First Trust

Quarterly Market Overview

Issue 78, July 2019

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

The Average Retail Investor Is Left Out Of The IPO Process

An initial public offering (IPO) occurs when a private company floats stock to outside investors for the first time in an effort to raise capital. Upon selling the shares, the company transitions from private to public. Companies go public in the primary market and then subsequently trade in the secondary market.

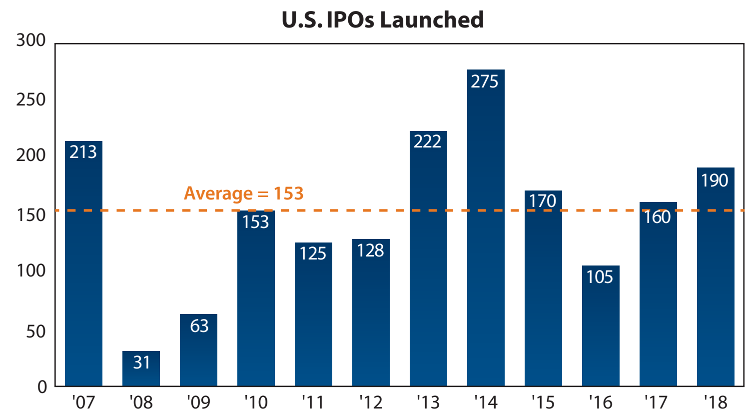
The overall tone of the IPO market can be influenced by such things as the state of the economy, interest rate levels and the strength of the stock market. The chart to the right shows how many U.S. IPOs (market capitalization > $50 million) were launched in each of the past 12 calendar years. As one might expect, due to the 2008-2009 financial crisis, which was accompanied by a recession that ran from 12/31/07-6/30/09, the number of IPOs brought to market plunged in 2008 and 2009, and remained fairly sluggish through 2012. Activity picked up notably from 2013 through 2018, with the exception of 2016, which was a presidential election year.

Renaissance Capital reported that 80 U.S. IPOs came to market in the first half of 2019, a pace that, if maintained, would generate a full-year total of 160, slightly higher than the 12-year average of 153. IPO activity today is tempered compared to three decades ago, when the internet revolution was taking hold and a lot of investors, including institutions, feared missing out on the action. Activity peaked in the U.S. in 1996, when nearly 700 IPOs were launched, according to the CFA Institute. Since then, the number of publicly listed companies, in general, has declined substantially. Credit Suisse revealed that the number of publicly listed companies in the U.S. declined from approximately 7,300 in 1996 to around 3,600 in 2016, according to CNBC.

As we noted from the start, the purpose of bringing an IPO is to raise capital. In the first half of 2019, the 80 companies that went public raised a total of $29.7 billion, according to Renaissance Capital. That pace is comfortably ahead of the $40.4 billion annual average for the 12-year period ended 2018. The biggest yearly take in the period was $85.3 billion (2014). It was also the most active year, with 275 IPOs.

There was a huge disparity in the amount of IPO capital raised in Q1'19 and Q2'19. In Q1'19, the 18 IPOs launched raised just $4.7 billion, while the 62 that came to market in Q2'19 took down $25.0 billion. Suffice it to say, the tone of the stock market heading into Q1'19 was much different than that of Q2'19. The S&P 500 Index posted a total return of -13.52% in Q4'18, according to Bloomberg. That is not the most confidence-inspiring climate for any company seeking to go public. Fortunately, the market rebounded in Q1'19. The S&P 500 Index posted a total return of 13.65%, and the IPO market came alive. At the close of June 2019, the IPO pipeline consisted of 60 companies, according to CNBC. The S&P 500 Index posted a total return of 4.30% in Q2'19, so the climate is still conducive for launching IPOs, in our opinion.

Paul Donahue, Morgan Stanley's head of equity capital markets for the Americas, expects IPO activity to remain busy in Q3'19 and beyond, according to Bloomberg. Donahue notes that there are hundreds of growth companies spanning many sectors that could come public over the next 24 months.



Source: Renaissance Capital. IPOs with a market cap above $50 million.

