Equity Newsletter

3rd Quarter 2025

First Trust

We hold a balanced, moderately positive view of U.S. equities, and for now, we expect continued economic expansion. The healthy labor market, benign monetary policy, and robust technology driven capital investments are key positives for equities. That said, we believe risks worth monitoring closely include any resurgence in tariff and trade uncertainty, or any early evidence that the labor market is significantly weakening. As such, we continue to favor exposure to dividend paying equities and quality growth companies.

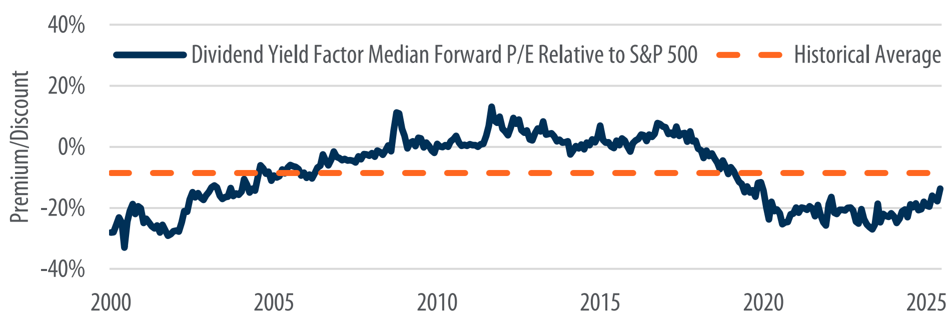
Dividend paying equities, especially dividend growers, are timely core holdings, in our view

- Policy - Federal Reserve monetary easing favors dividend payers, in our view, while the continuation of the 2017 tax cuts maintains the preferential tax treatment of qualified dividends over interest income and ordinary income.
- The dividend factor was an underperformer in 2023 and 2024 compared to most other factors but has been a better performer in 2025. In an equity market where we expect more modest returns compared to the last several years, we believe dividends will provide a greater share of the total return. Despite this, the dividend factor is still at a larger discount to the S&P 500 Index than its average over the last 20 years (Chart 1).
- As of June 30, 2025, the S&P 500 Index was trading at 22x forward price-to-earnings (P/E), the S&P 500 Growth Index at 28x, and the Dow Jones U.S. Select Dividend Index at 12x.
- Given the prominent role we expect dividends to play in total returns going forward, we prefer dividend growers as they have historically outperformed other dividend cohorts and are typically higher in quality (Chart 2).

American Exceptionalism

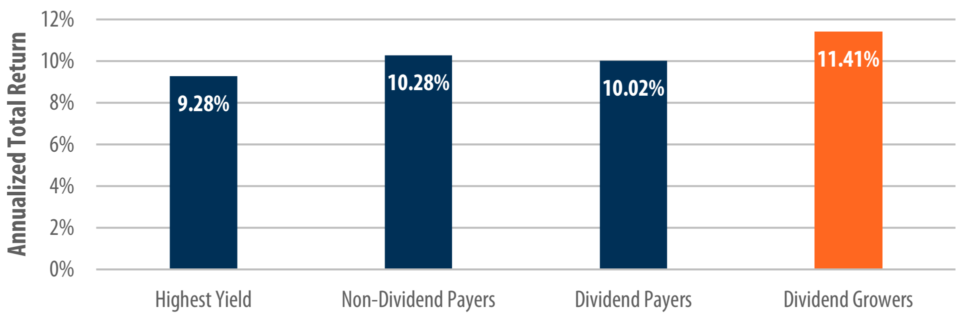
- The S&P 500 Index returned 6.2% in the first half of 2025, finishing at a record high. Despite the continued strength of the U.S. stock market, some have questioned whether American exceptionalism has peaked. After all, the U.S. dollar has weakened this year, and the rest of the world's stock markets are generally outperforming the U.S. year-to-date.
- Perhaps the critics are right? We would heartily disagree. Simply put, the strength and exceptionalism of the American economy and U.S. corporations is without peer throughout the rest of the world. The U.S. remains the preeminent economic power.
- The U.S. accounts for nearly half of the world's publicly traded market capitalization, with approximately $64.7 trillion as of June 30, 2025. In comparison, China ranks second with a significantly lower market capitalization of $10.8 trillion, which is less than the combined market capitalization of just four U.S. companies: NVIDIA, Microsoft, Apple and Berkshire Hathaway.
- One big reason for the dominance of American companies is they are extremely well run and the returns on shareholder capital are elite. Among the top 10 countries by market capitalization, the U.S. boasts the highest return on equity (ROE) and return on assets (ROA) (Chart 3). We were all taught that "capital goes to where it is treated best" and no country on earth treats capital better than the United States.

