First Trust

Quarterly Market Overview

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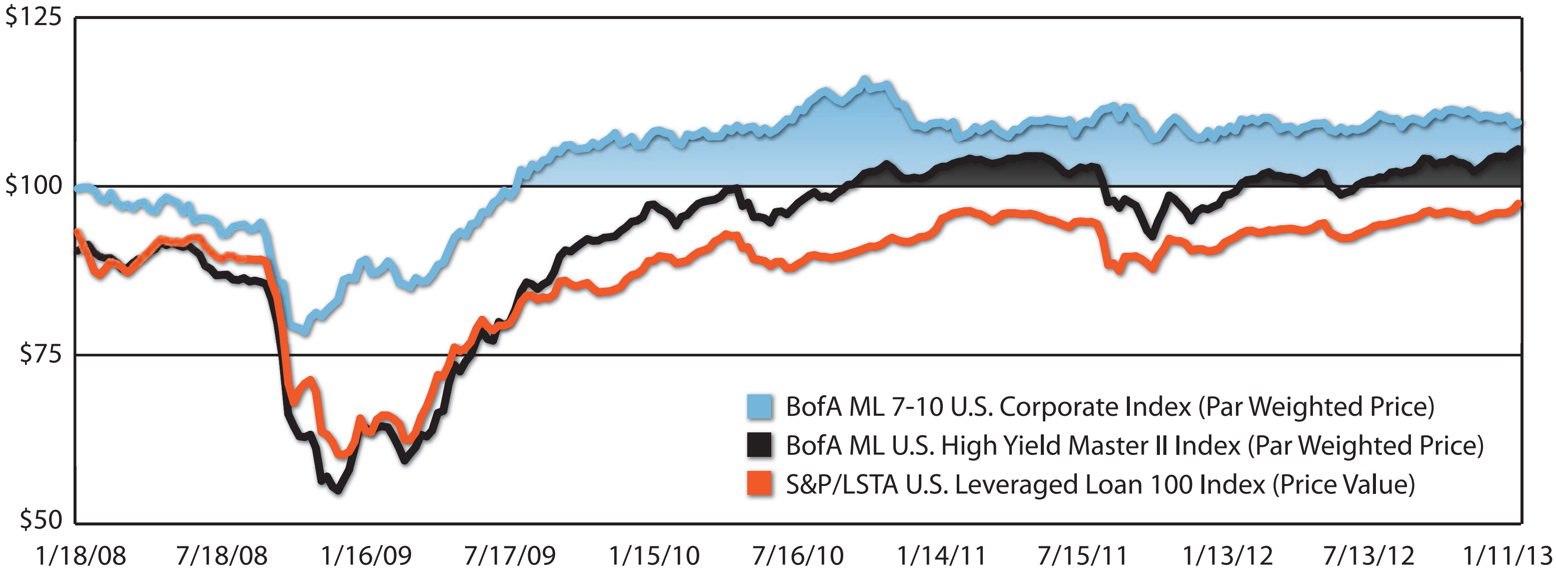
Mr. Carey has over a quarter century of experience as an Equity and Fixed-Income Analyst and is a recipient of the Chartered Financial Analyst (CFA) designation. He is a graduate of the University of Illinois at Champaign-Urbana with a B.S. in Physics. He is also a member of the CFA Society of Chicago and the CFA Institute. As Chief Market Strategist, Bob and his staff supervise approximately $63.0 billion in assets. 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.*

We invite you to visit Bob's Market Commentary Blog at www.ftportfolios.com for more insight.

Some Bond Investors Have It Made In The Shade



Source: Bloomberg

Retail investors have overwhelmingly favored bond mutual funds over U.S. stock mutual funds since the end of 2007. Since 2007, on a net basis, *outflows* from U.S. stock mutual funds totaled $405 billion, compared to *inflows* to bond mutual funds totaling $1.14 trillion, according to Strategic Insight. Net *outflows* from U.S. stock funds really began to accelerate following the so-called "flash crash" on May 6, 2010. On that day, the DJIA plunged nearly 1,000 points within a matter of minutes due to a presumed computer trading glitch and that experience, in our opinion, left an indelible mark on the collective psyche of the retail investor. But therein lies the rub. Investors who no longer seemed interested in holding an equity stake in Corporate America seemed willing to buy its debt obligations. While retail investors were fleeing U.S. stock funds they, in turn, were funneling tens of billions of dollars into corporate bond funds. In just the past two calendar years (2011 & 2012), net *inflows* to open-end high current yield funds alone totaled over $50 billion, according to Strategic Insight. These are funds that primarily invest in speculative-grade corporate debt that carry a credit rating below BBB. For the record, the cumulative total return on the S&P 500 from the end of the last bear market in stocks (3/9/09) through 1/11/13 (see end date on chart) was 136.2%. That return topped both of the cumulative total returns of the BofA ML U.S. High Yield Master II Index, up 125.9%, and the BofA ML 7-10 U.S. Corporate Index, up 71.7%. The shaded areas in the chart reflect the premiums to par value that investment grade and speculative-grade corporate bonds have traded at as far back as mid-2009. Notice, however, that leveraged loans (senior loans), which feature a floating-rate component, still trade below par. That is so because the rate of interest they pay (indexed to LIBOR) is lower than the rates offered by their fixed-rate, speculative-grade cousin (high yield). Keep this mind for when the 3-month LIBOR rate begins to rise.