As was the case in the dot-com bubble days, a lot of the companies going public of late, particularly in the fields of tech and biotech, are not profitable, according to news service Vox. Three big differences, however, are that they have tended to be more seasoned, have better business models and offer more established revenue streams.

The biggest drawback to the IPO process is that shares are difficult to come by, especially for retail investors. Those that are fortunate enough to gain access to them tend to be limited to a few hundred shares, according to The Street. It notes that institutional investors usually receive the lion's share of the allocation. The average investor is left out of the mix almost by design.

What is the allure of IPO shares? In addition to garnering a more favorable cost basis, it is the potential to capture a pop in the price of the shares on the first day of trading, particularly when it comes to the most popular and anticipated offerings. This pertains to those shareholders that are free to flip, or sell, their shares in the secondary market once trading commences. Data from University of Florida professor Jay Ritter shows that, from 1980 through 2016, the average first-day's return for those U.S. IPOs brought to market was 18%.

Not every IPO gets off on the right foot. Barron's reported at the close of 2018 that 65 of the most recent 100 offerings were considered "busted IPOs," which meant that their year-end closing prices were below their formal IPO price on the first day of trading, according to 24/7 Wall St. As we learned from the euphoria surrounding the IPOs brought during the tech boom, investors are usually better served by leaving emotion out of their decision-making process. The fear of missing out is not a sound reason to invest one's capital, in our opinion.

With respect to being left out of the IPO process, retail investors who have an interest in the IPO market do have some options once the IPOs hit the secondary market. There are currently seven exchange-traded funds (ETFs) that focus on IPOs after they go public. Collectively, these ETFs have approximately $1.5 billion in assets under management.

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Promises Kept

From our perspective, investor interest in the internet revolution began in earnest in 1995. As we pointed out in our discussion of IPOs, the all-time high in IPO offerings occurred in 1996. In hindsight, what we have learned from the irrational exuberance that permeated the stock market in the late 1990s, a phrase uttered by Federal Reserve Chairman Alan Greenspan in a 1996 speech, was that the marketing, or hype, of cutting-edge technologies can get ahead of the delivery of said innovations. The good news is that the cutting-edge technologies and corresponding benefits promised back then were eventually delivered.

We also know that a lot of people got burned investing in technology stocks after the bubble burst in March 2000. From 3/27/00-10/9/02 (peak to trough), the S&P 500 Information Technology Index plunged 82.43%, according to Bloomberg. While staying the course is easier said than done, it would have served those that did quite well. As indicated in the table to the right, from 12/31/94-6/28/19, the top-performing sector in the S&P 500 Index was Information Technology, followed closely by Health Care. By the way, the main reason why Health Care was a close second has to do with the performance of biotechnology stocks. There is that word (technology) again. The S&P 500 Biotechnology Index posted the best showing of the S&P 500 Index's subsectors for the period (12/31/94-6/28/19), with a cumulative total return of 3,786.13%, or an average annualized gain of 16.11%, according to Bloomberg. For those investors who still subscribe to a buy and hold philosophy, the S&P 500 Index's 9.97% average annualized total return essentially matched its 9.99% average annual total return from 1926-2018, according to Ibbotson Associates/Morningstar.

S&P 500 Index & Sectors

Cumulative & Annual & Average Annual Total Returns (12/30/94-6/28/19)

