First Trust

Quarterly Market Overview

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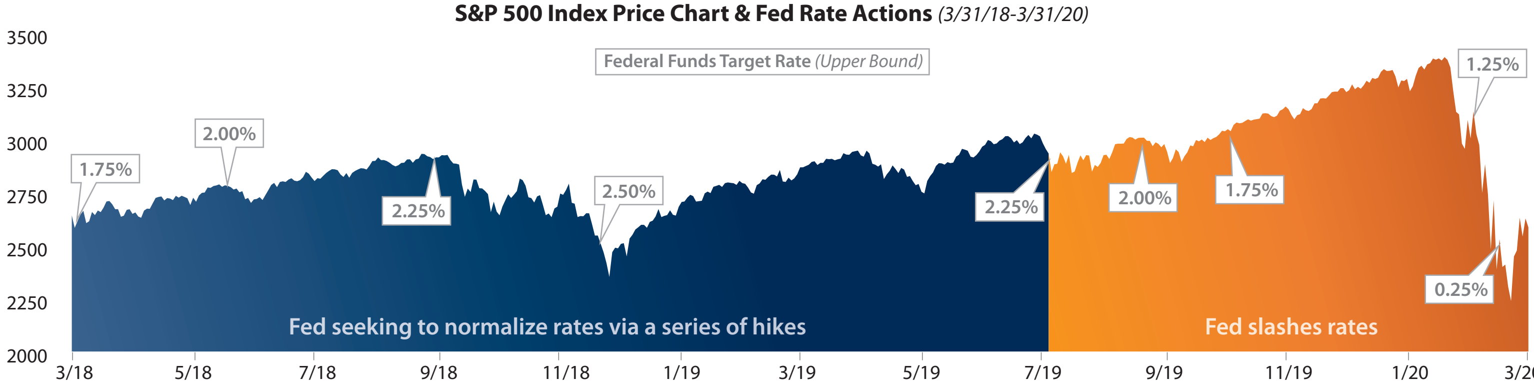
We invite you to visit Bob's Market Commentary Blog at www.ftportfolios.com for more insight.

The Federal Reserve went from normalizing interest rates in 2018 to a complete about-face due to tariffs and COVID-19

S&P 500 Index Price Chart & Fed Rate Actions *(3/31/18-3/31/20)*



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

The Fed has been knee-deep in it for the past couple of years...

The onset of the coronavirus (COVID-19) pandemic has inflicted tremendous damage on the global economy. It single-handedly brought an end to the bull market in stocks in Q1'20, although that nearly happened in Q4'18. At this time, we don't know how long it will take for the virus to run its course or for a vaccine to become available for the masses. History suggests that vaccines take roughly 18 months to win approval and go to market, but some are hoping for closer to 12 months this time around. Perhaps an existing drug will be proven effective against the virus. What we do know is that, with respect to the U.S. economy and the stock market, a lot was already happening before COVID-19 arrived in the U.S. Here is a brief take on that story:

- ☐ **Federal Reserve ("Fed") in 2018**: While the data in the chart above begins on 3/31/18, the fact is that the Fed had already been raising its federal funds target rate (upper bound) since December 2015, albeit slowly at first. Those hikes began to accelerate in 2017 (3 hikes) and 2018 (4 hikes). The Fed had stated in 2018 that it sought to normalize interest rates now that the economy was on solid-footing. Rates had been left artificially low for seven years to help mitigate the economic fallout from the 2008-2009 financial crisis. All in, the Fed had raised rates from a low of 0.25% in December 2015 to 2.50% in December 2018. Two things happened in December 2018 that nearly ended the bull market: the Fed stated that the federal funds target rate was still in need of additional increases to attain a neutral posture and President Donald J. Trump announced he was escalating the trade tariffs that the U.S. was imposing on China. The Trump administration's tariff policy was already having an impact on economic activity and the market, at least on the margin, prior to the announcement, in our opinion. The S&P 500 Index declined by 19.78% (price-only) from its all-time high at the close of 9/20/18 through 12/24/18, according to Bloomberg. The selling stopped after the Fed commented it would be pausing on making any more rate hikes for the foreseeable future. Just months later it was "publicly encouraged" by President Trump himself to turn the stimulus spigot back on to help give the economy a boost.
- ☐ **Trump's Trade Tariffs**: The Trump administration launched its first round of tariffs on imported goods and services on 3/8/18, a little more than two years ago. It involved a 25% tariff on imported steel and a 10% tariff on imported aluminum. Keep in mind that Trump had just recently signed his tax reform bill (Tax Cuts & Jobs Act of 2017) into law on 12/22/17. Early on, the Trump administration had stated that they wanted to embark on their tariff campaign from a position of strength, and they did. Real U.S. GDP growth stood at an annualized rate of 3.5% in Q2'18, according to the Bureau of Economic Analysis. A year later (Q2'19), however, growth came in at an annualized pace of just 2.0%. This was around the time that Trump began to turn up the pressure on Fed Chairman Jerome Powell to lower interest rates. The escalation of the tariffs, particularly those targeting China, appeared to be tempering growth at home. In February 2020, the White House acknowledged that President Trump's stance on trade had depressed economic growth and business investment, according to Bloomberg. While the Trump administration did negotiate a "phase one" deal with China in January 2020, in which China agreed to purchase an additional $200 billion in goods and services from the U.S. by 2021, the tariffs largely remain intact. The tariff campaign stands at 25 months and counting.
- ☐ **Fed in 2019-2020**: The Fed came through for President Trump. It lowered the federal funds target rate (upper bound) from 2.25% in July 2019 to 1.75% in October 2019. Unfortunately, COVID-19 came along in Q1'20 and has proved formidable enough to trigger a global recession. Hence, the move down to 0.25%.
- ☐ **Bottom Line**: History has proven to investors time and again that it does not pay to fight the will of the Fed. Hard times are likely to persist over the next few months, including the next two corporate earnings seasons. The silver lining is that the Fed, Treasury Department and Congress are all working with the Trump administration to pull together trillions of dollars of aid and stimulus to help prop up workers, companies and municipalities in this time of need. We believe that a remedy will be found for this pandemic in due time. We encourage investors to stay the course. And, remember, don't fight the Fed!

