ETFs with the Potential for Capturing the "New Listing" Premium

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Summary of Q2 2019 ETF Flows and Trends[1]

- Total US-listed ETF assets reached $3.99 trillion at the end of Q2 2019, a 12.8% year-over-year increase. Estimated net asset flows in Q2 2019 totaled $80 billion, slightly above the prior four quarter average of $74 billion.
- Taxable Bond ETFs received the strongest estimated net inflows in Q2 2019, totaling $39 billion, the strongest quarterly estimated net inflows for the category on record. Municipal Bond ETFs received $2.3 billion in estimated net inflows in Q2 2019, increasing year-over-year assets by 27%.
- US Equity ETFs received the second highest estimated net inflows with $37 billion, bringing the category's year-over-year increase in total assets to 16%. The narrower Sector Equity ETFs category saw estimated net inflows of $510 million, reversing the estimated net outflows of the two previous quarters.
- International Equity ETFs received $1.6 billion in estimated net inflows, increasing year-over-year assets by 5%.
- Alternative and Allocation ETFs had estimated net outflows of $0.5 billion and $0.2 billion, respectively, in Q2 2019.

Table 1

	Total US-Listed ETF Assets		Estimated Net Asset Flows	
US Category Group	**As of 6/30/2019**	**Year-over-year % change**	**Q2 2019**	**Prior Quarter (Q1 2019)**
US Equity	$1,895,779,185,214	15.7%	$36,763,250,734	$16,725,649,082
International Equity	$749,762,285,580	5.2%	$1,599,757,911	$7,334,780,577
Taxable Bond	$719,553,198,744	24.6%	$38,586,048,980	$33,663,467,203
Sector Equity	$447,820,090,188	0.4%	$510,417,052	($5,170,278,745)
Commodities	$70,069,572,240	2.7%	$793,777,189	($766,607,783)
Alternative	$51,311,967,456	5.7%	($521,997,173)	$1,144,796,342
Municipal Bond	$40,748,261,010	26.6%	$2,258,052,002	$1,096,533,848
Allocation	$12,601,458,483	-1.2%	($191,694,601)	($999,957,581)
Total	$3,987,646,018,915	12.8%	$79,797,612,094	$53,028,382,943

Source: Morningstar, as of 6/30/19. Includes all US-listed exchange-traded funds, exchange-traded notes and other exchange-traded products. All net inflow and outflow numbers are estimates based on information provided by Morningstar.

Initial public offerings, or IPOs, often generate significant media attention, largely due to the outsized returns that may occur on a stock's first trading day. New listings tend to favor innovative and potentially disruptive stocks that intrigue investors. But beyond the initial excitement of new listings is another investment story that has received much less attention. During the first three or four years of aftermarket trading, IPOs and spin-offs have often exhibited distinct return characteristics that may provide opportunities for investors seeking to outperform the broader equity market.

Below, we take a closer look at three First Trust ETFs which seek to exploit the unusual pattern of returns for new listings, examining some of the distinct performance drivers for these stocks, and how investment advisors may consider utilizing these funds.

Skewed Aftermarket Performance

Simply put, apart from the first trading day, most new IPOs and spin-offs have tended to perform rather poorly during their first few years; however, average returns for the group have been quite strong. This divergence is explained by the strong performance of leading stocks, which has more than compensated for the poor performance of laggards. Thus, a diversified approach that captures the "average"—a "new listing" premium—may be desirable, even while the likelihood of choosing individual winners is relatively low.

IPOX Schuster studied the aftermarket performance of over 5,000 IPOs and spin-offs that began trading in the US from 1985 to 2018 (See Table 2 and Chart 1 on the following page). They found that after 12, 24, 36, and 48 months (excluding the first trading day), over half the stocks in the universe had generated negative returns. At the end of 48 months, the median cumulative return was -19.8%. However, over each of these time periods, average returns were significantly better, with cumulative gains reaching +42.5% after 48 months. According to IPOX Schuster, a similar pattern can be observed outside the US as well.

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Past performance is not a guarantee of future results and there is no assurance that the events or improvements mentioned herein will continue.