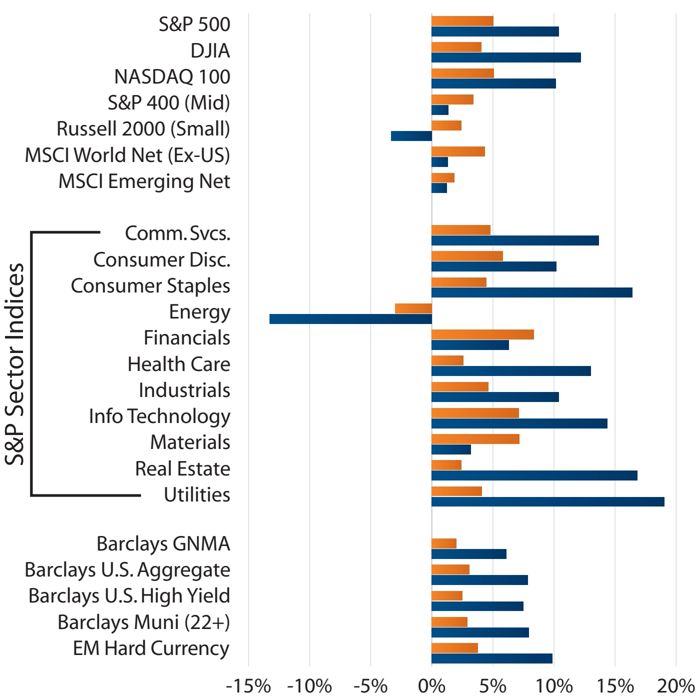
Index	Cumulative	Average Annualized
Information Technology	1,586.43%	12.22%
Health Care	1,525.18%	12.05%
Consumer Discretionary	1,217.66%	11.09%
Consumer Staples	989.90%	10.24%
Industrials	969.13%	10.15%
S&P 500	926.26%	9.97%
Energy	756.53%	9.16%
Utilities	713.87%	8.93%
Financials	675.20%	8.71%
Materials	531.32%	7.81%
Communication Services	313.33%	5.96%
Real Estate	N/A*	N/A*

*Source: Bloomberg. Past performance is no guarantee of future results. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. The respective S&P 500 Sector Indices are capitalization-weighted and comprised of S&P 500 constituents representing a specific sector. *Real Estate became its own sector in 2016. 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.*

The outlook for 5G looks promising...

- By utilizing new frequencies of the wireless spectrum, 5G aims to deliver higher bandwidth, lower latency and support for connected devices ("Internet of Things").
- 5G's support of multiple devices is predicated on speed. 5G is expected to be some 20 times faster than the current 4G technology. (Zion Market Research)
- The global 5G infrastructure market is expected to grow from $1.3 billion in 2018 to $22.5 billion by 2025. That would constitute a compound annual growth rate of 50.1% between 2019 and 2025. (Zion Market Research)
- The major U.S. telecommunications carriers are expected to begin rolling out 5G service selectively in the second half of 2019. (Lifewire)

Total returns for Q2 and past 12 months (6/28/19)



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)	Q3'19E	Q3'18A	Q4'19E	Q4'18A	2019E	2018A
Communication Svcs. (10.2%)	**2.25**	2.12	**2.46**	2.17	**8.89**	11.78
Consumer Disc. (10.2%)	**11.39**	10.49	**11.22**	9.67	**41.86**	39.84
Consumer Staples (7.3%)	**7.97**	7.82	**7.78**	7.13	**30.03**	29.35
Energy (5.0%)	**7.63**	8.44	**7.51**	9.22	**25.53**	30.61
Financials (13.1%)	**9.26**	9.92	**9.45**	4.34	**38.79**	31.25
Health Care (14.2%)	**16.67**	13.14	**16.82**	12.26	**64.32**	50.04
Industrials (9.4%)	**10.08**	9.83	**10.16**	8.98	**37.59**	37.43
Information Tech. (21.5%)	**16.48**	16.69	**19.65**	17.13	**65.12**	63.70
Materials (2.8%)	**5.25**	5.16	**5.06**	4.30	**19.61**	21.58
Real Estate (3.1%)	**1.28**	1.68	**1.38**	1.78	**5.34**	6.40
Utilities (3.3%)	**5.02**	5.13	**3.16**	2.34	**15.77**	15.41
S&P 500 Index	**42.40**	41.38	**43.76**	35.03	**163.60**	151.60
S&P 400 Index (Mid-Cap)	**29.32**	27.42	**30.77**	21.20	**110.59**	95.98
S&P 600 Index (Small-Cap)	**13.59**	10.06	**15.40**	9.77	**47.95**	39.05

Source: Standard & Poor's (7/2/19). Sector weightings as of 6/28/19.
There is no guarantee past trends will continue or projections will be realized.

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