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.

The outlook for global economic growth is looking a bit more upbeat and that could provide a boost to stocks

Global Economic Growth (Real GDP)

	World	U.S.	Advanced	Emerging
2009	-0.1%	-2.8%	-3.4%	2.8%
2010	5.4%	2.5%	3.1%	7.4%
2011	4.3%	1.6%	1.7%	6.4%
2012	3.5%	2.2%	1.2%	5.4%
2013	3.5%	1.7%	1.3%	5.1%
2014	3.6%	2.6%	2.1%	4.7%
2015	3.4%	2.9%	2.2%	4.3%
2016	3.2%	1.5%	1.7%	4.3%
2017 Est.	3.6%	2.2%	2.2%	4.6%
2018 Est.	3.7%	2.3%	2.0%	4.9%

Source: International Monetary Fund (October 2017)

Global Equity Indices (Total Returns in USD)

	MSCI Daily Net World	S&P 500	MSCI Daily Net World (ex U.S.)	MSCI Daily Net Emerging Markets
2009	29.99%	26.46%	33.67%	78.51%
2010	11.76%	15.06%	8.95%	18.88%
2011	-5.54%	2.11%	-12.21%	-18.42%
2012	15.83%	16.00%	16.41%	18.22%
2013	26.68%	32.39%	21.02%	-2.60%
2014	4.94%	13.69%	-4.32%	-2.19%
2015	-0.87%	1.38%	-3.04%	-14.92%
2016	7.51%	11.96%	2.75%	11.19%
2017 (9/29)	16.01%	14.24%	19.17%	27.78%

Source: Bloomberg. Past performance is no guarantee of future results.

While it might seem strange to sound upbeat about the potential for world economic growth turning higher this late into a recovery, we do find the prospects for higher growth encouraging. The International Monetary Fund (IMF) sees world real GDP rising by an estimated 0.5 percentage points from the 3.2% posted in 2016 to the 3.7% it is projecting for 2018. That is the latest forecast from the IMF. Weaker global economic growth has been a concern for investors ever since we registered a nice 5.4% bounce in 2010. That came on the heels of the 2008-2009 financial crisis. For comparative purposes, world real GDP growth averaged 4.2% from 1999-2008, according to the IMF. It hasn't been that high on a calendar year basis since 2011.

The 2008-2009 financial crisis was global in scope, and the recovery process has been slow relative to past recoveries, in our opinion. Central banks have played a big role in the process since 2008 in an attempt to stimulate growth. Data from JP Morgan Asset Management indicates that the top 50 central banks around the globe initiated a total of 690 interest rate cuts from the collapse of Lehman Brothers in September 2008 to December 2016, according to CNBC. The Federal Reserve began its rate cutting in September 2007. Keep in mind that the U.S. was the epicenter of the financial crisis.

One of the things that stands out in the table above is the fact that growth in emerging/developing economies has consistently outpaced growth in the U.S. and other advanced economies. This was also the case from 1999- 2008, when real GDP growth averaged 6.2% in emerging/developing economies, compared to 2.6% in the U.S. and 2.5% in advanced economies, according to the IMF. It is important to acknowledge though that the pace of growth has declined as well in recent years in the emerging/developing economies.

The most obvious reason for the trend toward slower growth in the emerging/developing economies was the orchestrated cool down in China. From 1999-2008, real GDP growth in China averaged 10.1%. That torrid pace enabled China to supplant Japan as the world's second-largest economy in 2010, according to *The New York Times*. In 2012, China's government announced that it intended to slow economic growth in an effort to rebalance its economy, according to *The Atlantic*. Its new GDP target was set at 7.5%.

China has been successful in tempering its economic growth rate. In March 2016, China announced it was lowering its growth target again to 6.5-7.0%, according to *The Wall Street Journal.* Real GDP was 6.7% in 2016, and is projected to be 6.8% in 2017 and 6.5% in 2018, according to the IMF. As part of the rebalancing process, China is transitioning from a manufacturing-based economy to a services economy, with an emphasis on increasing domestic consumption, according to the *Financial Times*.

The rebound in the energy sector, particularly crude oil, could be a plus for many emerging/developing economies, in our opinion. Of the top 20 countries with the largest proven crude oil reserves (reasonable certainty of being recovered), only two would be considered developed economies: Canada and the U.S., according to *CEOWORLD*. The price of crude oil plunged from $107.26 per barrel on 6/20/14 to $26.21 per barrel on 2/11/16, or a decline of 75.56%, according to Bloomberg. From 2/11/16-9/29/17, the price of crude oil nearly doubled to $51.67 per barrel, which must have been a welcome sight for those nations heavily dependant on revenue from the sale of crude oil.

