Quarterly Commentary | 2nd Quarter 2019

FIRST TRUST TARGET DATE FUNDS

Market Overview

In Q2’19, the S&P 500 Index posted a total return of 4.30%. Ten of the 11 major sectors that comprise the S&P 500 Index were up. Based on total returns, the top-performer was Financials, up 8.00%, while the worst showing came from Energy, down 2.83%, according to Bloomberg. The S&P MidCap 400 and S&P SmallCap 600 Indices posted total returns of 3.05% and 1.87%, respectively, in the quarter. With respect to foreign stocks, developed markets outpaced emerging markets. The MSCI Daily Total Return Net World ex U.S. (USD) and MSCI Daily Total Return Net Emerging Markets (USD) Indices posted total returns of 3.79% and 0.61%, respectively, in the quarter. Foreign stock returns may have been boosted by a modest dip in the U.S. dollar. The U.S. Dollar Index (DXY) fell 1.18% in the second quarter, according to Bloomberg.

Over the past three months (April-June), investors have gone from risk-on to risk-off to risk-on again. In our opinion, the most notable change in that period was the Trump administration’s ratcheting up of tariffs on roughly $200 billion of imported goods from China. On 5/10/19, tariffs jumped from 10% to 25%. President Donald Trump continues to threaten China with extending the tariffs to the remaining $300 billion or so in goods shipped to the U.S. annually. He even made overtures at the end of May that Washington would begin imposing a 5% tariff on imports from Mexico beginning on 6/10/19 if it did not stop illegal immigration at the southern border. Fortunately, an agreement was reached, and the tariff threat was subsequently withdrawn. The best thing that could happen to the equities markets is a new trade deal with China, in our opinion.

The yield on the benchmark 10-year Treasury note (T-note) closed trading on 6/28/19 at 2.01% (Bloomberg). The yield stood 47 bps below its 2.48% average for the 10-year period ended 6/28/19. Since the start of April, the yield curve in the government bond market has once again flattened out due to the decline in the yield on the 10-year T-note. At the end of March 2019, both President Trump and White House economic advisor Larry Kudlow called on the Federal Reserve (“Fed”) to lower the federal funds target rate by 50 basis points, according to CNBC. While the Fed has yet to do any rate cuts, via its purchasing power, bond investors pushed the yield on the 10-year T-note down from 2.50% at the close on 4/30/19 to 2.01% on 6/28/19, or 49 bps (Bloomberg). Investors have signaled to the Fed that they like the idea of a couple of rate cuts moving forward.

The low interest rate climate in the U.S. has been entrenched since the 2008-2009 financial crisis. Low rates can motivate investors to assume more risk to generate higher returns. In the current bull market (3/9/09-6/28/19), the S&P 500 Index has posted a cumulative total return of 439.55%, or an average annualized gain of 17.76% (Bloomberg). For comparative purposes, over the current bull market (3/9/09-6/28/19), the S&P 500 Index has posted a cumulative total return of 439.55%, or an average annualized gain of 17.76% (Bloomberg). The yield on the U.S. 10-Year Treasury Note (T-Note) closed trading on 6/28/19 at 2.01%. That is well above the 1.18% yield on the U.S. Dollar Index (DXY) on 6/28/19.

Corporate America remains flush with cash and companies have increased the amount of foreign profits they are bringing back to the U.S. under the new tax law. The passage of the Tax Cuts and Jobs Act in December 2017 reduced the tax rate on repatriated foreign profits to 15% for cash holdings and 8.0% for more illiquid assets. Data released in the latter half of 2018, U.S. companies repatriated $776.51 billion (revised higher by $111 billion over figure released in March 2019). That is well above the $155.08 billion repatriated by U.S. companies in 2017.

Review of the Four Main Asset Classes:

Domestic Equity:
The domestic equity portion of the portfolio underperformed the S&P 500 Index in Q2’19 due to stock selection. At the individual strategy level, three of the six domestic style strategies underperformed their respective style benchmarks. The U.S. Large-Cap Value strategy underperformed the S&P 500 Value Index during Q2’19 mostly due to sector allocation, mostly because of an overweight position in the Communication Services sector. Sector allocation overall had a negligible effect on relative performance, but stock selection within the Information Technology sector partially offset the underperformance. The U.S. Large-Cap Growth strategy underperformed the S&P 500 Growth Index during Q2’19 due to stock selection, especially within the Information Technology sector. Sector allocation mitigated the underperformance, mostly because the strategy held no weight in the Energy sector. The U.S. Mid-Cap Value strategy underperformed the S&P MidCap 400 Value Index during Q2’19 mostly due to stock selection, especially within the Financials sector. Sector allocation also contributed to the underperformance, mostly due to an overweight position in the Industrials sector. However, stock selection within the Communication Services sector mitigated the underperformance. The U.S. Mid-Cap Growth strategy outperformed the S&P MidCap 400 Growth Index during Q2’19, mostly due to sector allocation. Particularly, the strategy held no weight in the Energy sector, which contributed to the underperformance. Sector allocation also contributed to the underperformance, especially within the Financials sector. However, stock selection within the Industrials sector partially offset the underperformance. The U.S. Small-Cap Value strategy underperformed the S&P SmallCap 600 Value Index due to stock selection, especially within the Consumer Discretionary and Industrials sectors. Sector allocation partially offset the underperformance, mostly due to an overweight position in the Consumer Staples sector. The U.S. Small-Cap Growth strategy underperformed the S&P SmallCap 600 Growth Index mostly due to stock selection, especially within the Consumer Discretionary sector. Sector allocation also contributed to the underperformance, mostly due to an overweight position in the Communication Services sector. However, stock selection within the Industrials sector mitigated the underperformance.