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Sharp sell-offs in the stock market can trigger the urge to be opportunistic via sector investing

Qtr.	Sector	Return
Q2'09	Financials	35.67%
Q3'09	Real Estate	31.71%
Q4'09	Info. Tech.	10.70%
Q1'10	Industrials	13.08%
Q2'10	Utilities	-3.73%
Q3'10	Comm. Svcs.	20.96%
Q4'10	Energy	21.47%
Q1'11	Energy	16.79%
Q2'11	Health Care	7.87%
Q3'11	Utilities	1.55%
Q4'11	Energy	18.19%
Q1'12	Financials	22.00%
Q2'12	Comm. Svcs.	14.13%
Q3'12	Energy	10.14%
Q4'12	Financials	5.91%
Q1'13	Health Care	15.81%
Q2'13	Financials	7.25%
Q3'13	Materials	10.31%
Q4'13	Industrials	13.51%
Q1'14	Utilities	10.10%
Q2'14	Energy	12.09%
Q3'14	Health Care	5.45%

Since most investors likely have a portion of their securities portfolio already allocated to at least one equity core holding offering broad market exposure (domestic, foreign or both), in times like these, it is only natural to contemplate targeting other potential opportunities lurking within this newly-formed bear market. One of the most common questions that we get from brokers and advisors over time is the following: What is your top sector moving forward? While it is a fair question, nobody has a crystal ball. Having said that, we would like to cite a recent example to illustrate how challenging the process can be. Keep in mind, we assume that investors, by nature, tend to employ a long time horizon when putting money to work, while traders tend to operate in minutes, hours, days, weeks and months.

On each side of this text, we show the top-performing S&P 500 Index sectors, based on total return, for each of the past 44 calendar quarters. The period captures nearly all of the previous bull market (3/9/09-2/19/20). It was one of the longest and most prosperous bull markets on record. Here were the number of quarters in which each respective sector posted the highest total return in a given quarter: 8 (Information Technology); 7 (Energy, Health Care & Utilities); 6 (Financials); 3 (Communication Services); 2 (Industrials & Materials); 1 (Consumer Discretionary & Real Estate) and 0 (Consumer Staples). For comparative purposes, here were the cumulative total returns from each of the 11 sectors from 3/31/09-3/31/20 (44 quarters): 584.57% (Information Technology); 505.39% (Consumer Discretionary); 349.99% (Health Care); 338.21% (Real Estate); 292.90% (Industrials); 255.05% (Financials); 252.00% (Consumer Staples); 231.21% (Utilities); 168.39% (Materials); 144.75% (Communication Services.); and -11.72% (Energy), according to Bloomberg.