For more than 2½ years, Europe has been employing a similar approach to quantitative easing (bond buying) that the U.S. used in an effort to stimulate growth and instill confidence in its markets by driving interest rates lower, and in some instances, into negative territory. The economy in Europe has strengthened in 2017 and the European Central Bank is considering reducing its monthly bond purchases (60 billion euros) by at least half starting in January, according to Bloomberg. While encouraging, Europe is very much a work in progress that should be monitored moving forward, in our opinion.

The chart above displaying the returns of some major global equity indices helps make the case for being diversified, in our opinion. Retail investors in the U.S. have been doing just that in recent years. From the start of 2009 through August 2017, investors funneled a net $450.4 billion into World Equity mutual funds, according to data from the Investment Company Institute. They did so despite the fact that each of the foreign stock indices featured posted two or more years of negative total returns, while the S&P 500 Index had none.

For those investors with significant exposure to high-grade bonds...

BofA ML 7-10 Yr. U.S. Treasury Index

Year	Index Yield (Prior Year-End)	Index Total Return
1997	6.42%	10.48%
1998	5.85%	12.39%
1999	4.87%	-5.17%
2000	6.67%	14.61%
2001	5.57%	6.87%
2002	5.49%	14.32%
2003	4.19%	1.90%
2004	4.53%	4.34%
2005	4.57%	2.39%
2006	4.75%	2.72%
2007	4.90%	10.28%
2008	3.96%	17.91%
2009	2.22%	-5.87%
2010	3.68%	9.30%
2011	3.02%	15.15%
2012	1.59%	4.11%
2013	1.41%	-5.82%
2014	2.71%	8.55%
2015	2.07%	1.61%
2016	2.20%	0.97%
YTD (9/17)	**2.36%**	**2.79%**

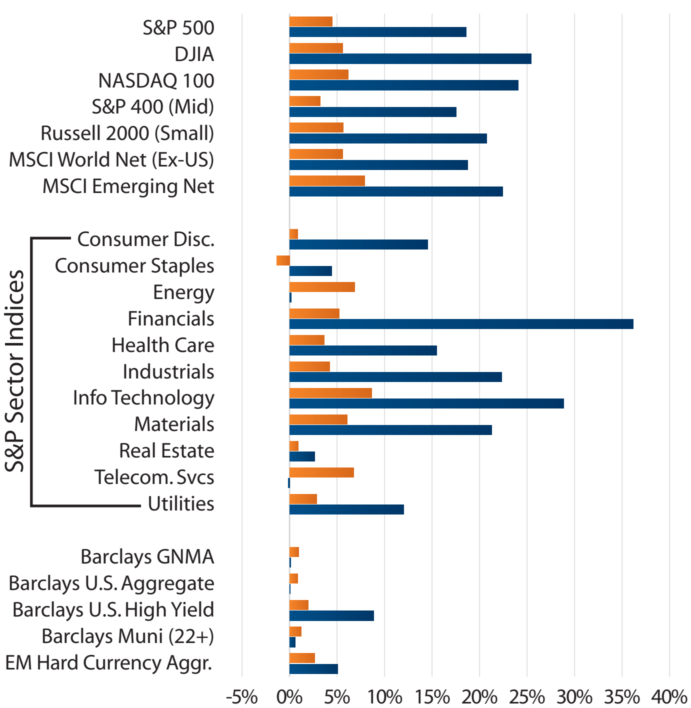
Source: Bloomberg. Past performance is no guarantee of future results.

For the record, we have been writing about the potential for rising interest rates since Q4'11. We wrote a blog post on 10/28/11 alerting Treasury investors of the possibility of rising interest rates moving forward. It wasn't the only post we have done on the subject of rising rates and the historical impact such an event can have on the valuations of high-grade bonds, in particular. In that post on 10/28/11, we noted that interest rates were at historically low levels. We also mentioned that, while Treasuries have provided investors throughout time with the optimum protection against credit risk, they have always been vulnerable to interest rate risk. The benchmark 10-year Treasury note (T-note) closed trading on 10/28/11 at a yield of 2.32%, according to Bloomberg. Nearly six years later, little has changed on that front. The 10-year T-note closed trading on 9/29/17 at a yield of 2.33%, up just one basis point. Wow! What we now know that we couldn't have imagined back then was just how steadfast the Federal Reserve (the "Fed") was going to be about maintaining a low interest rate climate in response to the 2008-2009 financial crisis.

