First Trust

# Quarterly Market Overview

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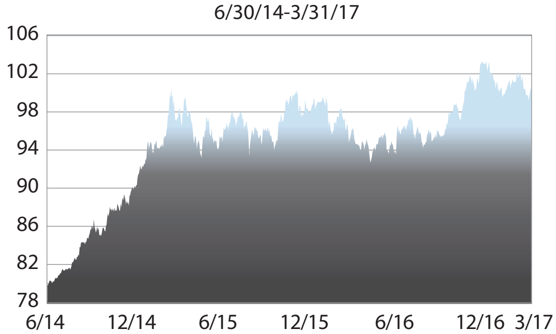
Mr. Carey has 30 years of experience as an Equity and Fixed-Income Analyst and is a recipient of the Chartered Financial Analyst (CFA) designation. He is a graduate of the University of Illinois at Champaign-Urbana with a B.S. in Physics. He is also a member of the CFA Society of Chicago and the CFA Institute. Bob is the Chief Market Strategist at First Trust Advisors L.P., and 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.

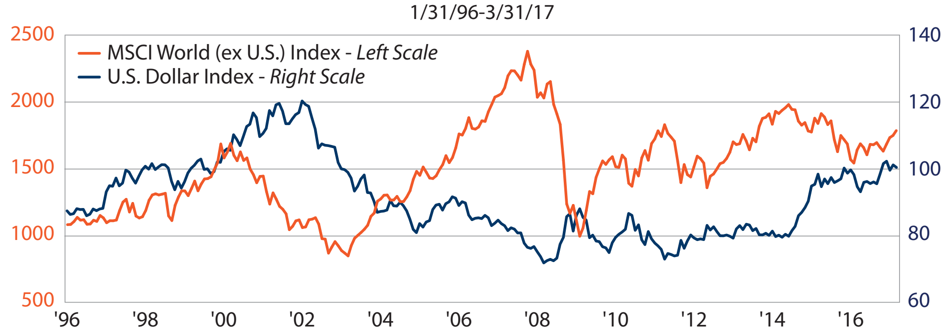
## Don't forget to account for the U.S. dollar when investing in foreign stocks

**U.S. Dollar Index (DXY)**
6/30/14-3/31/17




*Source: Bloomberg.*

**MSCI World (ex U.S.) Index vs. U.S. Dollar**
1/31/96-3/31/17




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

The U.S. Dollar Index reflects the general international value of the dollar. The index tracks the following six currencies: the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc. The chart directly above shows that the U.S. dollar has strengthened since June 2014. From 6/30/14-3/31/17, the index level rose from 79.78 to 100.35, or an increase of 25.78%. The bulk of the upward move, however, occurred within the first nine months. From 6/30/14-3/13/15, the index level rose from 79.78 to 100.33, or an increase of 25.76%. That is essentially the same gain that was posted through 3/31/17. So while it is common to hear the financial media comment on the strengthening of the U.S. dollar, it has actually been in a trading range of 92.63 to 103.30 (shaded blue in chart) from 3/13/15-3/31/17. Since January 1996, the high for the U.S. Dollar Index was 120.90 (7/5/01), while the low was 71.33 (4/22/08).

A strong dollar can make U.S. goods and services less competitive, with respect to price, in the global marketplace. It can also negatively impact the returns that U.S. investors receive from owning foreign securities, and vice versa. Analysts initially expected a Trump victory on 11/8/16 would weaken the U.S. dollar due to his protectionist trade policy proposals, according to *The Wall Street Journal*. That quickly changed to the theory that President Trump's plans for large fiscal spending could potentially boost inflation to the extent that the Federal Reserve might need to raise interest rates, which could strengthen the U.S. dollar. As you might imagine, predicting the direction of currencies is not easy, even for professionals.

From 12/31/95 through 2/28/17 (most recent data), total assets invested in Domestic equity mutual funds rose from $1.05 trillion to $6.76 trillion, or an increase of 543.81%, according to data from the Investment Company Institute (ICI). Over that same period, ICI data shows that total assets invested in World equity mutual funds rose from $196.51 billion to $2.30 trillion, or an increase of 1,070.42%. That is nearly double the rate of increase posted by Domestic equity funds.

