First Trust

Quarterly Market Overview

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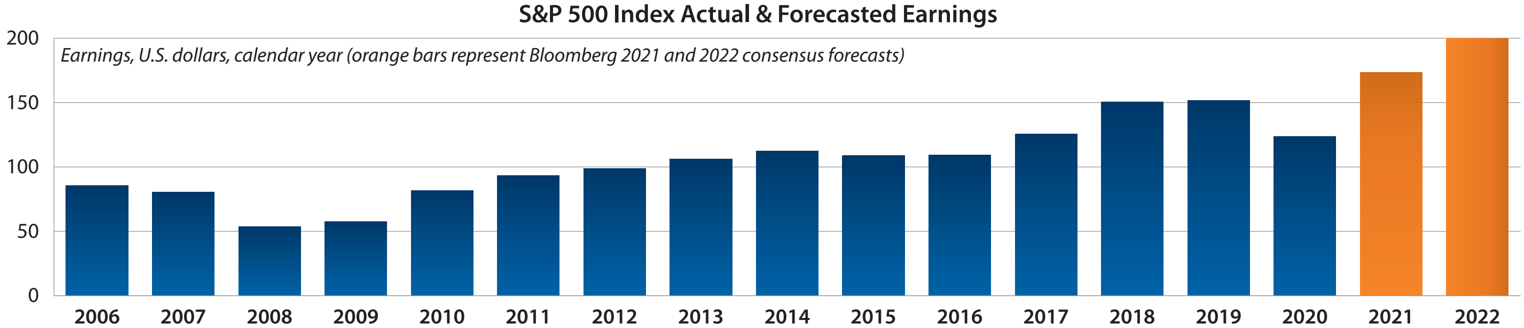
We invite you to visit Bob's Market Commentary Blog at www.ftportfolios.com for more insight.

Let's talk about the E in P/E

S&P 500 Index Actual & Forecasted Earnings



Source: Bloomberg as of 4/5/21. This chart is for illustrative purposes only and not indicative of any actual investment. **Past performance is no guarantee of future results.** *There is no assurance the projected forecasts will be achieved.*

Earnings season is about to commence and we suspect that equity investors are banking on some good results. Bloomberg's consensus year-over-year (y-o-y) earnings per share (EPS) growth rate estimate for the S&P 500 Index ("index") for Q1'21 stood at 23.44% as of 4/5/21. If achieved, it would likely go a long way in reassuring investors that the rally in the stock market is being driven by more than just speculative buying. The projection for Q2'21 came in at 50.45%, more than double the growth rate target for Q1'21. Now that is a real "attention getter." We do, however, need to acknowledge that Q2's y-o-y comparison should reflect a notable bounce when you consider that the COVID-19 outbreak began to wreak havoc on the economy towards the end of Q1'20. The full-year 2021 EPS growth rate estimate (y-o-y) was 25.33% as of 4/5/21 (see first orange bar in chart above), according to Bloomberg. It is expected to be followed up by a 15.06% y-o-y pop in earnings in 2022 (second orange bar in chart). We will revisit the chart in a moment.

These earnings growth projections help explain why stocks have performed so well over the past 12 months. The stock market is a discounting mechanism that takes into consideration all available information, including present and future events. It is common to hear pundits say that the market is looking out six to nine months to determine today's price levels. When unanticipated events present themselves, the market tends to digest the news rather quickly and adjusts accordingly, as was the case with the onset of the COVID-19 pandemic in Q1'20. Which brings us back to the rally in stocks. Thanks largely to the trillions of dollars of stimulus brought forth by the federal government to help mitigate the economic fallout from COVID-19, the sharp sell-off in the stock market from 2/19/20 through 3/23/20 turned out to be short-lived. Considering the climate we were in, the rebound in the market has been stellar. From 3/31/20 through 3/31/21, the S&P 500 Index posted a total return of 56.35%, according to Bloomberg. Despite the onset of COVID-19 in Q1'20, the index still managed to generate a total return of 18.40% in 2020. For comparative purposes, from 1926-2020, the S&P 500 Index posted an average annual total return of 10.28%, according to Ibbotson & Associates/Morningstar.

