First Trust

Quarterly Market Overview

Issue 76, January 2019

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

Don't let political rancor discourage you from taking on the risk needed to build wealth

Ask a registered voter of any U.S. political party what they stand for and you'll likely get an earful. Ask those very same people to define who they are as an investor and there is a good chance you might get a pause followed by a vague or loosely worded explanation. We believe that investors should be just as in tune and passionate about their money as they are about their brand of politics. Sometimes the two converge. Due to the 24/7 news cycle and the broad reach of the internet, people are being inundated with political news/agendas designed not only to inform, but misinform as well. In many cases, it is up to the consumer of this information to judge its authenticity, which is easier said than done. Based on the investigative work of U.S. intelligence agencies, we've learned that at least one foreign government has exploited social media sites in the U.S. in an effort to shape thought and influence elections. Congress has even held public hearings with the largest social media companies to learn more about it, yet some in the Trump administration still refuse to validate their findings. Political pundits and the cable news channels often note how polarized the two major parties (Republicans and Democrats) have become with respect to ideology. You'll hear politicians and the media refer to such things as "wedge issues." These are the ones that have helped forge this deep divide over time, and it only seems to be getting worse. It certainly doesn't seem healthy. Some of these wedge issues are financial in nature, hence the reference about convergence. Tax cuts only help the rich! The government bailed out Wall Street but not Main Street in the 2008-2009 financial crisis! The stock market is rigged by Wall Street firms and other large institutions! Does anyone remember when the rich and institutional investors were regarded as the "smart money?" Politics may have become like sport (us vs. them) to some, but investing should never be construed as a game, in our opinion. Our main concern is that investors not let emotion cloud their judgement when investing. Having a plan can help investors navigate the noise.

While political elections occur intermittently, investors vote with their dollars on a daily basis. This is why we monitor capital flows in the financial services industry. Aside from surveys, it is one of the few methods for gaining insight into investor psychology at any given time. Sometimes a pattern emerges. Mutual fund flows are a good barometer for following the investment patterns of retail investors ("little guy"). Over the past decade, flows indicate that the little guy has not been following the smart money. From 12/31/08-11/30/18 (one month shy of a decade), investors liquidated a net $783.78 billion from Equity funds, compared to funneling a net $1.409 trillion into Bond funds, according to data from the Investment Company Institute (ICI). There were just three years (2009, 2013 & 2014) of positive net inflows to Equity funds. That is a significant disparity in fund flows when you factor in the returns posted by stocks and bonds. From 12/31/08-11/30/18, the S&P 500 Index posted a cumulative total return of 277.08%, compared to 78.03% for the ICE BofAML U.S. Corporate Index and 30.29% for the ICE BofAML 7-10 Year Treasury Index, according to Bloomberg. This indicates to us that something has likely changed with respect to investor sentiment at the retail level. Institutional buying and corporate stock buybacks were largely responsible for the market's upside, in our opinion. The shift in retail investor sentiment could be tied to the aforementioned financial wedge issues as well as the pain and frustration from enduring the two severe bear markets in the first decade of the new millennium. Why do we believe this? Let's look at the previous decade. From 12/31/98-12/31/08, investors poured a net $952.76 billion into Equity funds, compared to net inflows totaling $418.48 billion into Bond funds, according to data from the ICI. Over that period, the S&P 500 Index posted a cumulative total return of -13.00%, compared to 54.74% for the ICE BofAML U.S. Corporate Index and 93.09% for the ICE BofAML 7-10 Year Treasury Index, according to Bloomberg. Equity funds took in a huge amount of capital despite a poor showing by the S&P 500 Index – a 180 degree difference from this past decade.

President Trump stated on the campaign trail that America was going to win so often under his leadership that people were going to grow sick and tired of all the winning. While that is a nice thought, and likely a bit of tongue in cheek, though it is hard to tell sometimes, the bottom line is that all presidents are judged by their wins and losses while in office. That is what historians are for. President Trump is only about halfway through his first term and so far it looks like he has won more than he has lost. When it comes to the stock market, the S&P 500 Index has posted an average annualized total return of 9.84% since Donald Trump won the presidential election (11/8/16-12/31/18), according to Bloomberg. From 1926-2018 (93 years), the S&P 500 Index generated an average annual total return of 9.99%, according to Ibbotson Associates/Morningstar. That means that the stock market under President Trump's watch has performed roughly in line with the historical norm. While that may not sound like a win to President Trump, we believe it is a win for investors considering how long the bull market in stocks has lasted. For the record, we believe the bull market still has legs. Investors, particularly retail investors, should find both comfort and confidence in seeing history repeat itself. There is no reason to turn one's nose up at a near double-digit return. Stock market corrections and bear markets come and go. It's time in the market, not timing the market that works for most investors. An estimated 10,000 baby boomers turn 65 every day in the U.S., according to *Kiplinger*. It notes that the single greatest retirement fear revealed in the latest Transamerica Retirement Survey is outliving one's savings. Historically speaking, owning common stocks is one of the most effective avenues for building wealth. There is nothing wrong with taking an interest or an active role in politics. We believe, however, there is something wrong with letting politics shape an investment strategy.