Over the past couple of decades, retail investors in the U.S. have come to embrace the merits of allocating a percentage of their assets earmarked for equities to foreign stocks, in our opinion. As far back as the late 1980s, conventional thought was that a 10% to 15% weighting in international equities might be suitable for some U.S. investors. The basic premise was that since economic cycles around the globe were often staggered, meaning that when the U.S. was in the midst of recession while other countries might be in the midst of economic expansions, it could potentially be advantageous to invest in non-dollar denominated equities. Over the past decade or so, due in part to faster rates of economic growth overseas, conventional thought upped that 10-15% to 25% or more. As of 2/28/17, total World equity fund assets ($2.30 trillion) represented 25.39% of all Equity fund assets (9.06 trillion), according to the ICI. One can really see the commitment in the net inflows to World equity funds since the end of 2009 (post financial crisis), in our opinion. From 2009 through February 2017 (most recent data), net inflows to World equity funds totaled $401.3 billion, compared to net outflows totaling $863.4 from Domestic equity funds. Ironically, U.S. stocks performed far better than their foreign counterparts during the period. From 12/29/09-2/28/17 (same period as ICI data), the S&P 500 Index posted a cumulative total return of 146.69%, compared to just 33.80% for the MSCI Daily Total Return Net World (ex U.S.) USD Index, according to Bloomberg. Over that same period, the U.S. Dollar Index (DXY) rose by 29.87%, according to Bloomberg. That represented a significant upward move in the U.S. dollar and created a major headwind for the foreign stock holdings of U.S. investors, in our opinion.

Since most U.S. investors likely have the bulk of their investment capital invested here at home, we believe it may be prudent for some to allocate a portion of that capital outside of the U.S., which means assuming some currency risk. While some may choose investment vehicles that seek to hedge or mitigate currency fluctuations, a case can be made for the investor with a longer-term horizon to simply ride such fluctuations out. A lot of challenging financial and geopolitical events have occurred around the globe over the past couple of years, but as we pointed out, the U.S. Dollar Index stood at essentially the same level on 3/31/17 as it did on 3/13/15. We believe this is encouraging news for those U.S. investors owning foreign stocks.