Through the years, we have been steadfast in our belief that corporate earnings dictate the direction of the stock market over time. It is especially true when the market has been setting new highs for a number of years. While many things can impact the performance of the market, such as dramatic shifts in the Federal Reserve's monetary policy or large-scale tax reform, corporate earnings remain the number one catalyst for stocks, in our opinion. Investors have had to cope with more significant events than just COVID-19 in recent years, such as the 2008-2009 financial crisis. The silver lining has always been that the market, as measured by the S&P 500 Index, has never failed to fully recover from any down market period. It has proven itself to be resilient. As indicated in the chart above, S&P 500 Index earnings fell from $80.50 per share in 2007 to $53.80 per share in 2008 (financial crisis). From 2008 through 2019 (recovery period prior to COVID-19 pandemic), earnings increased from $53.80 per share to $151.74 per share, or a gain of 182.04%. From 12/31/07 through 12/31/2019, the S&P 500 Index posted a total return of 184.17%, according to Bloomberg. This is a good example of the market behaving as intended, in our opinion. We think investors should find that reassuring, but not everyone agrees. A recent survey from Bankrate.com revealed that 39% of the U.S. adults it polled said they had no capital invested in the stock market either prior to the COVID-19 pandemic or currently, according to its own release. Nearly one out of every two respondents (48%) believe the stock market is rigged against individual investors. Considering how the stock market has performed over the past year, that is an unfortunate and costly perspective to maintain, in our opinion.

The stock market does not go up in a straight line. Even while in the midst of a bull market, like the one we are currently in, there is always a chance for pullbacks and corrections. Pullbacks (up to a 10.00% decline in price from the most recent high) and corrections (10.00% to 19.99% sell-off) are considered to be healthy and normal occurrences for the market. Data from Yardeni Research indicates that there have been 38 declines of at least 10% in the S&P 500 Index since 1950, according to The Motley Fool. That equates to a correction every 1.87 years, on average, with an average duration of about six months.

Continued

Corporate earnings and top-line sales (revenue) growth projections by sector

It is good to see that there are still plenty of investors willing to assume some additional risk in an attempt to generate higher returns. As of 4/9/21, data from Bank of America indicated that equity funds took in a record $576 billion since last November, according to Reuters. That is more than the $452 billion of inflows reported over the last 12 years combined. The money is flowing in despite the fact that the major U.S. stock indices are trading at or near their respective all-time highs. As of 4/9/21, the 12-month forward-looking price-to-earnings (P/E) ratio on the S&P 500 Index was 22.4, according to FactSet. For comparative purposes, the average P/E on the index was 17.09 for the 50-year period ended 4/9/21, according to Bloomberg. Investors are likely being drawn in by the potential reopening of the entire U.S. economy by mid-year.

There are other signs that investors have a growing appetite for equities in the current climate. Data from Renaissance Capital shows that a total of 101 equity IPOs (market caps above $50 million) have been priced in the U.S. this year (thru 4/1/21), up 288.5% from the same period in 2020, according to its own release. The 101 companies raised a combined $39.2 billion, up 463.9% from the same period a year ago.

While a lot of attention is being garnered by the surge in the yield on the benchmark 10-year Treasury-note (T-note), the Federal Reserve ("Fed') is not fazed by it. The yield on the 10-year T-note rose by 82 basis points to 1.74% in Q1'21, according to Bloomberg. Fed Chairman Jerome Powell commented on 3/24/21 that he is not concerned about the rise in bond yields because he believes it reflects growing optimism about the economy's prospects, according to *The Wall Street Journal*. Powell believes that COVID-19 is still the biggest risk for the U.S. economy. At 1.74%, the yield on the 10-year T-note is too low to compete with the historical return on stocks, in our opinion. It stood 138 basis points below its 20-year average of 3.12% on 3/31/21.

One of the key developments in the market over the past couple of quarters has been the sharp shift in sentiment from growth to value stocks, which have tended to be more cyclical in nature. Value stocks now have the leadership role in the market and it could stay that way providing the economy fully reopens.

S&P 500 & Sector Indices

(Estimated Y-O-Y Earnings & Revenue Growth Rates as of 4/5/21)

