First Trust

Quarterly Market Overview

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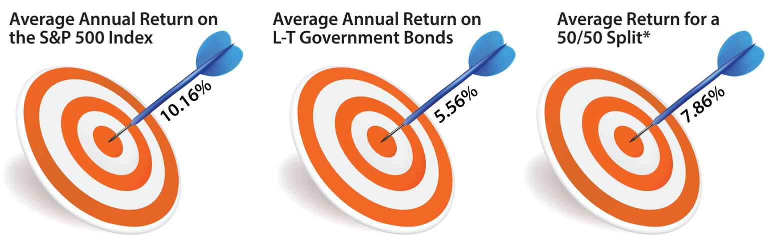
We invite you to visit Bob's Market Commentary Blog at www.ftportfolios.com for more insight.

Everyone should consider having an asset allocation plan when investing their capital...even when times are good



Source: Ibbotson Associates/Morningstar (1926-2017)
*The 50/50 Split repesents 50% in both the S&P 500 Index and Long-Term (L-T) Government Bonds

Reasons to have an asset allocation strategy

Asset allocation is primarily a tool for investors with long time horizons. It brings structure and discipline to the investment process. If adhered to, it can help keep emotion from clouding one's judgement. Two common themes that have cost investors dearly throughout the decades are impulsively chasing returns in the market and buying into the market out of a fear of missing out. An asset allocation plan can help temper such desires. It can reduce the overall risk in an investment portfolio by diversifying over a number of asset classes, especially if those asset classes are not highly correlated.

Set Realistic Performance Expectations

Going back decades, the assumed annual rate of return used in retirement planning has been around 8%. The Texas Employee's Retirement System, Austin, announced in 2017 that it was lowering its assumed rate of return from 8%, where it stood for the 20-year period ended 8/31/16, to 7.5%, according to *Pensions & Investments*. It also stated it was adopting a new asset allocation plan that would allow greater exposure to alternative investments. We'll touch on this point later. The U.S. government uses the 8% target as well. With respect to Social Security benefits, it will add an 8% bonus to your annual payments for each year you delay beyond your full retirement age up to the age of 70, according to *Kiplinger's Personal Finance*.

Perhaps the most compelling evidence for an 8% assumed annual rate of return is depicted in the above chart. From 1926-2017 (92 years), a 50% weighting in large-capitalization (cap) stocks, as measured by the S&P 500 Index, and a 50% weighting in long-term government bonds generated an average annual total return of 7.86%. On the risk spectrum, large-cap stocks and U.S. government bonds are positioned near the lower-end of their respective asset classes. Over that 92-year period, both the S&P 500 Index and long-term government bonds posted 24 negative calendar-year returns. The two were down the same year only five times. Setting a goal of generating a 7.5-8.0% average annual total return for one's investment portfolio over time is a reasonable assumption from which to forge an allocation plan featuring a simple blend of high quality stocks and bonds, in our opinion. Like most things in life, however, financial planning is not a one size fits all proposition.

One-stop shop approach

In the old days, perhaps the most popular choice for this approach to asset allocation was the Balanced fund, designed to allocate approximately 60% of its assets to equities and 40% to bonds. While these types of mutual funds are still around today, investors now have a plethora of vehicles that offer different levels of exposure to various asset classes, both domestic and foreign. Morningstar currently has several "Allocation" categories (portfolios available for sale in the U.S.) that it tracks based on the amount of equity exposure the funds assume, ranging from as little as 15-30% to as much as 85%-plus. Morningstar also has categories labeled "World Allocation" and "Tactical Allocation", the latter of which is designed to "have material shifts across equity regions, and bond sectors on a frequent basis." Last but not least is the Target-Date category. Target-Date portfolios "aim to provide investors with an optimal level of return and risk, based solely on the target date." Portfolio managers adjust the asset allocation based on proximity to the target date. These funds have become popular with 401(k) participants. As far back as 2014, they were included as an investment option in more than 75% of all plans in the U.S., according to the Investment Company Institute. When it comes down to it, investors can keep things simple if they prefer it that way.

