First Trust — *Quarterly Market Overview*

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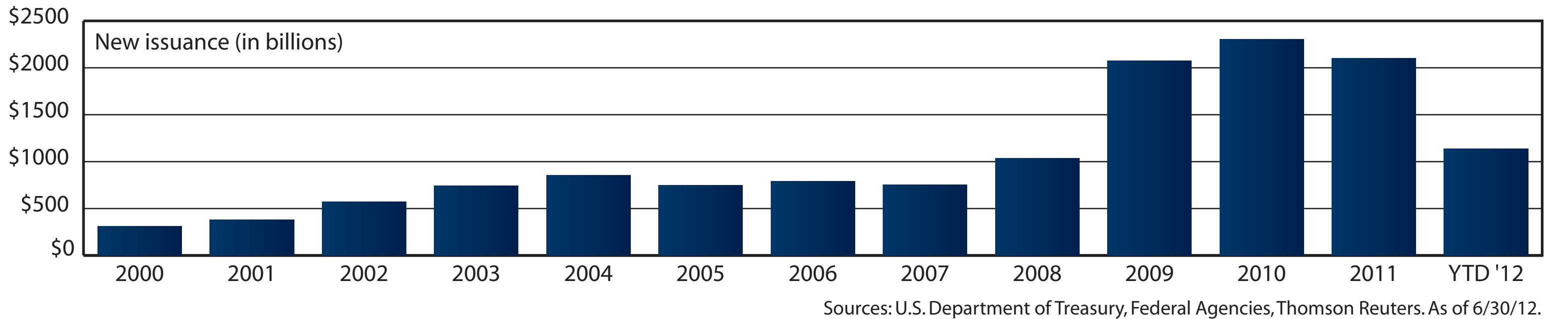
Mr. Carey has appeared throughout the United States and Canada as a guest on television and radio programs. These programs include: Bloomberg TV, CNBC and on Chicago's WBBM Newsradio 780's Noon Business Hour. He has been quoted by several publications, including *The Wall Street Journal, The Wall Street Reporter, Bloomberg News Service, and Registered Rep.*

Misconceptions Can Sometimes Lead To Costly Mistakes When Investing

For our 50th issue of the *Quarterly Market Overview,* we thought it would be worthwhile to focus on the importance of getting the story straight, or at least as accurate as possible, before executing an investment transaction or asset allocation. Like it or not, thanks to the Internet, we live in a 24/7 news cycle where traditional media outlets now have to compete with bloggers and anyone holding a cellphone that can snap a picture. While it is nice to get the news in real time, the need for speed on the information superhighway can lead to incomplete or erroneous reporting. Look no further than the current election campaign season where the finger pointing has already started between President Obama and Mitt Romney. Good thing the Internet has also brought us some fact-checkers to help sort things out. Helping to sort things out is what we strive to do for our clients, as well. Two of the most common themes we find with misconceptions is that they are often linked to important events and those events sometimes trigger a recency bias. Recency bias essentially involves acting on the most recent data or trend rather than incorporating the new information into a broader historical perspective.

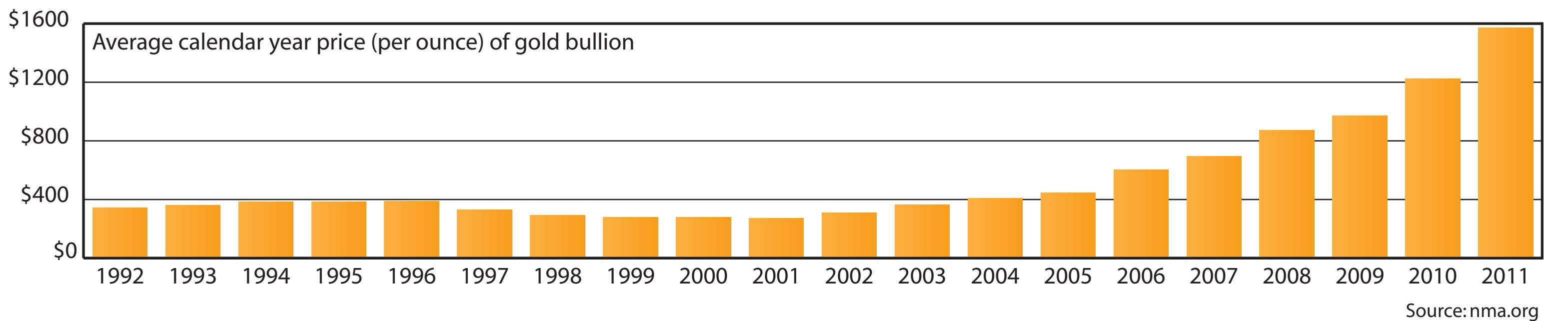
Example #1: My love/hate relationship with government debt won't come back to bite me!



