William Housey, CFA

Senior Vice President, Senior Portfolio Manager

William has 22 years of investment experience and has extensive experience in the portfolio management of both leveraged and unleveraged credit products, including senior loans, high-yield bonds, credit derivatives (CDS/LCDS) and work-outs/corporate restructurings. Prior to joining First Trust, William served as Executive Director and Co-Portfolio Manager at Van Kampen Funds, Inc., a wholly-owned subsidiary of Morgan Stanley ("Morgan Stanley/Van Kampen"), where he was a Portfolio Manager of institutional structured products and a Senior Analyst. William previously managed two collateralized loan obligations (CLOs) and an unlevered comingled institutional fund.

MARKET OVERVIEW - FIXED INCOME

We believe that after some consolidation in interest rates after the substantial move that occurred in the first quarter, interest rates will begin to move higher again to better reflect the recovery and acceleration in the U.S. economy. We expect the technical factors weighing on interest rates to subside as global growth accelerates.

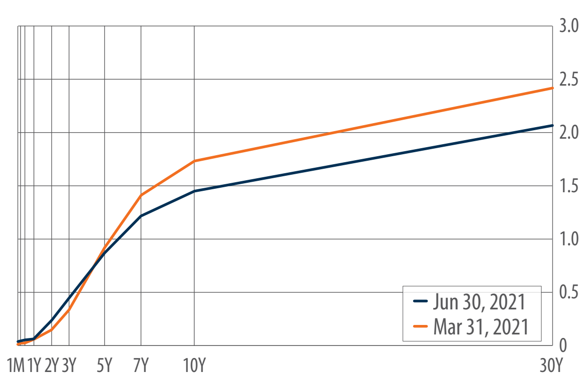
Longer-term U.S. Treasury demand has been supported by institutional foreign buyers, given the compelling yield levels in the U.S. relative to very low, even negative, foreign yields and institutional investors and pensions have been rebalancing portfolios. In the 2nd quarter, the yield curve flattened from 158 basis points ("bps") at the end of March to 120 bps on June 30th as the 2-year rose 9 bps to 0.25% and the 10-year Treasury decreased from 1.74% to 1.45% (see Chart 1).

The Fed remains committed to maintaining the fed funds rate and asset purchases at current levels while all survey members expect no rate hikes this year, however there was a noticeable hawkish shift as they now appear willing to begin talking about tapering its Quantitative Easing program. The "dot" plot now indicates Fed expectations for two, 25 bps hikes in 2023 bringing the Fed more in-line with market expectations for policy rates (see Chart 2). At the June meeting, the Fed increased their projection for GDP growth this year to 7.0% and maintained the unemployment projection at 4.5%. Concurrently, the Fed increased the PCE inflation projection from 2.4% to 3.4% by the end of this year followed by a reversion to 2.1% in 2022.

The labor market added 278,000 and 559,000 jobs in April and May, both softer than expectations but followed up with an additional 850,000 in June while the unemployment rate declined from 6.1% to 5.9% by June 30th. Job openings are stronger than ever, and we expect the recovery in employment to accelerate after the extended unemployment benefits expire in September. Oil increased over 20% for yet another quarter ending June over $73.00.

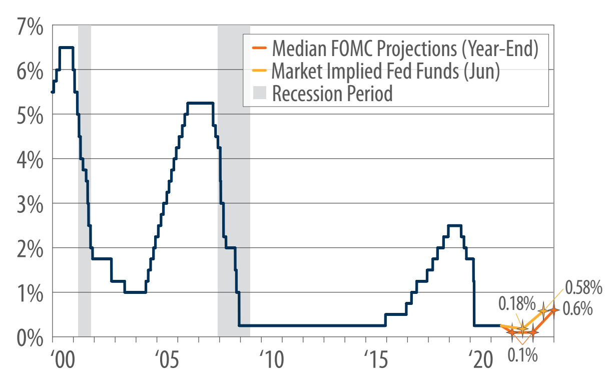
Fundamentals across the fixed income landscape continue to be strong, credit spreads have tightened, and valuation metrics remain elevated. We believe continued economic growth will support credit spreads and yield curve flattening affords an opportunity to take some profits in longer term assets.

CHART 1: U.S. TREASURY YIELD CURVE (%)



Source: FactSet Interest Rate Database

CHART 2: U.S. FEDERAL FUNDS TARGET RATE



Source: FactSet, Bloomberg, FOMC, 9/2000 – 6/2021
Projections from 7/2021 – 12/2023

There can be no assurance that any of the trends and projections cited herein will continue or come to fruition.

Definition: Duration is a measure of the weighted average life of a bond, which takes into account the maturity of each payment of a bond including coupons and the final maturity payment. The value of longer duration bonds are more sensitive to interest rate changes than shorter duration bonds.