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These stock and bond returns support the argument for a balanced approach to investing

5-Year Cumulative Total Returns:
Domestic & Foreign Equity Indices

Period	S&P 500	S&P MidCap 400	S&P SmallCap 600	MSCI World ex-U.S. (USD)	MSCI Emerging Mkts. (USD)
1995-1999	251.12%	182.09%	119.66%	87.73%	10.41%
1996-2000	131.98%	153.13%	88.96%	45.87%	-19.18%
1997-2001	66.24%	111.08%	65.94%	7.29%	-25.58%
1998-2002	-2.90%	36.44%	12.80%	-11.62%	-20.88%
1999-2003	-2.82%	55.35%	58.63%	3.90%	65.60%
2000-2004	-10.98%	57.73%	73.09%	-2.12%	25.34%
2001-2005	2.75%	51.09%	66.71%	29.56%	143.03%
2002-2006	35.03%	67.69%	80.14%	107.43%	229.97%
2003-2007	82.86%	111.81%	110.39%	177.22%	390.82%
2004-2008	-10.47%	-0.40%	4.48%	12.40%	47.04%
2005-2009	2.11%	17.46%	6.97%	25.00%	108.99%
2006-2010	11.99%	32.16%	25.48%	19.00%	85.15%
2007-2011	-1.24%	17.72%	10.10%	-16.84%	14.30%
2008-2012	8.59%	28.51%	28.46%	-13.82%	-3.03%
2009-2013	128.19%	169.04%	163.37%	84.56%	102.44%
2010-2014	105.14%	114.97%	121.81%	32.01%	11.03%
2011-2015	80.75%	66.06%	72.15%	17.50%	-20.45%
2012-2016	98.18%	104.03%	115.67%	37.57%	8.50%
2013-2017	108.14%	101.20%	109.94%	46.73%	25.99%
2014-2018	50.33%	34.01%	35.96%	4.24%	10.54%

Source: Bloomberg. Past performance is no guarantee of future results. The MSCI World ex-U.S. (USD) and MSCI Emerging Markets (USD) Indices do not reflect any foreign tax withholdings.

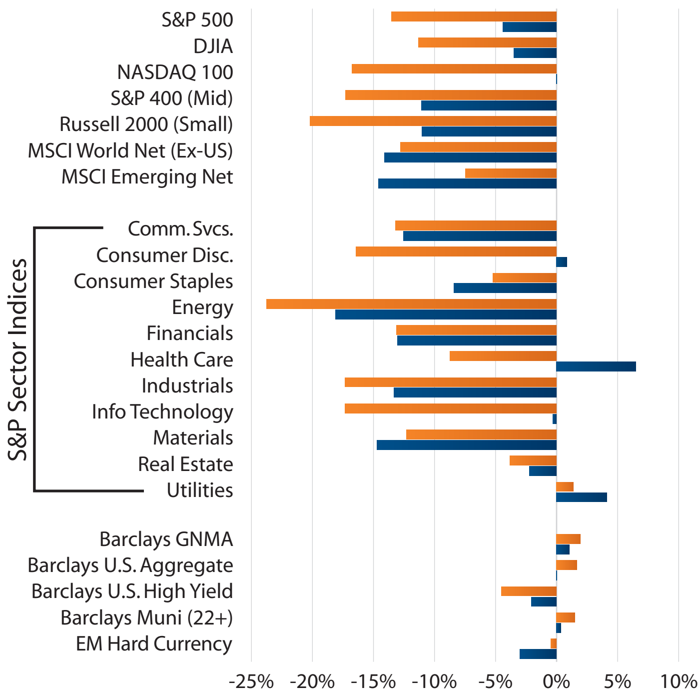
5-Year Cumulative Total Returns:
ICE BofAML Domestic & Foreign Bond Indices