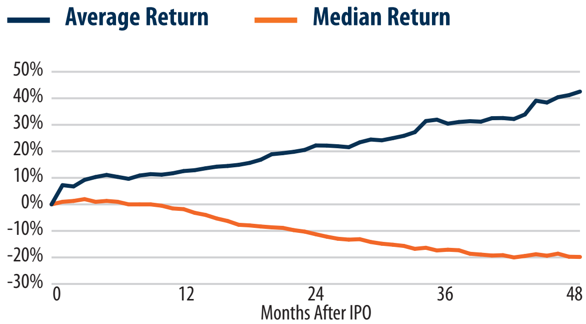
One challenge for investors seeking to pick only the best recent IPOs and spin-offs is the relative lack of information known about newly listed stocks compared to those that have been publicly traded for a longer period. As the number of research analysts covering new listings grows, and as management teams attempt to perform in the public eye, this information gap narrows, and the return dispersion between these stocks grows.

Hence, we believe investors are better off owning a diversified portfolio of recent IPOs and spin-offs—seeking to achieve "average" returns—rather than attempting to handpick a small number of these stocks.

Table 2: Aftermarket Performance (%) of IPOs and Spin-offs in the US (1985-2018)[2]

	Month 1	Month 3	Month 12	Month 24	Month 36	Month 48
(Median)	1.0	2.0	-1.8	-11.3	-17.1	-19.8
Average	7.3	9.2	12.6	22.2	30.4	42.5
(% Negative)	44.6	46.1	51.0	55.0	56.7	57.5

Chart 1: U.S. New Listing Performance (1985-2018)[2]



Three Strategies for Investing in IPOs & Spin-offs

Investors seeking diversified exposure to a portfolio of recent IPOs and spin-offs have three options among the First Trust lineup of ETFs. The most seasoned of these is the First Trust US Equity Opportunities ETF (FPX), which tracks the IPOX®-100 U.S. Index. This index is comprised of 100 of the largest recent IPOs and spin-offs domiciled in the US that have begun trading over the prior 1,000 trading days (approximately four years). For those seeking exposure outside the US, the First Trust International Equity Opportunities ETF (FPXI) invests in 50 of the largest new listings internationally, and the First Trust IPOX® Europe Equity Opportunities ETF (FPXE) invests in 100 of the largest new listings in Europe.

Fertile Ground for M&A Activity

Mergers & acquisitions (M&A) have been a distinct driver of returns for recent IPOs and spin-offs in recent years, according to IPOX Schuster. Over the past 10 years, nearly 18% of the US IPOs tracked by IPOX Schuster were acquired within the first four years of trading, many at significant premiums to the stock's pre-announcement market price.[3]

One recent example was the acquisition of electronic payment provider First Data—a stock that had its IPO in October 2015—by Fiserv, in an all-stock deal consummated in July 2019 at an 81% premium to First Data's closing price prior to the deal's January 2019 announcement.[4] Another example was the acquisition of US biotechnology company AveXis—a stock which had its IPO in February 2016—by Swiss pharmaceutical Novartis. This deal was consummated in May 2018 at an 88% premium to AveXis's pre-announcement closing price.[5] Because recent IPOs and spinoffs are often at the forefront of growth and innovation in their respective industries, we expect them to remain attractive targets for M&A activity.

Beyond Broad Benchmarks

Many broad benchmark indices require new listings to trade for a period of time before becoming index eligible. This provides another distinct source of potential performance for investment strategies—such as the aforementioned three ETFs—that can invest in stocks before they are added to broad benchmark indices. One prominent example for FPX was its addition of Facebook in September 2012, well before it was added to the S&P 500 Index in December 2013. During this period, Facebook gained roughly 150%, providing a significant source of outperformance for the ETF.[6]

More recently, FPX captured strong returns from cybersecurity provider Zscaler, which went public in March 2018. The stock had a total return of 95% through the first six months of 2019, yet remains excluded from the S&P 500 Index despite having a larger market cap than 94 of the current index constituents.[6]

Where Do These Strategies Fit?

Over the years, investment professionals have utilized FPX, FPXI, and (more-recently) FPXE in a variety of ways. One popular strategy has been to pair these ETFs with complementary funds that are positioned to perform well in different market environments. For example, FPX has often been combined with the more defensively postured First Trust Value Line® Dividend Index Fund (FVD). Others have utilized these ETFs to expand the breadth of their underlying portfolio holdings beyond those of broad benchmarks. Still others have used these ETFs as substitutes for traditional large-cap growth funds, or even as a more liquid, low-cost alternative to private equity deals, as many large IPOs are private equity-backed.

[1]Based on Morningstar data, as of 6/30/19. Includes all US-listed exchange-traded funds, exchange-traded notes, and other exchange-traded products.

[2]Source: IPOX Schuster LLC. Past performance is not a guarantee of future results. Performance data excludes initial day of trading. Initial average return was 21.8%, initial median return was 9.1%.

