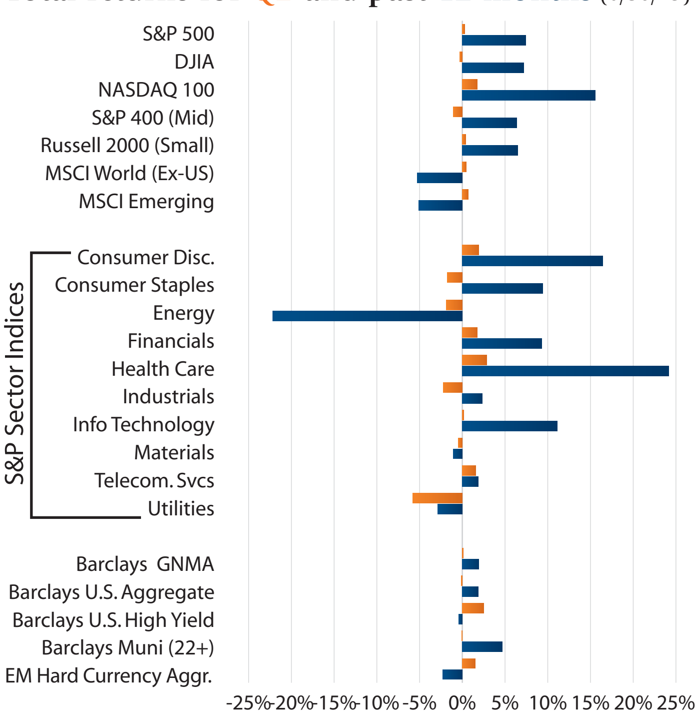
The Federal Reserve appears to be closing in on its first rate hike...

On Friday, July 10, 2015, Federal Reserve chairwoman Janet Yellen stated in a speech that she believes it would be "appropriate" to raise the federal funds target rate at some point later this year, according to *The New York Times*. We have been preparing investors for such a move since 2012. The Fed has kept the federal funds rate at 0-0.25% since December 16, 2008. The Fed lowered interest rates aggressively back then in an effort to combat the shocks to the economy and markets during the 2008-2009 financial crisis. Recent history suggests that investors are willing to shift capital into floating-rate leveraged loans, also known as bank or senior loans, if they sense that interest rates are heading higher. In 2013, when the yield on the 10-Year Treasury Note rose by 127 basis points to close the year at 3.03%, Bank Loan funds and ETFs reported net inflows totaling $61.3 billion, according to Morningstar. Because the Fed has maintained its easy monetary policy for so long, a lot of capital has flowed out of these funds. For the 12-month period ended 5/31/15, net outflows totaled $31.6 billion. As indicated in the chart, leveraged loan prices stood nearly 5% below par value on 6/30/15.

S&P/LSTA U.S. Leveraged Loan 100 Index *(Price)*



Total returns for Q2 and past 12 months (6/30/15)



Past performance is no guarantee of future results.

A Look Ahead:

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

	Q3'15E	Q3'14A	**Q4'15E**	Q4'14A	**2015E**	2014A
Financials	**5.65**	5.70	**5.82**	4.92	**23.22**	21.96
Information Technology	**10.00**	8.66	**12.78**	11.59	**41.44**	36.99
Health Care	**11.61**	8.98	**11.90**	8.65	**45.19**	35.79
Consumer Staples	**6.39**	6.44	**6.51**	5.85	**24.74**	24.16
Consumer Discretionary	**7.93**	6.90	**8.55**	7.70	**30.15**	27.70
Industrials	**7.61**	7.07	**7.62**	6.77	**28.73**	26.83
Telecom. Services	**2.98**	2.75	**2.64**	-1.28	**11.44**	7.21
Energy	**4.85**	12.56	**5.08**	6.74	**13.94**	42.93
Utilities	**4.30**	4.52	**2.78**	2.74	**13.72**	13.22
Materials	**3.96**	3.91	**4.07**	3.02	**15.80**	15.86
S&P 500 Index	**29.75**	29.60	**31.49**	26.75	**115.46**	113.01
S&P 400 Index (Mid-Cap)	**19.10**	13.09	**20.55**	15.36	**71.31**	58.87
S&P 600 Index (Small-Cap)	**8.42**	6.78	**9.25**	7.20	**30.13**	26.79

Source: Standard & Poor's (6/29/15)