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.

It is times like these when long-term investors just need to grin and bear it!

We would like to begin our brief discussion of bear markets with the following fact: the S&P 500 Index has never failed to recoup the losses sustained in a bear market. How do we know this? The index set its all-time high on 1/3/22. By the way, a bear market is defined as a 20% or greater decline in the price of a security or index from its most recent peak.

The chart to the right is a snapshot of all of the U.S. bear markets endured since the end of WWII, according to data from Yardeni Research. There have been 12, excluding the current bear market. The average duration of those 12 bear markets is about 12 months (367 days). The longest lasted 929 days (Tech Wreck spanning 2000-2002), while the shortest lasted 33 days (onset of COVID-19 Pandemic in Q1'20). The average price decline from the peak was 33.6%. The average price gain over the 12-months following the trough was 40.8%. On average, it has taken around 22 months to fully recover from a bear market, according to data from CNBC and Goldman Sachs.

What is the state of our current bear market? As of 9/30/22, it was 270 days and counting. A little more than three months shy of the 12-month average bear market since WWII. As of 9/30/22, the S&P 500 Index stood 25.25% below its all-time closing high posted on 1/3/22, according to Bloomberg. That is a little more than eight percentage points below the 33.6% average cited above. As of now, it qualifies as a modest bear market, in our opinion.

Suffice it to say, we would all like to know when this bear market will end. One of the things that has been lacking in the current bear market is capitulation, which means to surrender or give up. Some refer to it as throwing in the towel. In the stock market, it occurs when enough investors sell stock after losing hope that a rally could be in the offing. One of the more common methods for identifying capitulation is the Chicago Board Options Exchange Volatility Index, also know as the VIX. It is considered to be a decent gauge of fear in the equity markets. The higher the number on the VIX, the greater the level of volatility. For the 20-year period ended 9/30/22, the VIX averaged 19.49. A reading of 40 and above could signal that the market is finding a bottom, according to Business Insider. It has yet to reach the 40 mark in the current bear market.

Investors may also find it helpful to track the price-to-earnings (P/E) ratio on the S&P 500 Index. As of 10/11/22, Bloomberg projected a 2023 year-end P/E of 14.87. For comparative purposes, the index had a P/E multiple of 14.38 on 3/31/09, the quarter in which it bottomed back in the global financial crisis. Keep in mind, that 14.38 P/E reflected a much deeper bear market (see table). As of 9/30/22, the trailing 12-month P/E on the index stood at 17.57, slightly above its 50-year average of 17.23, but well below its 24.76 mark at the close of 2021, according to Bloomberg. While stocks are not cheap, valuations have come in a lot over the past few months.

It is times like these that truly test the resolve of investors. If you consider yourself to be an investor then be one. Stick to your plan. If possible, save some cash for when the turn in the market comes. The buy, hold and accumulate strategy has been successful over the long haul. There are still many headwinds plaguing the stock market today, including the potential for a weaker U.S. economy in 2023. Two events that could potentially lighten the load on the market would be an end to the war between Russia and Ukraine and to see China reopen its cities in lockdown combating COVID-19.

S&P 500 Index Bear Markets Since WWII

Bear Market Dates	# of Days	S&P 500 Price Decline (From Peak)	S&P 500 Price Gain (12 Mos. After Trough)
5/29/46-10/9/46	133	-26.6%	8.1%
6/15/48-6/13/49	363	-20.6%	42.1%
7/15/57-10/22/57	99	-20.7%	31.0%
12/12/61-6/26/62	196	-28.0%	32.7%
2/9/66-10/7/66	240	-22.2%	32.9%
11/29/68-5/26/70	543	-36.1%	43.7%
1/11/73-10/3/74	630	-48.2%	38.0%
11/28/80-8/12/82	622	-27.1%	58.3%
8/25/87-12/4/87	101	-33.5%	26.0%
3/24/00-10/9/02	929	-49.1%	33.7%
10/9/07-3/9/09	517	-56.8%	68.6%
2/19/20-3/23/20	33	-33.9%	74.8%
1/3/22-9/30/22	270*	-24.0%	?

Source: Bloomberg and Yardeni Research. Number of days includes weekends and holidays.
Bear market still in progress.* ***Past performance is no guarantee of future results.*

Some additional thoughts on bear markets...

While bear markets come and go for various reasons, the catalyst(s) involved in triggering them likely involve some form of serious excess over an extended period. As one might suppose, the catalyst(s) for exiting bear markets is likely to involve a strategy designed to either curb or eliminate said excess. Understandably, that takes time. One of the common threads linking most bear markets is an excess of capital targeting a specific niche of the economy.