[3]Source: IPOX Schuster LLC.

[4]Source: United States Securities and Exchange Commission; Form 8-K; First Data Corporation; January 16, 2019.

[5]Source: United States Securities and Exchange Commission; Form 8-K; Avexis, Inc.; April 6, 2018.

[6]Source: Bloomberg.

Reference to specific securities is for informational purposes only and is not a recommendation to buy or sell such securities, nor should they be assumed profitable.

Performance

The track record of the highlighted three ETFs has been relatively strong, providing significant outperformance versus broad benchmark indices. The US-focused FPX has outperformed the S&P 500 Index by over 3% per year on an annualized basis, since the fund's inception (4/12/2006). The international-focused FPXI has outperformed the MSCI World Ex-USA Index by over 1.5% per year on an annualized basis, since the fund's inception (11/4/2014). And the European-focused FPXE has outperformed the MSCI Europe Index by 1.9% since its inception (10/4/2018). Year-to-date, as of 6/28/19, FPX, FPXI, and FPXE have outperformed their benchmarks by 7.3%, 4.6%, and 6.8%, respectively.

For many, IPOs are regarded as tools for short-term speculation. Success or failure is judged by how well a stock performs on its initial trading day. But this perspective obscures some of the unique and potentially beneficial characteristics of recent listings, in our view. For investors seeking to gain exposure to the longer-term benefits of these stocks, and the new listing premium, we believe these three ETFs provide an unemotional, rigorous, and disciplined approach.

Performance Summary (%)

As of 6/28/19	Inception Date	Net Expense Ratio	Gross Expense Ratio	3 Month	YTD	1 Year	5 Year	10 Year	Since Fund Inception
FPX Performance*	4/12/06	0.59%	0.59%						
FPX Net Asset Value (NAV)				4.30	25.81	9.73	10.91	18.29	11.75
FPX Market Price				4.26	25.89	9.67	10.91	18.39	11.75
IPOX-100 U.S. Index**				4.45	26.14	10.31	11.49	18.98	12.40
Russell 3000® Index**				4.10	18.71	8.98	10.19	14.67	8.63
S&P 500 Index**				4.30	18.54	10.42	10.71	14.70	8.71
FPXI Performance*	11/4/14	N/A	0.70%						
FPXI Net Asset Value (NAV)				4.66	19.19	5.57	N/A	N/A	5.59
FPXI Market Price				4.50	19.45	5.26	N/A	N/A	5.50
IPOX International Index**				4.95	19.89	6.51	N/A	N/A	6.40
MSCI World ex USA Index**				3.79	14.64	1.29	N/A	N/A	4.06
FPXE Performance*	10/4/18	N/A	0.70%						
FPXE Net Asset Value (NAV)				7.73	22.59	N/A	N/A	N/A	4.66
FPXE Market Price				7.56	22.43	N/A	N/A	N/A	4.72
IPOX 100 Europe Index**				8.29	23.91	N/A	N/A	N/A	5.79
MSCI Europe Index**				4.48	15.80	N/A	N/A	N/A	2.76

Performance data quoted represents past performance. Past performance is not a guarantee of future results and current performance may be higher or lower than performance quoted. Investment returns and principal value will fluctuate and shares when sold or redeemed, may be worth more or less than their original cost. You can obtain performance information which is current through the most recent month-end by visiting www.ftportfolios.com.

***NAV** returns are based on the fund's net asset value which represents a fund's net assets (assets less liabilities) divided by a fund's outstanding shares. **Market Price** returns are based on the midpoint of the bid/ask spread on the stock exchange on which shares of a fund are listed for trading as of the time that a fund's NAV is calculated. Returns are average annualized total returns, except those for periods of less than one year, which are cumulative. FPX's performance reflects fee waivers and expense reimbursements, absent which performance would have been lower. Expenses are capped contractually at 0.60% per year, at least until April 30, 2020 for FPX.

Performance information for the indexes is for illustrative purposes only and does not represent the performance of any actual investment or fund. Indexes do not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Indexes are unmanaged and an investor cannot invest directly in an index. The **Russell 3000® Index** is comprised of the 3000 largest and most liquid stocks based and traded in the U.S. The **S&P 500 Index** is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. The **MSCI World Index Ex-U.S.** includes developed markets and is designed to provide a broad measure of stock performance throughout the world, with the exception of U.S.-based companies. The **MSCI Europe Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of 16 developed markets in Europe.