ASSET CLASS VIEWS AND RATIONALE

DURATION POSITIONING

Favor a Short Duration Position vs. Broad Fixed Income Market

During the June meeting, the FOMC maintained the target range for the federal funds rate at 0.00 – 0.25% and confirmed they will continue to increase their holding of Treasury securities by at least $80 billion per month and of agency mortgage-backed securities by at least $40 billion per month. Despite that commitment, there was a noticeable hawkish shift. The Fed now appears willing to begin talking about tapering its QE program and, while all 18 survey participants still expect no increases in the Federal Funds Rate in 2021, several moved their expectations forward and the median is now projecting two 25 basis point hikes in 2023. The Fed increased its projection for GDP growth to 7.0% while expecting unemployment to decline to 4.5% by the end of this year and increased the PCE inflation estimate to 3.4% by year end. The yield curve flattened in the 2nd quarter as longer-term yields, after surging in the first quarter, declined despite higher than expected inflation readings. Longer term U.S. Treasury demand has been supported by institutional foreign demand given the compelling yield levels in the U.S. relative to very low, even negative, foreign yields while institutional investors and pensions have been rebalancing portfolios following strong equity performance.

We expect the technical factors weighing on interest rates to subside as global growth accelerates. Moreover, despite softer than anticipated employment gains in April and May, job openings are stronger than ever, and we expect the recovery in employment to accelerate after the extended unemployment benefits expire in September. Moreover, the U.S. financial system remains flooded with liquidity from unprecedented fiscal and monetary stimulus, economic growth is robust, and the Fed is now talking about tapering bond purchases while moving forward expectations for lift-off. We believe that after some consolidation in interest rates after the substantial move that occurred in the first quarter, interest rates will begin to move higher again to better reflect the recovery and acceleration in the U.S. economy.

Fundamentals across the fixed income landscape continue to be strong, credit spreads have tightened, and valuation metrics remain elevated. We believe continued economic growth will support credit spreads and yield curve flattening affords an opportunity to take some profits in longer term assets. We expect the path of interest rates to be higher and that investors will benefit from shorter durations.

SECTOR POSITIONING

Ultra-Short Maturity

As interest rates increase, we believe ultra-short securities will exhibit lower volatility than other fixed income sectors while offering the potential for enhanced income relative to cash. However, yields on these securities have remained near historic lows given the Fed's actions to keep short term rates near 0%.

Mortgage-Backed Securities

We maintain exposure to agency mortgage-backed securities (MBS) because we believe they have limited credit risk and can reduce risk profiles given lower expected volatility and a lower correlation to corporate credit. Generic agency MBS would be expected to come under pressure when the Fed begins tapering MBS asset purchases. While MBS valuation levels are elevated and duration extension is a concern, we continue to actively manage this risk and have increasingly allocated to sub sectors within MBS that offer income and duration risk management opportunities. Within the MBS sector, CMBS appear to have attractive valuations relative to investment grade corporate credit valuations on a historical basis.

Senior Loans

Investor inflows into senior loan funds have continued for six months after over two years of outflows. We believe the economic reopening, lower default rates, higher commodities and a strong consumer paired with our expectations of a steepening yield curve should benefit senior loans. While senior loan prices and spreads have continued to tighten, we believe the income characteristics and return potential of senior loans appear favorable to investment grade and high yield bonds.

High Yield Bonds

High yield bonds are expected to benefit from improving fundamentals as the economic reopening is under way. Default rates are falling, commodity prices are up, and the consumer is strong. Valuations are very tight, but the income characteristics of high yield bonds appear attractive relative to higher rated credit. Economic growth is expected to support credit fundamentals and we believe the relatively short duration of the asset class is attractive in a rising rate environment.

Emerging Market Bonds

We expect large U.S. deficit spending with short term rates near zero to remain supportive of the fundamental picture of a weaker U.S. dollar which we believe benefits Emerging Market debt. The vaccine rollout in emerging continues to accelerate and Emerging Market manufacturing PMIs continue to signal expansion and the income characteristics of Emerging Market bonds are attractive compared to other fixed income assets.

Treasury Inflation Protected Securities (TIPS)

TIPS breakevens are inverted as the 5 year is higher than the 10 year, reflecting market expectations for inflation to run hotter over the intermediate term before cooling off. We believe it is possible for rising TIPS yields to offset an increase in breakeven rates which could result in TIPS underperforming nominal Treasuries.

U.S. Treasury Securities

The Federal Reserve remains committed to keeping the front end of the yield curve anchored, for now, and Treasury yields appear rich. In the second quarter, the curve flattened following aggressive steepening in the first three months of this year. We expect yields to head higher given the significant recovery in the U.S. economy, large deficit spending and the potential for tapering.

Investment Grade Corporate Bonds

Balance sheets and earnings have improved with the economic rebound and demand for credit remains strong considering meager global sovereign yields despite historically tight credit spreads and low yields. At current valuations, we are less constructive on investment grade corporate bonds and believe intermediate term corporates appear overvalued and vulnerable to rising rates.

Preferred Securities

Credit improvement momentum has been positive this year as large preferred issuers such as U.S. and European banks reported strong first quarter results and higher oil prices have been a tailwind for energy issuers. Strong inflows provide a positive demand backdrop and though spreads appear fairly valued, the sector provides attractive income characteristics compared to other fixed income asset classes.

Municipal Fixed Income

State economies continue to open, allowing for faster economic growth and President Biden's $1.9 trillion economic relief package provides a substantial boost to states, counties, cities, mass transit, healthcare providers and airports. As such, states like Illinois and New Jersey get a temporary reprieve. Significant spread compression occurred in the 2nd quarter and "A" and "BBB" rated bonds are now close to pre-COVID levels. We expect small incremental spread compression in small non-rated bonds and better relative total return potential to be found in high yield and "BBB" rated municipal securities.