International Equity:
The International Developed Markets strategy underperformed the MSCI EAFE Index during Q2’19 mostly due to stock selection, especially within the Consumer Staples sector. Sector allocation also contributed to the underperformance, mostly due to an overweight position in the Industrials sector. However, stock selection within the Industrials and Utilities sectors mitigated the underperformance.

Fixed-Income:
The iShares iBoxx $ Investment Grade Corporate Bond ETF and iShares 7-10 Year Treasury Bond ETF both outperformed the Bloomberg Barclays U.S. Aggregate Bond Index in Q2’19 as it became widely expected during the period that the Fed would cut interest rates at its July 2019 meeting, making longer-duration fixed-income securities relatively more attractive than those of shorter-duration. Fed Chairman Jerome Powell cited slowing global growth, uncertainties regarding trade, and weak inflation as reasons for more accommodative monetary policy. Conversely, the shorter-duration iShares Short Maturity Bond ETF underperformed the Bloomberg Barclays U.S. Aggregate Bond Index. The yield on the U.S. 10-Year Treasury continued its descent during the period, falling from 2.41% at the end of Q1’19 to 2.01% at the end of Q2’19.

REITs/Commodities/Other:
The SPDR Gold Trust significantly outperformed the Russell 3000 Index in Q2’19 as the price of gold jumped 9% in Q2’19. Despite the expectation that the Fed will cut rates later in 2019, the iShares Cohen & Steers Real Estate Investment Trust (REIT) ETF underperformed the Russell 3000 Index during Q2’19. 
RISK FACTORS

Plan sponsors and participants should consider the Funds’ investment objective, time horizon, risks, charges and expenses carefully before investing. Contact your financial advisor, visit www.ftportfolios.com, or call First Trust Portfolios L.P. at 877-937-4015 to request an Information Statement, which contains this and other information about the Funds. Read it carefully before you invest.

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The performance quoted does not guarantee future results. As with any investment, you can lose money by investing in the Funds. The mix of assets in the Funds is intended to diminish the risk of loss, but sometimes stocks, bonds, and other assets in the Funds’ portfolio may lose value simultaneously. While the Funds are managed to reduce equity market exposure and, therefore, equity market risk over time, investment in the Funds is exposed to market risk and other certain risks.

The Funds are subject to market risk which is the risk that a particular security owned by the Funds or shares of the Funds in general may fall in value.

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.

Changes in currency exchange rates and the relative value of non-U.S. currencies may affect the value of the Funds’ investments and the value of the Funds’ shares.

The Funds invest in small and/or mid-capitalization companies. Such companies may experience greater price volatility than larger, more established companies.

Certain securities held by the Funds are subject to credit risk, income risk, interest rate risk and prepayment risk. Credit risk is the risk that an issuer may default on its obligation to make principal and/or interest payments when due. Credit risk is heightened for senior loan securities. Income risk is the risk that income from the Funds’ fixed-income investments could decline during periods of falling interest rates. Interest rate risk is the risk that the value of debt securities will decline because of rising interest rates. Prepayment risk is the risk that, during periods of falling interest rates, an issuer may exercise its right to pay principal on an obligation earlier than expected. This may result in a decline in a fund’s income. Each of these risks may have an adverse effect on the Funds’ total return.

Companies that issue loans tend to be highly leveraged and thus are more susceptible to the risk of interest deferral, default and/or bankruptcy. Senior floating rate loans, in which the Funds may invest, are usually rated below investment grade but may also be unrated. As a result, the risks associated with these senior floating rate loans are similar to the risks of high-yield fixed income instruments.

High-yield securities or “junk” bonds are subject to greater market fluctuations and risk of loss than securities with higher ratings, and therefore, are considered to be highly speculative. These securities are issued by companies that may have limited operating history, narrowly focused operations, and/or other impediments to the timely payment of periodic interest and principal at maturity. The market for high-yield securities is smaller and less liquid than that for investment-grade securities.

The Funds may invest in securities of other investment companies, including exchange-traded funds (“ETFs”) or other pooled investment vehicles (“PIVs”) which involves additional expenses that would not be present in a direct investment in the underlying funds. In addition, the Funds’ investment performance and risks may be related to the investment performance and risks of the underlying funds.

The Funds may invest in Treasury Inflation-Protected Securities (“TIPS”), which are securities issued by the U.S. Government but differ from nominal rate Treasury securities in certain respects. TIPS are issued at fixed coupon rates lower than those of nominal rate Treasury securities, but the principal amount of TIPS fluctuates daily based on a pro-rata portion of the change in the Consumer Price Index as reported three months earlier. Coupon payments are made based on the adjusted principal value of the TIPS. In a falling inflationary environment, both the coupon payments and the value of TIPS will decline. Foreign governments may issue securities with features similar to TIPS.

The value of commodities and commodity-linked instruments typically is based upon the price movements of a physical commodity or an economic variable linked to such price movements. The prices of commodities and commodities-linked instruments may fluctuate quickly and dramatically and may not correlate to price movements in other asset classes. Each of these factors and events could have a significant negative impact on the Funds.

Real estate investment trusts and other real estate related companies are subject to certain risks, including changes in the real estate market, vacancy rates and competition, volatile interest rates and economic recession.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial advisors are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

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