Chart 1: Dividend Yield Factor Median P/E Premium/Discount to S&P 500 Index



Source: Bloomberg & Capital IQ. Monthly data is calculated from 1/31/00 to 6/30/25. The median monthly forward price-to-earnings (P/E) ratio is used for the premium or discount relative to the S&P 500 Index. The dividend yield factor is comprised of the top 30% of stocks by dividend yield from a universe of the largest 1,000 U.S. stocks with at least $1 million dollars in average daily volume over the last 3 months and 12 months of trading history. Chart is for illustrative purposes only and does not represent any actual investment.

Chart 2: Performance of Constituents by Dividend Policy
S&P 500 Index (1995 - 2024)



Source: First Trust, Capital IQ, Bloomberg.

Chart 3: Country Profitability

	ROA	ROE
United States	16.96	25.93
China	7.77	16.08
Japan	6.19	12.54
Hong Kong	3.81	13.31
India	9.25	19.88
Canada	5.50	12.84
United Kingdom	5.83	15.94
France	5.65	13.06
Germany	3.89	12.63
Taiwan	13.98	24.32

Source: Factset. Data as of 6/30/25. Data reflects MSCI Country Indexes.

See Definitions on Page 3

Past performance is no guarantee of future results.

Sector Views

Communication Services
- Internet and streaming firms are investing in Artificial Intelligence (AI) to increase monetization and improve efficiency.
- Growing risk of increasing regulation and anti-trust scrutiny for mega-cap internet.
- Streaming media is increasing mix of ad supported revenue to improve profitability.

Consumer Discretionary
- Low unemployment and strong wages are current positives for consumption, but declining job openings and a falling quit rate may indicate the potential for labor market normalization favoring employers.
- Cumulative impact of inflation in recent years remains painful for consumers, especially on the lower end of income distribution. Meanwhile, the Conference Board's Consumer Confidence Survey posted its 4th straight reading below 100 in June (93).
- Increasing e-commerce penetration, automation of warehouses are secular positives to profitability.

Consumer Staples
- Defensive sector, but offers what we see as relatively meager growth.
- Valuation not particularly attractive, in our view.

Energy
- We are relatively cautious towards energy given risks to oil prices, but note that energy sector equities provide strong free cash flow generation.
- While U.S. sanctions on Russian and Iranian crude oil are in force, OPEC, including Saudi Arabia, has increased oil production quotas in recent months.
- The U.S. economy is a key source of demand for energy, and we believe the U.S. will avoid recession in the immediate term. That said, oil consumption would be impacted by any slowdown in macroeconomic growth.
- Risk to global oil demand from any tariff escalation.
- Geopolitical tail risks to oil supply exist due to tensions in Middle East between Israel and Iran, although any resolution to Ukraine and Russia conflict would ease oil supplies.

Financials
- We expect a more industry friendly regulatory stance towards banking, including less scrutiny of mergers, and easing of capital requirements.
- Investment banking revenue and trading expected to strengthen amid increased capital markets activity and market volatility, respectively.
- Commercial and industrial (C&I) loan growth may accelerate in upcoming quarters if tariff policy uncertainty decreases. Businesses may also borrow more if the regulatory environment becomes more favorable with the current administration.
- Credit quality remains reasonable. That said, any significant rise in unemployment would increase delinquencies.
- Valuation levels are attractive, in our view.

Healthcare
- Provides opportunity to invest in growth that is less correlated to the business cycle, that said, policy uncertainty remains significant in the sector.
- Focus within the pharma industry is on key drugs such GLP-1s for obesity, and the need for innovation to build pipelines and re-accelerate growth.
- Biotechnology stands to benefit from secular innovation, and potentially increasing merger activity as cash rich Big Pharma is motivated to replenish their pipelines, additionally, funding environment for smaller biotechnology firms may ease over time.
- The growth of the life science tools industry may benefit from normalization of excess inventories, but biopharma and hospitals remain focused on maintaining spending discipline. Government and academic research spending is also important to the industry.
- Valuation is attractive in the sector, in our opinion.

Industrials
- Demand for CapEx is a secular driver that may benefit the sector, as firms are motivated to reshore supply chains and increase productivity in a tight labor market.
- Increasing infrastructure requirements to support data centers is another key secular driver for some industrial firms.
- ISM Manufacturing PMI continues to indicate cyclical weakness in industrial activity.
- Tariff policy is a risk to industrial exports.
- Defense industry names benefit from increasing geopolitical risk, as well as potential increases in defense spending on the part of U.S. allies over time.
- Valuation in sector is reasonable, in our view.

Information Technology
- We expect robust information technology corporate spending driven both by AI related capital spending, and a potential recovery in end markets outside of AI, such as traditional enterprise servers.
- Key semi end markets such as AI, high bandwidth memory, and vehicle electrification stand to benefit from secular tailwinds.
- We see innovation potentially benefiting cloud software firms, as well, with the implementation of AI features, such as process automation, improving value-added to clients.
- We prefer quality within the sector, particularly firms with strong corporate balance sheets and reasonable valuation.

Materials
- On a cyclical basis, risks to international growth from trade tensions, and weakness in Chinese construction are headwinds to basic materials demand.
- We believe incremental demand from clean energy grid infrastructure and electric vehicle transition is a secular positive for some metals, such as copper.
- Materials sector stands to benefit over time from policies and investment designed to reshore supply chains and improve resource security amid geopolitical tensions.