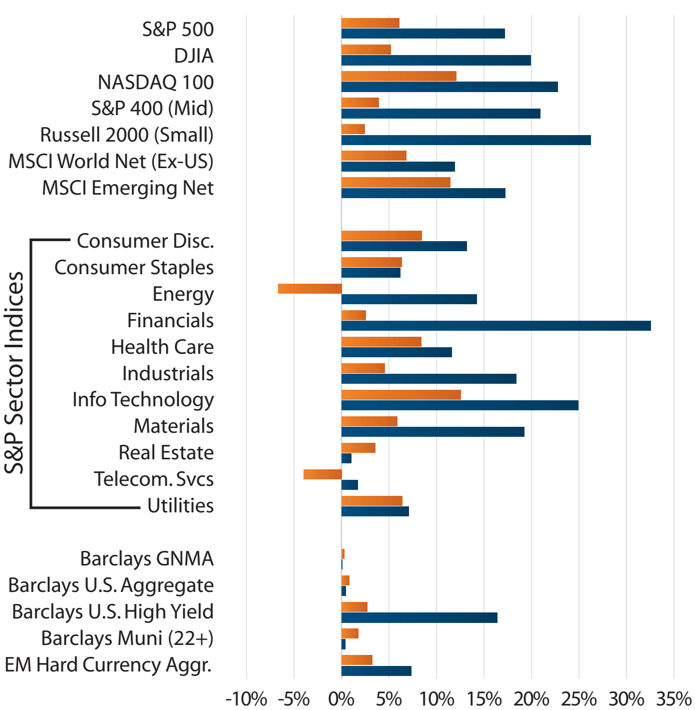


Continued

## 24 one-liners on the S&P 500 Index to help hone your perspective on U.S. equities

- The current bull market in U.S. stocks (S&P 500 Index) is the second-longest ever at 2,944 days (3/9/09-3/31/17). (Bespoke Investment Group)
- The longest bull market in the S&P 500 Index lasted 4,494 days (12/4/87-3/24/00) – 1,550 days (4.25 yrs.) longer than the current bull market. (Bespoke Investment Group)
- The cumulative total return on the S&P 500 Index in the current bull market was 314.14% as of 3/31/17. (Bloomberg)
- For comparative purposes, the cumulative total return on the S&P 500 Index was 251.94% on day 2, 994 of the longest bull market ever. (Bloomberg)
- The cumulative total return on the S&P 500 Index was 838.47% throughout the longest bull market, which included the "Internet Revolution." (Bloomberg)
- The S&P 500 Index's trailing 12-month price-to earnings (P/E) ratio stood at 30.57 on 3/23/00, one day prior to the end of the longest bull market. (Bloomberg)
- The S&P 500 Index's trailing 12-month P/E ratio stood at 21.72 on 3/31/17, while higher than its long-term average, still well below its level on 3/23/00. (Bloomberg)
- For the 25-year and 50-year periods ended 3/31/17, the average P/Es on the S&P 500 Index were 19.76 and 16.61, respectively. (Bloomberg)
- From 11/8/16-3/31/17 ("Trump Rally"), the S&P 500 posted a total return of 11.35%, above its annual average of 10.04% (1926-2016). (Bloomberg, Ibbotson Assoc./Morningstar)
- In Q4'16, preliminary data put S&P 500 Industrials (Old) cash holdings (ex cash from Financials, Utilities & Transportation companies) at $1.48 trillion. (S&P Dow Jones Indices)
- The all-time high for S&P 500 Industrials (Old) cash holdings was $1.49 trillion in Q3'16. (S&P Dow Jones Indices)
- S&P 500 Industrials (Old) cash holdings stood at $654.61 billion in Q4'08, just before the current bull market commenced on 3/9/09. (S&P Dow Jones Indices)
- S&P 500 Index companies paid out $103.82 billion in cash dividends in Q4'16 – 1st $100 billion quarter in the history of the S&P 500 Index. (S&P Dow Jones Indices)
- The number of S&P 500 Index companies paying a dividend at the end of 2016 totaled 418, up from 372 at the end of 2008. (S&P Dow Jones Indices)
- In U.S. dollar terms, the annual earnings posted by the S&P 500 Index doubled from $54.21 in 2008 to $108.60 in 2016. (Bloomberg)
- While it can fluctuate daily, Bloomberg's consensus annual earnings estimates for 2017 & 2018 stood at $128.97 and $144.78, respectively, on 3/31/17. (Bloomberg)
- The VIX Index (The CBOE Volatility Index®) stood at 12.37 on 3/31/17, below its current bull market average of 18.81 and its 20-year average of 20.85. (Bloomberg)
- The Federal Reserve ("Fed") has increased the federal funds target rate (upper bound) three times (total of 75 basis points), to 1.00%, since 12/16/15. (Bloomberg)
- Over that period (12/16/15-3/31/17), despite the rise in short-term interest rates, the S&P 500 Index posted a cumulative total return of 17.16%. (Bloomberg)
- For comparative purposes, the last time the Fed raised the federal funds target rate (upper bound) it hiked it 17 times (425 basis points) from 6/04-6/06. (Bloomberg)
- Over that period (6/30/04-6/30/06), despite the huge move in short-term interest rates, the S&P 500 Index posted a cumulative total return of 15.50%. (Bloomberg)
- In Q1'17, the number of stocks in the S&P 500 Index that were in positive territory totaled 350, or 69% of the 505 stocks in the index. (S&P Dow Jones Indices)
- From 2009-2016, the average number of stocks that finished the year in positive territory was 354, in line with the 350 up in Q1'17. (S&P Dow Jones Indices)
- Since 1945, on average, the S&P 500 Index has experienced a pullback (5.0%-9.9% decline) once a year and a correction (10%-19.9% decline) every 2.8 years. (S&P Global)

### Total returns for *Q1* and past 12 months (3/31/17)




*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) | **Q2'17E** | Q2'16A | **Q3'17E** | Q3'16A | **2017E** | 2016A |
|---|---|---|---|---|---|---|
| Consumer Disc. (12.3%) | **8.78** | 8.56 | **9.08** | 8.54 | **34.89** | 33.30 |
| Consumer Staples (9.3%) | **6.72** | 6.30 | **7.21** | 6.79 | **27.07** | 25.33 |
| Energy (6.6%) | **4.06** | -2.06 | **4.78** | 0.87 | **16.61** | -3.49 |
| Financials (14.4%) | **6.86** | 5.46 | **7.11** | 7.00 | **27.67** | 23.78 |
| Health Care (13.9%) | **13.35** | 10.94 | **13.66** | 10.69 | **53.28** | 42.45 |
| Industrials (10.1%) | **7.71** | 7.14 | **8.34** | 7.50 | **30.15** | 27.07 |
| Information Tech. (22.1%) | **11.35** | 8.27 | **12.24** | 9.23 | **50.03** | 37.99 |
| Materials (2.8%) | **5.05** | 4.91 | **4.16** | 3.73 | **17.89** | 13.01 |
| Real Estate (2.9%) | **1.24** | 1.51 | **1.24** | 1.48 | **5.00** | 7.38 |
| Telecom. Services (2.4%) | **3.19** | 1.92 | **3.18** | 2.60 | **12.28** | 9.86 |
| Utilities (3.2%) | **3.06** | 2.68 | **4.62** | 4.93 | **14.11** | 13.67 |
| S&P 500 Index | **31.77** | 25.70 | **33.69** | 28.69 | **129.62** | 106.26 |
| S&P 400 Index (Mid-Cap) | **21.12** | 16.38 | **22.41** | 18.63 | **84.79** | 64.53 |
| S&P 600 Index (Small-Cap) | **9.71** | 6.64 | **10.53** | 7.14 | **39.12** | 25.60 |

*Source: Standard & Poor's (4/6/17). Sector weightings as of 3/31/17).*