Make it as sophisticated as you want

With all of the investment products trading in the markets today, asset allocation can easily extend beyond a blend of stocks and bonds. The number of investment choices even within those two asset classes has expanded markedly. While investors should design an allocation plan factoring in their age, objectives, and risk tolerance, we believe that any wealth-building effort should be grounded by a healthy weighting in stocks. An investor looking for broader exposure to stocks and bonds may want to consider adding such alternative niches as real estate, commodities, managed futures, hedge funds and private equity.

Investors looking to shape their asset allocation strategy to fit their ideology may want to factor in other variables. With respect to stocks, do you favor passive management, active management or want exposure to both? How much of your equity exposure are you comfortable positioning in foreign stocks? Are you a growth-oriented, value-oriented or a blend style of investor? What would your split be between large-cap, mid-cap and small-cap stocks? Do you want to add some sectors to the mix? With respect to bonds, do you favor investment-grade, speculative-grade or want exposure to both? Are you seeking just yield or total return? What about floating-rate versus fixed-income? Well, you get the point.

Why do investors need to plan for their financial future? A survey conducted in 2015 by the American Institute of CPAs found that 57% of financial planners polled said that running out of money was their client's primary retirement concern, according to The Motley Fool. That says it all.

Continued

Some investors may still be struggling to make sense of the bull market in stocks

If this table looks familiar to you it is because we featured it back in the October 2015 issue. We wanted to update it so that investors can visualize just how low interest rate levels are and how far they may need to rise, using historical comparisons, to create enough headwind to help bring an end to the current bull market in stocks.

The current bull market in stocks is the second longest in history. If it stays on course it will celebrate its ninth anniversary on 3/9/18. The duration of the current bull market itself could be acting as a deterrent for those investors wanting to buy stocks, but refraining from doing so simply because the bull already seems long in the tooth. Another deterrent could be that the market has not experienced a meaningful sell-off in over a year. As of 1/4/18, data from Goldman Sachs indicated that the S&P 500 Index had gone 382 days without a 5% pullback, putting it just over two weeks shy of the longest streak on record, dating back to 1929, according to Business Insider. At the core of the ongoing rally has been a "buy the dip" mentality. In our opinion, pullbacks and corrections are a healthy part of any bull market. S&P Capital IQ reported that it takes the S&P 500 Index four months, on average, to fully recover from a correction (10% to 19.99% price decline), according to *Fortune*.

Our outlook for the equities markets in 2018 is bullish. The passage of the Tax Cuts and Jobs Act in December will hopefully boost economic activity moving forward. The biggest boost to the U.S. economy and markets could come from the reduction in the federal corporate rate from 35% to 21%. We'll be keeping a close eye on corporate earnings and expect them to rise.

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
12/29/17 (Ongoing)	1.50%	2.41%
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%

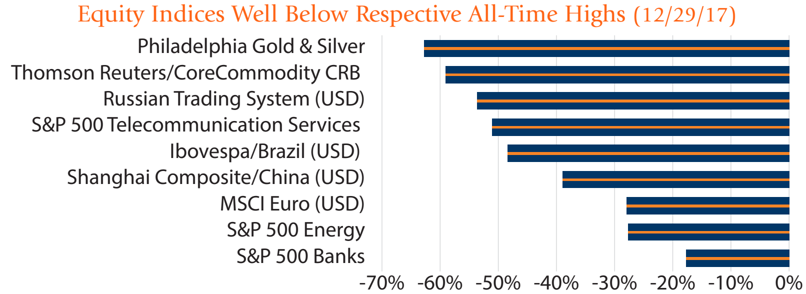
Source: Bespoke Investment Group, Bloomberg

While the federal funds target rate (upper bound) and yield on the 10-year Treasury note (T-note) stood at 4.75% and 4.65%, respectively, on the final day of the previous bull market, it was the two-year tightening phase from 6/04 to 6/06 that set the stage, in our opinion. The Fed raised the target rate a total of 17 times, from 1.00% to 5.25%, over that period. For comparative purposes, the Fed has raised the target rate just five times, from 0.25% to 1.50%, over the past two years (12/15-12/17).