Sources: U.S. Department of Treasury, Federal Agencies, Thomson Reuters. As of 6/30/12.

Normally, a big increase in supply brings higher yields, but it hasn't happened yet. The supply of new issue Treasuries noticeably increased in 2008 and then surged in subsequent years in response to the global financial crisis ("The Event"). The amount of new paper issued in just the first half of 2012 ($1.14 trillion) was double the $571.6 billion in total issuance in 2002. Suffice it to say that a good % of investors, both here and abroad, purchased much of this debt in an attempt to mitigate the numerous risks around the globe (the Fed's even buying Treasuries), particularly the debt crisis in Europe (Event #2). One of the main misconceptions inherent in this story, however, is that the medicine (quantitative easings by the Fed) used to treat the underlying illness (economic weakness) may have helped to some degree thus far, but the potential side effects from the burgeoning debt load may prove just as debilitating down the road.

Example #2: Gold bullion will continue to rise in price since the global supply is relatively small and risks abound!



Source: nma.org

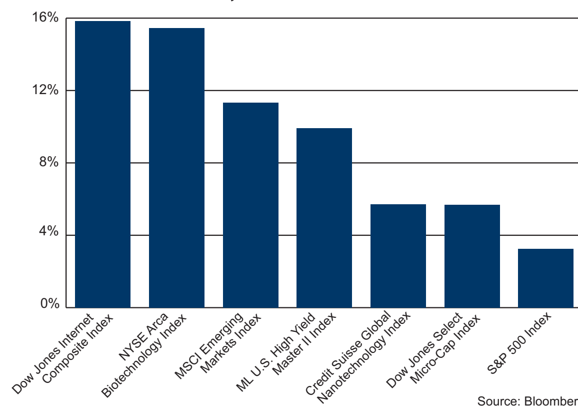
In the early 1990s, a gold analyst noted that one day we will wake up and find that bullion has started to rally and there is a good chance we won't even know why. Today, there are still many pundits touting the upside potential for the price of gold bullion. The introduction of ETFs that track the precious metal make it easier to buy. Many of the event risks currently tracked by investors throughout the globe are similar, if not extensions of the ones feared in the 1990s (think 1st Iraq war and 1993 terrorist attack on the World Trade Center), when the price of gold traded within a relatively narrow range. In fact, even production cuts couldn't drive its price higher when it was costing $320 to $340 an ounce to mine it in parts of South Africa. One of the main misconceptions about gold is the demand for it. Roughly 70% comes from jewelry. As the analyst insinuated, be humble and wise enough to admit it when you just don't or can't know.

Continued

So Much For The Idea Of Dodging Risk

Somebody apparently didn't get the memo. It's the one that told investors they needed to "run for cover." They needed to do so because of such punishing events as two deep bear markets in the span of a decade, the bursting of two scandal-induced bubbles (Internet and Mortgages), two lengthy wars and a scary "Flash Crash" on May 6, 2010. Well, we believe we know who didn't get the memo and it's institutional investors. The so-called "smart money." This used to be the group that the retail investor would follow into battle, sometimes getting into rallys late and paying a price for it. But the retail investor, on the whole, isn't following the smart money in the current bull market. Data from the Investment Company Institute clearly shows that, from the start of 2007 through May 2012 (65 months), investors pulled a net $345.3 billion dollars from equity mutual funds (a proxy for retail investors' money), while funneling $1.0 trillion (net) into bond mutual funds. We included the chart to the right to show investors that the equities markets, as well as the speculative-grade bond market, still reflect the expected risk/reward dynamic over time.

10-Year Price-Only Annualized Returns *(6/29/12)*



Some *50/50* Portfolio Pairings Worth Consideration

Senior Loans & High Yield Corporate Bonds

Corporate earnings are robust enough to justify taking on the credit risk associated with senior loans and high yield corporate bonds. The 2012 and 2013 earnings estimates for the S&P 500 are 7.6% and 13.9%, respectively, according to S&P. Both of these asset classes are speculative-grade in nature, and defaults are down. The interest paid by senior loans fluctuates over time (floats) based on the direction of the 3-Mo. Libor rate, which tends to track the fed funds rate. With investment-grade interest rates at historically low levels, the idea is to pair a floating rate vehicle with a fixed rate to boost income and shorten duration.