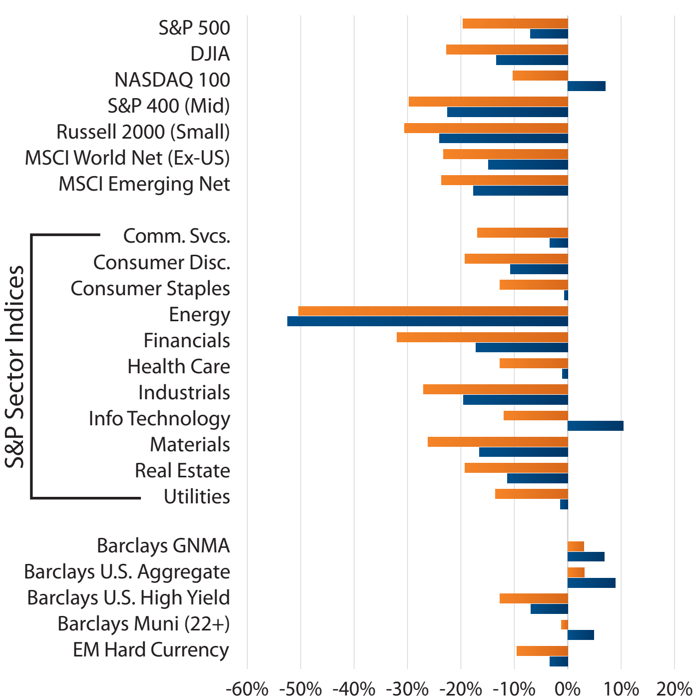
There are at least three glaring takeaways from this period, in our opinion. First, there were only three back-to-back quarters in which a sector repeated as the top-performer (Q4'10 & Q1'11, Q1'15 & Q2'15 and Q4'19 & Q1'20), so playing momentum by choosing the previous quarter's winner would have been largely ineffective. Second, while Consumer Discretionary topped the list just once in 44 quarters, it was the second-best performing sector over those 44 quarters. Third, despite topping the list seven times, Energy not only had the poorest showing for the period it actually posted a negative cumulative total return over those 44 months. We conclude that this process is indeed challenging.

It is now time to answer the question. Bear market aside, the two sectors that stand out the most right now are Communication Services and Information Technology, in our opinion. We base this on the prospects for 5G wireless technologies over the next several years. The U.S. rollout of 5G began in earnest in the second half of 2019. 5G infrastructure is needed to help make the Internet of Things (IoT) flourish.

Quarterly total returns provided by Bloomberg. ***Past performance is no guarantee of future results.***

Qtr.	Sector	Return
Q4'14	Utilities	13.19%
Q1'15	Health Care	6.53%
Q2'15	Health Care	2.84%
Q3'15	Utilities	5.40%
Q4'15	Materials	9.69%
Q1'16	Comm. Svcs.	16.61%
Q2'16	Energy	11.62%
Q3'16	Info. Tech.	12.86%
Q4'16	Financials	21.05%
Q1'17	Info. Tech.	12.57%
Q2'17	Health Care	7.10%
Q3'17	Info. Tech.	8.64%
Q4'17	Cons. Disc.	9.87%
Q1'18	Info. Tech.	3.53%
Q2'18	Energy	13.48%
Q3'18	Health Care	14.53%
Q4'18	Utilities	1.36%
Q1'19	Info. Tech.	19.86%
Q2'19	Financials	8.00%
Q3'19	Utilities	9.33%
Q4'19	Info. Tech.	14.40%
Q1'20	Info. Tech.	-11.93%

Total returns for Q1 and past 12 months (3/31/20)



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)	Q2'20E	Q2'19A	Q3'20E	Q3'19A	2020E	2019E
Communication Svcs. (10.8%)	**2.03**	**2.14**	**2.21**	1.91	**8.80**	8.25
Consumer Disc. (9.8%)	**4.90**	**10.15**	**9.21**	10.51	**30.28**	39.48
Consumer Staples (8.0%)	**7.61**	**7.63**	**8.30**	7.72	**30.90**	30.50
Energy (2.6%)	**-1.57**	**5.47**	**-0.20**	6.41	**1.26**	16.09
Financials (10.8%)	**7.98**	**10.33**	**7.96**	10.39	**32.40**	43.44
Health Care (15.5%)	**16.95**	**14.80**	**18.46**	13.44	**70.48**	55.62
Industrials (8.2%)	**4.96**	**9.31**	**7.52**	9.60	**27.19**	35.48
Information Tech. (25.4%)	**15.81**	**15.48**	**17.65**	15.25	**70.51**	62.92
Materials (2.4%)	**4.60**	**5.08**	**4.30**	4.22	**16.91**	17.05
Real Estate (3.0%)	**1.22**	**2.12**	**1.24**	1.71	**5.05**	7.00
Utilities (3.5%)	**3.54**	**3.39**	**5.30**	5.06	**16.44**	15.66
S&P 500 Index	**32.77**	**40.14**	**38.15**	39.81	**146.57**	157.12
S&P 400 Index (Mid-Cap)	**19.06**	**25.37**	**24.22**	23.28	**91.24**	94.98
S&P 600 Index (Small-Cap)	**7.40**	**10.52**	**10.75**	8.78	**39.36**	30.68

Source: S&P Dow Jones Indices (4/8/20). Sector weightings as of 4/1/20.
There is no guarantee past trends will continue or projections will be realized.