You should consider a fund's investment objectives, risks, and charges and expenses carefully before investing. Contact First Trust Portfolios L.P. at 1-800-621-1675 or visit www.ftportfolios.com to obtain a prospectus or summary prospectus which contains this and other information about a fund. The prospectus or summary prospectus should be read carefully before investing.

ETF Characteristics

A fund's return may not match the return of its underlying index. Securities held by a fund will generally not be bought or sold in response to market fluctuations.

Investors buying or selling fund shares on the secondary market may incur customary brokerage commissions. Market prices may differ to some degree from the net asset value of the shares. Investors who sell fund shares may receive less than the share's net asset value. Shares may be sold throughout the day on the exchange through any brokerage account. However, unlike mutual funds, shares may only be redeemed directly from the fund by authorized participants, in very large creation/redemption units. If the fund's authorized participants are unable to proceed with creation/redemption orders and no other authorized participant is able to step forward to create or redeem, fund shares may trade at a discount to the fund's net asset value and possibly face delisting.

Risk Considerations

A fund's shares will change in value, and you could lose money by investing in a fund. One of the principal risks of investing in the fund is market risk. Market risk is the risk that a particular stock owned by a fund, fund shares or stocks in general may fall in value. There can be no assurance that a fund's investment objective will be achieved.

A fund may invest in securities issued by companies concentrated in a particular industry. A fund may invest in small capitalization and mid capitalization companies. Such companies may experience greater price volatility than larger, more established companies.

The stocks of companies that have recently conducted an initial public offering are often subject to price volatility and speculative trading. These stocks may have exhibited above-average price appreciation in connection with the initial public offering prior to inclusion in a fund. The price of stocks included in a fund may not continue to appreciate and their performance may not replicate the performance exhibited in the past.

An investment in a fund containing securities of non-U.S. issuers is subject to additional risks, including currency fluctuations, political risks, withholding, the lack of adequate financial information, and exchange control restrictions impacting non-U.S. issuers. These risks may be heightened for securities of companies located in, or with significant operations in, emerging market countries. The fund may invest in depositary receipts which may be less liquid than the underlying shares in their primary trading market.

FPXE is subject to greater risks of adverse events which occur in the European region and may experience greater volatility than a fund that is more broadly diversified geographically. A significant number of countries in Europe are member states in the European Union, and the member states no longer control their own monetary policies. In these member states, the authority to direct monetary policies, including money supply and official interest rates for the Euro, is exercised by the European Central Bank. The United Kingdom's referendum on June 23, 2016 to leave the European Union (known as "Brexit") sparked depreciation in the value of the British pound, short-term declines in the stock markets and heightened risk of continued economic volatility worldwide.

The economy of China differs, often unfavorably, from the U.S. economy in such respects as structure, general development, government involvement, wealth distribution, rate of inflation, growth rate, allocation of resources and capital reinvestment, among others. The central government has historically exercised substantial control over virtually every sector of the Chinese economy through administrative regulation and/or state ownership. Actions of the Chinese central and local government authorities continue to have a substantial effect on economic conditions in China. Furthermore, China's economy is dependent on the economies of other Asian countries and can be significantly affected by currency fluctuations and increasing competition from Asia's other emerging economies.

FPXI is subject to certain risks associated specifically with Hong Kong, including Hong Kong's political and economic environment and the volatility of and the concentration of real estate companies listed on the Hong Kong Stock Exchange. Because of Hong Kong's reversion to China, any increase in uncertainty as to the economic and political status of Hong Kong or a deterioration of the relationship between China and the U.S. could have negative implications on stocks listed on the Hong Kong Stock Exchange. Securities prices on the Hong Kong Stock Exchange can be highly volatile and are sensitive to developments in Hong Kong and China, as well as other world markets.

As the use of Internet technology has become more prevalent in the course of business, a fund has become more susceptible to potential operational risks through breaches in cyber security.

Changes in currency exchange rates and the relative value of non-U.S. currencies will affect the value of a fund's investments and the value of fund shares.

Certain funds currently has fewer assets than larger funds, and like other relatively new funds, large inflows and outflows may impact the fund's market exposure for limited periods of time.

The funds are classified as "non-diversified" and may invest a relatively high percentage of its assets in a limited number of issuers. As a result, the funds may be more susceptible to a single adverse economic or regulatory occurrence affecting one or more of these issuers, experience increased volatility and be highly concentrated in certain issuers.

First Trust Advisors L.P. is the adviser to the funds. First Trust Advisors L.P. is an affiliate of First Trust Portfolios L.P., the funds' distributor.

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