For those who read our newsletter every quarter, you know that we have been bullish on equities for years, specifically U.S. stocks. We were speaking with an optimistic tone even before the financial crisis abated in Q1'09. We have never wavered from the notion that stocks remain one of the top wealth builders over time – warts and all. This is not to say that investors can't also be opportunistic in capturing capital appreciation in the debt markets. In fact, many still have an opportunity to do it today thanks to an over-accommodating Fed. Investors who have unrealized gains in their bond mutual funds, for example, can either sell their shares and realize said gains, or continue to hold their positions and likely see those unrealized gains erode over time. From an income perspective, investors need to be cognizant of the fact that the yield they are earning from their bond fund may be bolstered by bonds trading at a premium to par (see top of next page for more on par value). As those bonds are retired or sold there is a high probability the proceeds will be reinvested into lower yielding debt securities. What about the potential for higher interest rates in 2013? *The Wall Street Journal* reported in December that a survey of the Treasury bond market's 21 primary dealers (trade directly with the Federal Reserve and underwrite Treasury debt sales) produced a median 10-Year T-Note yield estimate of 2.25% for the close of 2013. The highest estimate was 3.0%. We believe there is considerable upside left in equities. We can't say the same for bonds.

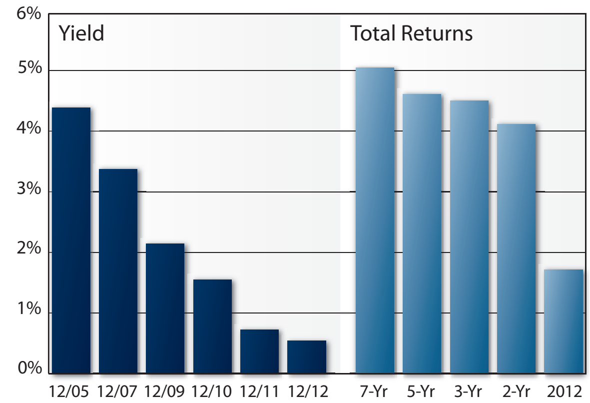
Continued

Here's what the "tea leaves" say about Treasuries...

When it comes to performance expectations, the difference between investing in bonds and investing in equities can be summed up in two words: par value. A bond's par value is the dollar amount on which interest is calculated and the amount paid to holders at maturity. Par values effectively cap the return on bonds when the security is held to maturity. While some common stock shares may state a nominal par value, it has essentially no impact on the trading of the stock. When interest rates fall to extremely low levels, as is the case today, they literally have next to no room left to fall and that, in turn, lessens the chance of potentially capturing any capital appreciation on bonds in the short-run.

The chart clearly illustrates this point. The yield on the Barclays Capital U.S. Treasury: Intermediate Index has declined steadily since 2005. The index's yield closed 2012 at 0.59%. For most of that seven-year span, the index generated an attractive annualized return between 4% and 5%, but performance was more than cut in half in 2012. Even if interest rate levels were to remain constant in 2013, the total return on the index would be less than 1.0%. With the U.S. core CPI rate at 1.9%, holding Treasuries is something we believe is worth reassessing.

U.S. Treasury: Intermediate Index Yields & Returns



Source: Barclays Capital. 2-, 3-, 5- and 7-year performance figures are annualized total returns. 2012 is a calendar year total return. Past performance is no guarantee of future results.