A few deep value opportunities still lingering

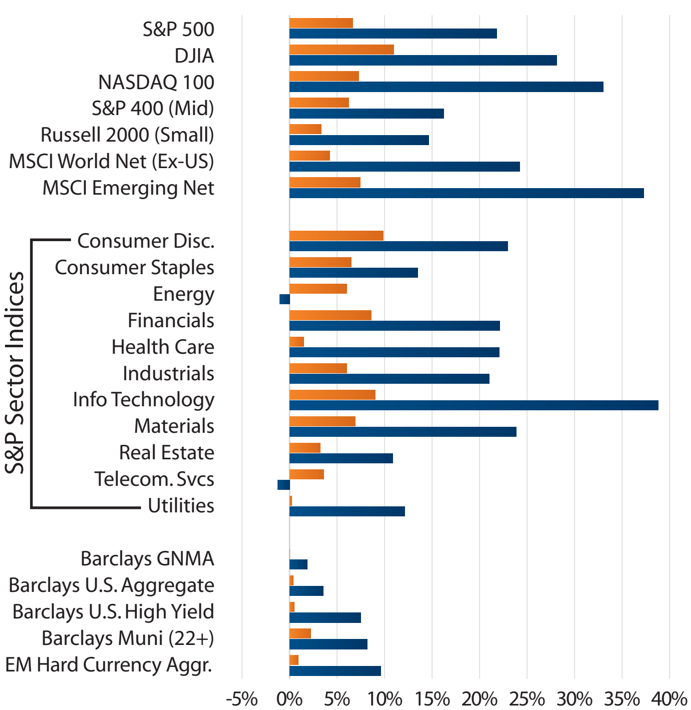
Most of the major U.S. and global equity indices closed 2017 at or near their all-time highs. There are still a few areas of the market, however, that are sitting well below their highs. The nine indices featured in the chart to the right closed 2017 anywhere from 17.67% (S&P 500 Banks) to 62.76% (Philadelphia Gold & Silver) below their respective all-time highs. Our takeaway from the chart is that commodities, including a broad-based basket, precious metals, energy and two countries (Russia & Brazil) whose economies rely on the sale of commodities, permeate the list. The one thing that has been largely missing in the economic recovery is inflationary pressure. If it rises moving forward, it could help boost commodity prices.

Equity Indices Well Below Respective All-Time Highs (12/29/17)



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

Total returns for Q4 and past 12 months (12/29/17)



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)	Q1'18E	Q1'17A	Q2'18E	Q2'17A	2018E	2017E
Consumer Disc. (12.2%)	**8.26**	8.05	**9.45**	8.71	**37.39**	34.52
Consumer Staples (8.2%)	**6.64**	5.99	**7.32**	6.72	**29.60**	27.14
Energy (6.1%)	**4.76**	3.88	**5.48**	2.75	**21.40**	15.04
Financials (14.8%)	**7.53**	6.83	**7.79**	6.98	**31.54**	26.92
Health Care (13.8%)	**14.01**	10.52	**14.56**	11.78	**58.00**	46.70
Industrials (10.3%)	**7.00**	6.37	**8.58**	8.02	**32.77**	29.87
Information Tech. (23.8%)	**13.85**	10.30	**13.77**	10.81	**59.73**	49.24
Materials (3.0%)	**5.49**	4.62	**5.73**	4.89	**20.62**	17.64
Real Estate (2.9%)	**1.17**	1.37	**1.26**	1.29	**5.10**	5.51
Telecom. Services (2.1%)	**3.12**	2.70	**3.20**	2.80	**12.44**	11.05
Utilities (2.9%)	**3.91**	3.75	**3.34**	3.06	**15.27**	14.45
S&P 500 Index	**33.97**	28.82	**35.95**	30.51	**145.80**	125.00
S&P 400 Index (Mid-Cap)	**21.68**	17.81	**24.61**	19.79	**97.95**	78.26
S&P 600 Index (Small-Cap)	**9.92**	7.19	**11.55**	7.70	**46.11**	32.96

Source: Standard & Poor's (1/3/18). Sector weightings add up to 100.1% as of 12/29/17.