Cloud Computing & Biotechnology

While this may not seem like a match, it is, in our opinion, if you take a step back to see the forest for the trees. What do these two have in common beyond technology? Both are believed to be on the cusp of surpassing their predecessors. Cloud computing companies (outsourcing IT) are competing hard with the more established companies from the past 15 years, also known as "old" tech. Biotechnology companies have established themselves as the cutting edge for new drugs. Biotech firms have such a deep pipeline of potential products that big pharma is either acquiring them or forging licensing agreements with them.

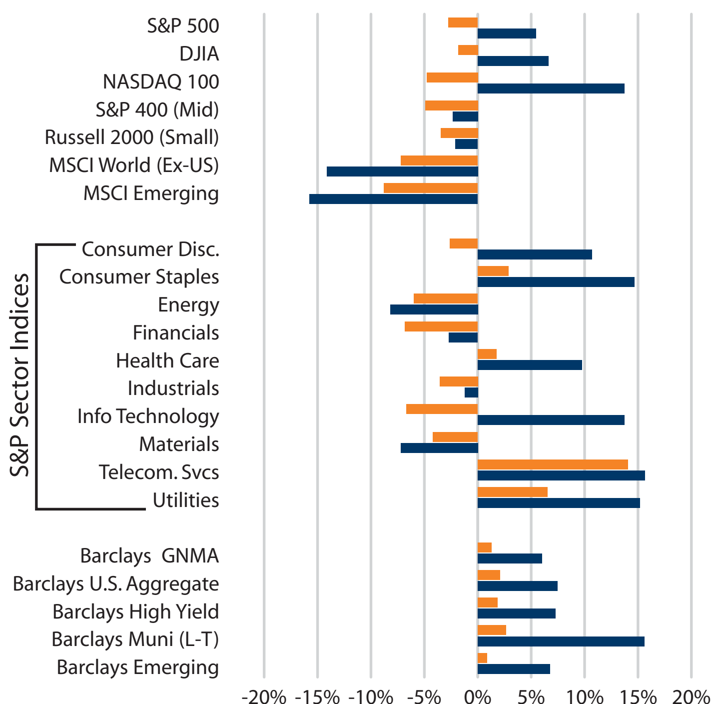
Energy MLPs & Energy Stocks

Master Limited Partnerships (MLPs) essentially provide investors the opportunity to invest in the distribution and storage sides of the oil and gas business. MLPs are structured as partnerships and, assuming compliance with applicable tax regulations, do not pay income taxes. Taxes are typically incurred at the shareholder level. The performance of MLPs tend to be driven more by the demand for energy than the price of the commodity. The greater the demand for oil and gas the higher MLP distributions can potentially go. Pairing the distribution side with the exploration and production side could make for a well-rounded approach.

Equity REITs & Homebuilders

REITs have been one of the best performing asset classes worldwide since the end of the bear market. The FTSE NAREIT Equity REITs Index posted a cumulative total return of 245.6% from 3/9/09 through 6/29/12. Even after factoring in how far equity REITs have rallied, the index's price value on 6/29 was still 25.7% below its 10-year high. Homebuilders look like they are just beginning to turn the corner. The National Association of Home Builders/Wells Fargo builder sentiment index surged six points to 35 in July, the highest reading since March 2007. The S&P Homebuilding Select Index's price value is roughly 60% below its 5-yr. high.

Total returns for Q2 and past 12 months (6/29/12)



A Look Ahead:

The outlook for earnings (year-over-year comparison in $)...

	Q3'12E	Q3'11A	**Q4'12E**	Q4'11A	**2012E**	2011A
Financials	**4.20**	4.48	**4.51**	4.05	**16.59**	16.23
Information Technology	**9.08**	7.32	**11.35**	9.26	**37.19**	31.44
Health Care	**8.60**	7.70	**8.55**	7.40	**34.00**	31.08
Consumer Staples	**5.73**	5.51	**5.89**	5.56	**22.14**	21.38
Consumer Discretionary	**5.60**	5.18	**6.52**	5.58	**22.21**	20.81
Industrials	**6.12**	5.44	**6.32**	5.42	**23.89**	20.96
Telecom. Services	**1.89**	1.95	**1.52**	1.21	**7.19**	6.85
Energy	**11.81**	14.11	**12.14**	10.04	**47.39**	47.94
Utilities	**4.21**	4.13	**2.58**	2.32	**12.85**	12.47
Materials	**3.92**	3.92	**3.84**	1.87	**16.61**	16.20
S&P 500 Index	**26.31**	25.29	**28.00**	23.73	**103.73**	96.44
S&P 400 Index (Mid-Cap)	**15.91**	13.23	**16.65**	13.36	**59.86**	50.31
S&P 600 Index (Small-Cap)	**6.68**	5.26	**7.20**	5.23	**25.06**	20.59

Source: Standard & Poor's (7/5/12)