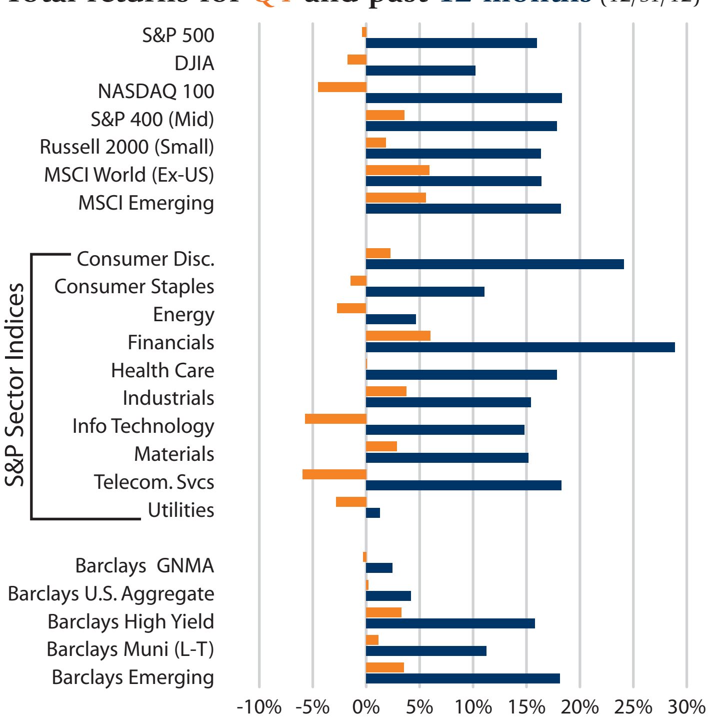
To borrow a page from real estate...capturing the biggest returns in the stock market comes down to location, location, location!

For those investors who do not already employ the equity strategy known as "core and explore," you might want to consider it after taking a glance at the historical calendar year returns featured in the table below. For those who already allocate capital to core equity positions as well as overweight specific sectors in their investment portfolio, we suggest that you also take a look at what is transpiring in the market at the subsector level. Packaged product vendors operating in the ETF and UIT industries, in particular, are now marketing more and more funds/portfolios targeting subsectors. The chart below shows the top performing U.S. style/market cap, foreign (developed vs. emerging markets), U.S. sector and subsector for each of the past 10 calendar years.

	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
U.S. Style-Market Cap	19.08% MCV	4.67% SCG	30.65% MCG	41.22% MCG	-28.94% SCV	13.50% MCG	23.65% SCV	13.58% MCG	22.38% SCV	49.06% SCG
Non-U.S. Developed vs. Emerging	18.22% EMG	-12.21% DEV	18.88% EMG	78.51% EMG	-43.56% DEV	39.42% EMG	32.14% EMG	34.00% EMG	25.55% EMG	55.82% EMG
S&P 500 Sectors	28.81% Financials	19.91% Utilities	27.66% Con. Disc.	61.72% Info. Tech	-15.43% Con. Staples	34.40% Energy	36.80% Tel. Svcs.	31.37% Energy	31.54% Energy	47.23% Info. Tech.
S&P 500 Subsectors	114.44% Household App.	45.14% Gas Utilities	69.07% Const. Farm & Machinery	368.68% Health Care Facilities	39.99% Brewers	112.62% Fert. & Ag. Chemicals	75.78% Steel	77.26% Oil & Gas Refineries	93.02% Fert. & Ag. Chemicals	176.25% Internet Soft. & Svcs.

Source: Bloomberg
Notes: **U.S. Style-Market Cap** features total returns from the following indices: S&P 400 Growth (MCG); S&P 400 Value (MCV); Russell 2000 Growth (SCG); and Russell 2000 (SCV). **Non-U.S. Developed vs. Emerging** features total returns (USD) from the MSCI World (Ex-U.S.) Index (DEV) and MSCI Emerging Markets Index (EMG).

Total returns for Q4 and past 12 months (12/31/12)



A Look Ahead:

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

	Q1'13E	Q1'12A	**Q2'13E**	Q2'12A	**2013E**	2012E
Financials	**4.71**	3.93	**4.83**	4.38	**19.47**	16.63
Information Technology	**9.12**	8.27	**9.40**	8.14	**39.47**	32.91
Health Care	**8.88**	8.35	**9.18**	8.02	**36.46**	32.39
Consumer Staples	**5.33**	5.06	**6.06**	5.48	**24.11**	22.03
Consumer Discretionary	**5.45**	4.91	**6.25**	5.30	**25.25**	22.18
Industrials	**5.65**	5.48	**6.45**	6.17	**25.21**	22.98
Telecom. Services	**2.06**	1.90	**2.36**	2.29	**8.91**	7.67
Energy	**11.35**	11.52	**12.09**	12.21	**48.23**	45.14
Utilities	**3.08**	2.98	**2.71**	2.68	**12.47**	11.73
Materials	**4.75**	4.23	**5.12**	4.46	**18.08**	14.84
S&P 500 Index	**26.29**	24.24	**27.97**	25.43	**112.62**	98.19
S&P 400 Index (Mid-Cap)	**14.72**	12.84	**16.37**	13.74	**66.06**	55.12
S&P 600 Index (Small-Cap)	**6.71**	5.28	**7.39**	5.51	**29.83**	22.57

Source: Standard & Poor's (1/10/13)