The Fed held the federal funds target rate (upper bound) at 0.25% for seven years (12/08-12/15). To fortify its commitment to stimulating the U.S. economy, the Fed in essence doubled down by initiating three quantitative easing programs that spanned November 2008 to October 2014. These programs involved buying hundreds of billions of dollars of Treasuries and mortgage-backed securities in the open market. While the implied goal was to help keep interest rates low, the downside of these programs was that the Fed expanded the assets on its balance sheet from around $1.0 trillion to approximately $4.5 trillion today, according to Bloomberg. So what has changed? The Fed has increased the federal funds target rate (upper bound) four times since 12/16/15 from 0.25% to 1.25%. As of 9/29/17, the federal funds futures market put the probability of another quarter-point rate hike at its December 13th meeting at 69.5%, according to Bloomberg. If executed, it would take the target rate to 1.50%. The Fed has stated it is contemplating three increases in 2018 and two in 2019, according to CNBC. In October 2017, the Fed will begin trimming some of its bond holdings. It will start slow and increase quarterly to $50 billion by October 2018, according to CNBC. The combination of rate hikes and the unwinding of the Fed's balance sheet could help push interest rates higher over time. A little more economic growth along with additional inflationary pressure would likely accelerate the process, in our opinion. Here are four things to consider should interest rates rise moving forward:

- From 1997-2016, total assets invested in high-grade (government, corporate and municipal) bond mutual funds rose from $520.13 billion to $2.54 trillion, according to data from the Investment Company Institute.
- The table on the left can be used as a proxy for the historical relationship between rate fluctuations and high-grade bond returns.
- Since 1997, the index in the table has posted only three negative total returns (1999, 2009 & 2013). In 1999, the index's yield rose from 4.87% to 6.67%. In 2009, it rose from 2.22% to 3.68%. In 2013, it rose from 1.41% to 2.71%.
- While the chart shows that yields have declined overall since 1997, the bull market in bonds has been in progress since 9/30/81, when the yield on the 10-year T-note peaked at 15.84% at the close of trading, according to Bloomberg.

Total returns for Q3 and past 12 months (9/29/17)



Sources: Bloomberg and Barclays. Past performance is no guarantee of future results.

A Look Ahead:

A year-over-year earnings comparison in U.S. dollar terms. The S&P 500 Index dollar figures reflect the 11 major sectors on a weighted-adjusted basis.

Index (Weighting In S&P 500)	**Q4'17E**	Q4'16A	**Q1'18E**	Q1'17A	**2017E**	2016A
Consumer Disc. (11.9%)	**9.39**	8.50	**8.47**	8.05	**34.55**	33.30
Consumer Staples (8.2%)	**7.33**	6.53	**6.64**	5.99	**27.17**	25.33
Energy (6.1%)	**3.78**	0.41	**4.42**	3.88	**13.99**	-3.49
Financials (14.6%)	**7.18**	5.86	**7.39**	6.83	**27.99**	23.78
Health Care (14.5%)	**13.34**	10.32	**14.11**	10.52	**49.07**	42.45
Industrials (10.2%)	**8.17**	6.55	**7.32**	6.37	**30.98**	27.07
Information Tech. (23.2%)	**15.55**	12.45	**13.13**	10.30	**48.91**	37.99
Materials (3.0%)	**4.46**	2.71	**5.24**	4.62	**18.28**	13.01
Real Estate (3.0%)	**1.36**	1.83	**1.22**	1.37	**5.26**	7.38
Telecom. Services (2.2%)	**2.81**	2.54	**3.13**	2.70	**11.44**	9.86
Utilities (3.1%)	**2.91**	2.40	**3.88**	3.75	**14.50**	13.67
S&P 500 Index	**34.81**	27.90	**33.56**	28.82	**127.05**	106.26
S&P 400 Index (Mid-Cap)	**23.35**	16.25	**21.97**	17.81	**83.03**	64.53
S&P 600 Index (Small-Cap)	**10.97**	6.47	**10.05**	7.19	**35.44**	25.60

Source: Standard & Poor's (9/28/17). Sector weightings as of 9/29/17.