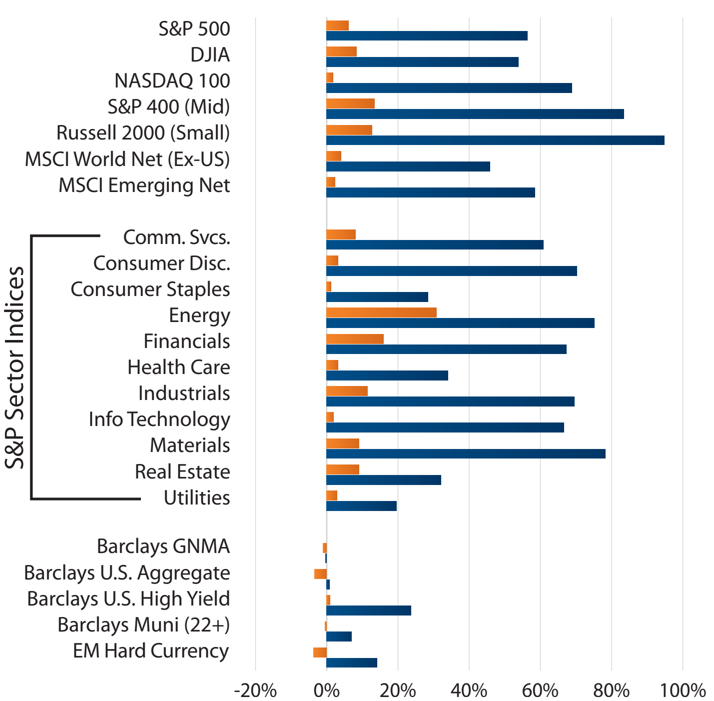
	2021 Earnings Est.	2022 Earnings Est.	2021 Revenue Est.	2022 Revenue Est.
S&P 500 Index	25.3%	15.1%	10.5%	6.3%
Comm. Services	9.0%	17.4%	9.5%	9.6%
Consumer Disc.	39.7%	43.4%	17.1%	12.6%
Consumer Staples	9.0%	6.0%	5.6%	1.8%
Energy	NM*	38.6%	29.0%	4.7%
Financials	28.5%	10.4%	2.8%	3.5%
Health Care	14.5%	6.8%	8.5%	5.0%
Industrials	59.3%	33.9%	11.1%	9.0%
Info. Tech.	22.1%	12.1%	12.7%	6.9%
Materials	42.2%	5.3%	1.6%	13.1%
Real Estate	3.2%	8.2%	5.8%	6.4%
Utilities	3.6%	6.5%	1.6%	6.4%

Source: Bloomberg. Consensus estimates using fiscal year revenue from each company.
**NM stands for not meaningful/previous year negative.*

Some takeaways from the table above...

- For the market to trend higher, we believe that corporate earnings will need to grow, and perhaps the best catalyst for growing earnings is to increase revenues.
- For both 2021 and 2022, a total of six of the 11 major sectors that comprise the index reflect positive double-digit y-o-y earnings growth rate estimates.
- For both 2021 and 2022, a total of eight of the 11 major sectors reflect y-o-y revenue growth rate estimates of 5.0% or more.
- The 2021 earnings growth rate estimates seem to be much higher for cyclicals. Industrials and Materials already stand out and their projections could improve with the passage of an infrastructure spending plan.

Total returns for Q1 and past 12 months (3/31/21)



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 (per share). The S&P 500 Index dollar figures reflect the 11 major sectors on a weighted-adjusted basis.

Index (Weighting In S&P 500)	Q2'21E	Q2'20A	Q3'21E	Q3'20A	2021E	2020E
Communication Svcs. (10.9%)	**2.34**	1.58	**2.50**	1.95	**9.97**	7.26
Consumer Disc. (12.4%)	**8.40**	4.19	**10.17**	11.41	**35.34**	28.29
Consumer Staples (6.1%)	**7.96**	7.94	**9.15**	9.35	**33.20**	32.08
Energy (2.8%)	**3.90**	-8.25	**4.79**	-1.65	**15.98**	-27.58
Financials (11.3%)	**9.09**	7.65	**8.97**	11.72	**36.78**	32.66
Health Care (13.0%)	**20.27**	15.12	**20.74**	15.26	**81.57**	57.93
Industrials (8.9%)	**7.01**	2.08	**8.63**	4.62	**29.96**	13.59
Information Tech. (26.6%)	**19.58**	14.48	**21.38**	16.23	**86.79**	67.79
Materials (2.7%)	**7.05**	3.62	**6.17**	3.84	**24.67**	15.86
Real Estate (2.5%)	**1.09**	1.14	**1.11**	0.98	**4.48**	5.28
Utilities (2.7%)	**3.73**	3.80	**5.36**	4.88	**16.92**	15.60
S&P 500 Index	**41.24**	26.79	**44.82**	37.90	**172.46**	122.38
S&P 400 Index (Mid-Cap)	**29.92**	9.00	**32.84**	19.70	**124.93**	74.12
S&P 600 Index (Small-Cap)	**13.84**	-5.95	**15.87**	8.59	**60.09**	-4.03

Source: S&P Dow Jones Indices (3/30/21). Sector weightings as of 3/31/21.
There is no guarantee past trends will continue or projections will be realized.

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