Period	7-10 Yr. U.S. Treasury	U.S. Corporate	U.S. High Yield	Fixed-Rate Preferred	7-10 Yr. Global Gov't ex U.S. (USD)
1995-1999	46.85%	48.01%	60.27%	45.13%	40.86%
1996-2000	36.81%	32.86%	26.19%	40.06%	14.37%
1997-2001	44.23%	42.26%	18.50%	43.19%	5.09%
1998-2002	49.25%	41.98%	2.64%	40.15%	31.83%
1999-2003	35.32%	41.44%	27.76%	43.70%	29.75%
2000-2004	48.88%	51.97%	38.18%	58.05%	53.89%
2001-2005	33.03%	42.03%	49.67%	37.32%	43.18%
2002-2006	27.81%	33.84%	59.99%	35.14%	58.94%
2003-2007	23.32%	27.16%	66.72%	11.33%	43.28%
2004-2008	42.69%	9.40%	-4.23%	-23.94%	37.03%
2005-2009	28.73%	24.29%	36.06%	-13.11%	26.37%
2006-2010	37.44%	33.51%	52.58%	-2.18%	46.94%
2007-2011	54.09%	37.54%	42.53%	-5.79%	46.66%
2008-2012	45.44%	45.02%	61.14%	20.67%	36.55%
2009-2013	16.16%	53.36%	135.14%	55.51%	15.94%
2010-2014	33.95%	37.68%	53.02%	49.51%	9.14%
2011-2015	24.53%	24.92%	26.68%	41.50%	-1.30%
2012-2016	9.20%	23.12%	42.58%	39.07%	-5.44%
2013-2017	7.53%	18.77%	32.57%	35.38%	-0.36%
2014-2018	15.21%	17.83%	20.64%	34.41%	3.54%

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

- The two tables feature 5-year performance figures to give some historical perspective on what a buy and hold investment approach can do for investors.
- Each of the tables shows 100 cumulative total returns spanning five major equity indices and five major bond indices. There were 15 negative return periods posted by the equity indices, compared to eight for the bond indices.
- One of the key takeaways from studying the returns in the tables is the potential upside of employing asset allocation to better diversify risk.
- Example #1: Compare the equity cumulative total returns from 1998-2002 to the bond returns for the same period. Good time to have exposure to bonds.
- Example #2: Compare the bond cumulative total returns from 2003-2007 to the equity returns for the same period. Good time to have exposure to stocks.
- Example #3: Compare the equity cumulative total returns from 2007-2011 to the bond returns for the same period. Good time to have exposure to bonds.
- Example #4: Compare the bond cumulative total returns from 2013-2017 to the equity returns for the same period. Good time to have exposure to stocks.
- Both stocks and bonds can help investors build wealth over time. As noted, they can outperform one another in multi-year periods, so it pays to own both.

Total returns for *Q4* and past 12 months (12/31/18)



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)	**Q1'19E**	Q1'18A	**Q2'19E**	Q2'18A	**2019E**	2018E
Communication Svcs. (10.1%)	**2.07**	3.59	**2.20**	3.90	**8.85**	11.77
Consumer Disc. (9.9%)	**8.79**	9.21	**10.99**	10.47	**43.22**	40.05
Consumer Staples (7.4%)	**6.98**	6.77	**7.81**	7.63	**31.00**	29.61
Energy (5.3%)	**7.18**	6.30	**7.72**	6.66	**31.95**	28.97
Financials (13.3%)	**9.31**	7.88	**9.47**	9.11	**38.24**	35.49
Health Care (15.5%)	**16.32**	12.15	**16.79**	12.49	**66.88**	52.97
Industrials (9.2%)	**8.59**	8.93	**10.64**	9.70	**40.00**	37.53
Information Tech. (20.1%)	**15.82**	15.30	**16.33**	14.59	**70.39**	65.71
Materials (2.7%)	**5.31**	5.49	**6.35**	6.63	**22.75**	22.00
Real Estate (3.0%)	**1.14**	1.49	**1.27**	1.45	**5.05**	5.89
Utilities (3.3%)	**4.29**	4.45	**3.65**	3.49	**16.39**	15.88
S&P 500 Index	**39.46**	36.54	**42.37**	38.65	**171.04**	156.96
S&P 400 Index (Mid-Cap)	**26.97**	22.30	**30.21**	25.06	**120.72**	102.30
S&P 600 Index (Small-Cap)	**12.16**	9.14	**14.16**	10.07	**57.21**	41.97

Source: Standard & Poor's (1/3/19). Sector weightings as of 12/31/18.
There is no guarantee past trends will continue or projections will be realized.

As of 9/28/18, the Global Industry Classification Standard (GICS) was reconstituted and the Telecommunications Services sector was renamed Communication Services. GICS sector information for periods prior to 9/28/18 may not necessarily be comparable to the reconstituted sectors.

All charts and tables herein are for illustrative purposes only. Indices do not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Indices are unmanaged and an investor cannot invest directly in an index.

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