In 1996, Federal Reserve ("Fed") Chairman Alan Greenspan coined the term "irrational exuberance" to describe the frenzy driving up the asset values of technology companies during the internet revolution. After the technology bubble burst in 2000, investors endured a lengthy and punishing bear market (see table). A similar scenario occurred a few years after the end of that bear market. It involved the subprime mortgage crisis, which surfaced in 2007. It later mushroomed into the 2008-2009 global financial crisis, which brought about an even more punishing, albeit less lengthy, bear market (see table).

We enter the Q4'22 in the midst of yet another bear market. This one is most certainly grounded in excess due to the trillions of dollars of monetary (Fed) and fiscal (Congress) stimulus injected into the U.S. financial system to help mitigate the fallout from the COVID-19 pandemic. The Fed has been aggressively tightening monetary policy since it began hiking short-term interest rates in March, 2022. The Fed will likely initiate even more rate hikes in the months ahead to lower the elevated rate of inflation stemming from the surge in the U.S. money supply, in our opinion. We are about to find out just how stubborn inflation is.

Again, nobody really knows when the current bear market will end. We could learn a great deal about the state of the business climate when companies report their Q3'22 earnings results. The stock market is a discounting mechanism that tends to forecast 6-9 months out to help determine where to position capital today. Investors should note that when attempting to time a market bottom in order to maximize an entry point said bottom may occur well in advance of the actual catalyst(s) credited with triggering it.

Continued

Bond yields are getting high enough where they could soon compete with stock returns

The benchmark U.S.10-year Treasury Note (T-note) hit an all-time closing low of 0.51% on 8/4/20. From 8/4/20 through 9/30/22, its yield rose to 3.83%. At the same time, the Consumer Price Index (CPI) surged from 1.3% on 8/31/20 to 8.2% as of 9/30/22. Once the Fed realized that inflation was not going to be transitory, it moved quickly to combat it. Since the first increase of the federal funds target rate (upper bound) in March, from 0.25% to 0.50%, the Fed has continued to tighten, hiking rates another 275 basis points (bps) between May and September. The Fed has also signaled that there will be more rate hikes to come.

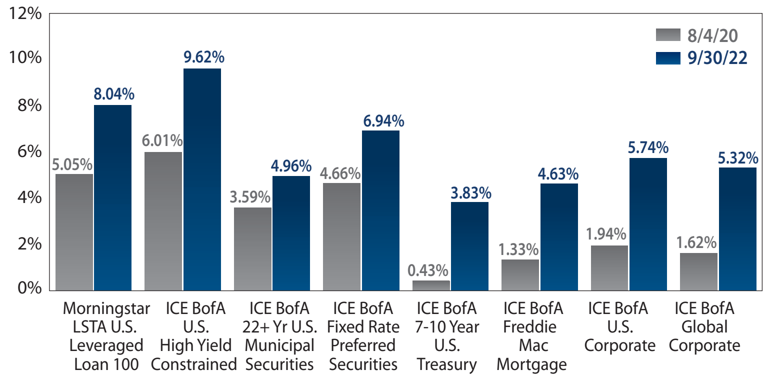
Over the same period, the yields on the major bond indices featured in the chart to the right are also up significantly. We believe that bond yields are now high enough to warrant investors putting them on their radar screens. Keep in mind, bond yields could continue to trend higher from here.

While you may or may not know, there is a debate going on as to whether or not the U.S. is already in recession. Regardless of which side of the argument you might take, there is a metric that has a history of accurately forecasting recessions 12-24 months after presenting itself.

This metric reveals the yield spread between the 2-year T-note and the 10-year T-note. When the yield of the 2-year T-note is higher than the yield on the 10-year T-note, the yield curve has become inverted, which is not normal. As of 9/30/22 the yield on the 2-year T-note was 45 bps higher than the yield on the 10-year T-note. Investors expect a higher rate of return for longer maturity bonds due to the time commitment. Over the past 30 years, the average yield on the 10-year T-note exceeded that of the 2-year T-note by 111 bps. Historically, an inverted yield curve has been analogous to a flashing yellow light (caution) with respect to the economy.

The Fed is not the only central bank raising interest rates. The World Bank reported that the number of announced interest rate increases by central banks around the globe in July was the highest on record, according to *The Wall Street Journal*. This collective effort in 2022 has helped reduce the amount of negative-yielding debt worldwide. As of 9/30/22, negative-yielding debt totaled $1.7 trillion, substantially lower than the $13.1 trillion outstanding the year before, as measured by the Bloomberg Global Aggregate Negative Yielding Debt Index.