Real Estate Investment Trusts (REITs)
- Higher yielding sector sensitive to interest rate movements, stands to benefit if rates decline.
- Data center REITs provide a strong secular opportunity but are sensitive to the information technology spending environment on a cyclical basis.

Utilities
- Defensive, dividend paying nature more attractive in times of macroeconomic uncertainty.
- Utilities are sensitive to interest rate movements, a potential positive if rates have peaked.
- Data center power consumption is a source of secular growth in electricity demand.

DEVELOPED MARKETS

Europe

- Inexpensive valuation in comparison to U.S. stocks.
- German fiscal stimulus announcements have improved sentiment towards Europe.
- European Central Bank may continue to ease policy amid moderate inflation and Euro strength, as the central bank turns its focus to stimulating growth.
- Manufacturing exports may slow in upcoming quarters due to U.S. tariff policy, and any potential reversal of tariff front-running.
- European sentiment stands to benefit from any de-escalation of the Ukraine/Russia conflict.
- Geopolitical risk from increased influence of populism on national politics within Eurozone, and tariff uncertainty.

United Kingdom

- Manufacturing PMI surveys point to contraction in industrial activity.
- The Bank of England expected to gradually ease interest rate policy, while fiscal policy may tighten, potentially including tax increases or welfare reform.
- Recently announced U.S.-U.K. trade deal may lower tariff risks, but some tariffs will remain in place, and full details have not been completely decided.
- Inexpensive valuation in comparison to U.S. stocks.

Japan

- Growth outlook is tempered by U.S. tariff uncertainty, which negatively impacts business sentiment. U.S.-Japan trade is under negotiation, but the risk remains that higher tariffs on Japan may go into effect in early August, barring any deal.
- Bank of Japan may refrain from any further tightening of monetary policy, given the risks to growth from trade policy uncertainty.
- Japan benefits from "friend-shoring" and increased secular demand for advanced technology exports such as automation equipment.
- Structurally low return on equity, although some corporate governance reforms have been implemented by the Tokyo Stock Exchange.
- Challenging demographics limit long-run potential economic growth.

Australia

- Commodity exporter which stands to benefit from higher commodity prices.
- Exports of raw materials to China key driver of economic growth.

Canada

- U.S. is key trading partner, stands to benefit from strong U.S. growth, but tariff rhetoric creates uncertainty.
- Energy and metals exporter, which stands to benefit if oil prices rise and demand for basic materials is strong, would suffer from a U.S. recession or a decline in oil prices.

EMERGING MARKETS

Emerging Asia

- Chinese policymakers have introduced fiscal and monetary stimulus measures to buttress growth. That said, the Chinese macro picture remains murky, as potential weakness in international trade and Chinese real estate investment are key risks.
- Despite ongoing U.S./China talks on trade, rising geopolitical tensions present risk to supply chains for key technologies and materials, and complicate U.S. firms' decisions to invest in China. Chinese exports to U.S. are likely to remain impacted by U.S. tariff policy, in our view.
- India may be less impacted by U.S. tariffs given less focus on goods exports to U.S. than some other countries, although specific industries, such as pharma, may be impacted by U.S. trade policy; additionally, the Reserve Bank of India (RBI) has adopted an accommodative monetary policy stance.

Latin America

- Mexican economy stands to benefit from exports to U.S., but would be negatively impacted by any eventual U.S. recession. Over time, supply chain diversification away from China may be a structural tailwind to exports.
- Populist election results impact sentiment towards the region, as fiscal discipline may be called into question.
- Brazil and Latin America overall are sensitive to demand for commodity exports.
- Tariffs are a risk to the region, but Mexico benefits from more favorable terms for U.S.-Mexico-Canada-Agreement (USMCA) compliant goods.

Definitions

The **S&P 500 Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. The **S&P 500 Growth Index** contains those securities with growth characteristics from the S&P 500 Index. The **Dow Jones U.S. Select Dividend Index** consists of 100 widely-traded, dividend-paying stocks derived from the Dow Jones U.S. Total Market Index℠. Index data is for illustrative purposes only and not indicative of any actual investment. Indices are unmanaged and investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. These returns were the result of certain market factors and events which may not be repeated in the future.

Forward Price-to-Earnings (P/E) of a stock is the price divided by the estimated EPS over the next 12 months.

Earnings per share (EPS) is the monetary value of earnings per outstanding share of common stock for a company during a defined period of time, often a year.

Return on Assets (ROA) ratio shows how efficiently a company uses its assets to generate profits. It reveals what earnings are generated from invested capital. A higher ROA means a company is more efficient and productive at managing its balance sheet to generate profits.

Return on Equity (ROE) is a measure of a company's financial performance. It is calculated by dividing net income by shareholders' equity.

References to specific securities should not be construed as a recommendation to buy or sell and should not be assumed profitable.

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