Yield to Maturity on Bond/Loan Indices

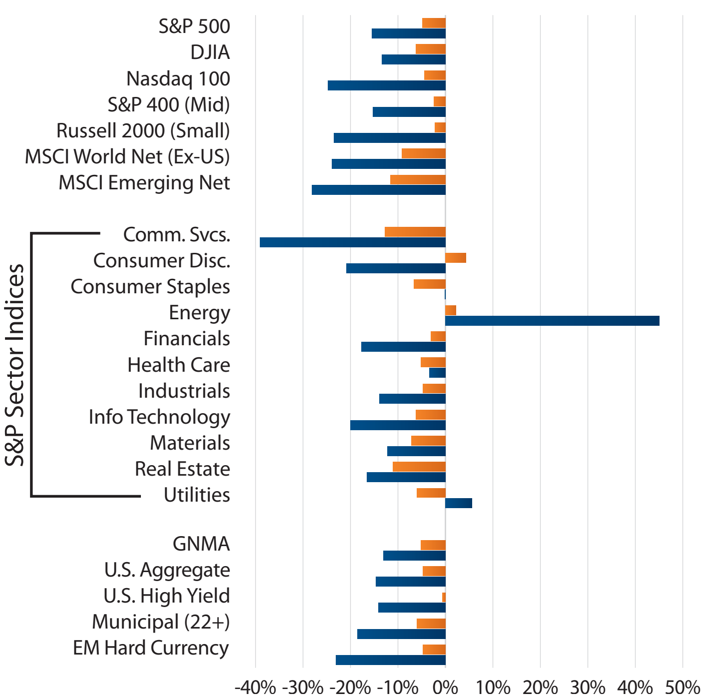


Source: Bloomberg. The Morningstar LSTA U.S. Leveraged Loan 100 Index reflects a weighted average yield. ***Past performance is no guarantee of future results.***

Most bond investors likely know that as yields rise bond prices fall. The following shows a comparison of the prices of the major bond indices in the chart as of 8/4/20 and 9/30/22: Morningstar LTSA U.S. Leveraged Loan 100 (94.48 vs. 91.71); ICE BofA U.S. High Yield Constrained (99.63 vs. 83.60); ICE BofA 22+ Yr U.S. Municipal Securities (112.32 vs. 88.57); ICE BofA Fixed Rate Preferred Securities (104.94 vs. 86.28); ICE BofA 7-10 Year U.S. Treasury (115.67 vs. 84.00); ICE BofA Freddie Mac Mortgage (107.54 vs. 86.17); ICE BofA U.S. Corporate (116.21 vs. 86.75); and ICE BofA Global Corporate (112.68 vs. 87.15), according to Bloomberg. With more Fed rate hikes expected, bond yields could move higher. That should translate into even better opportunities for investors, in our opinion.

Although inflation remains stubbornly high, opportunities are already taking shape. A lot of air has already been let out of the speculative bubbles in the markets. All of the major headwinds that investors have heard about over the past year or so have yet to be remedied. One of those potential headwinds is the upcoming election. If the Republicans win control of the House in November, we could see government gridlock dominate the last two years of the Biden administration. Hopefully, gridlock will rein in government spending.

Total returns for Q3 and past 12 months (9/30/22)



Sources: Bloomberg and Bloomberg Fixed Income Indices. ***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)	**Q4'22E**	Q4'21A	**Q1'23E**	Q1'22A	**2022E**	2021A
Communication Svcs. (8.1%)	**2.93**	3.13	**2.88**	2.79	**10.96**	12.44
Consumer Disc. (11.7%)	**11.63**	13.37	**11.44**	6.07	**38.02**	45.29
Consumer Staples (6.9%)	**8.89**	8.90	**8.90**	8.38	**34.44**	35.12
Energy (4.5%)	**19.05**	12.52	**17.37**	14.09	**79.66**	31.08
Financials (11.0%)	**10.99**	16.06	**11.92**	10.78	**35.65**	59.26
Health Care (15.1%)	**22.22**	18.86	**23.64**	20.12	**84.77**	78.09
Industrials (7.9%)	**11.41**	8.49	**10.22**	7.71	**41.06**	31.88
Information Tech. (26.4%)	**29.99**	27.05	**27.06**	24.65	**100.17**	93.50
Materials (2.5%)	**8.35**	7.92	**7.96**	9.07	**35.91**	30.52
Real Estate (2.8%)	**1.63**	2.37	**1.76**	2.05	**7.31**	8.00
Utilities (3.1%)	**3.34**	2.75	**4.78**	4.57	**16.44**	15.27
S&P 500 Index	**57.37**	56.73	**56.75**	49.36	**208.75**	208.20
S&P MidCap 400 Index	**46.79**	45.89	**48.43**	39.40	**177.88**	153.84
S&P SmallCap 600 Index	**24.01**	25.80	**23.23**	14.28	**83.49**	74.25

Source: S&P Dow Jones Indices (9/29/22). Sector weightings as of 9/30/22.
There is no guarantee past trends will continue or projections will be realized.