A GUIDE TO

ALPHADEX®

EXCHANGE-TRADED FUNDS
For decades, ETFs have served investors looking to replicate the returns of the market. Originally ETFs were based on traditional market indexes in which all of the stocks in a relevant market segment were included and generally weighted based on market capitalization. Such traditional market indexes, like the S&P 500, overweight larger companies simply because of their size and not their actual worth.

INDEXING TRANSFORMED

The ETF industry has evolved to include alpha-pursuing index funds for investors looking to achieve potentially better investment results. This approach has been referred to as enhanced indexing, new beta, customized beta, beta plus, and smart beta. No matter how you say it, it describes one thing — an enhanced form of passive index investing. This investment approach is based on indexes which select and weight stocks using methods other than the market capitalization weighted approach used by traditional index funds.

In the early 1990s, several academic studies were released supporting the ability to generate outperformance through the use of purely quantitative measures. Drawing on this academic research, another evolution of enhanced indexing occurred — fundamental indexing. A fundamental index attempts to limit exposure to over-priced stocks and increase exposure to those companies which are trading at more attractive valuations based on its fundamentals. Determining how much weight a company should represent within an index is based on fundamental screens and factors such as:

- Price-to-book value
- Price-to-cash flow
- Price-to-sales
- Price-to-earnings ratio
- Price-to-sales
- Price-to-momentum
- Return on assets
- Intraday Liquidity
- Fully Invested
- Tax Efficient
- Transparent

Similar to active management, the goal of a fundamental index is to identify those stocks from within a traditional broad-based index which exhibit the fundamental characteristics that enable them to provide the greatest potential for capital appreciation. Because ETFs provide additional features such as tax efficiency, exchange-traded liquidity, and transparency, we believe ETFs may be a better alternative to active management when seeking alpha.

The First Trust AlphaDEX® exchange-traded funds are designed to track the performance of a group of indexes which employ the proprietary, rules-based AlphaDEX fundamental stock selection methodology. While different methods of indexing will have inherent limitations at different times, we believe that fundamental indexes have the potential to generate higher long-term returns, and often times reduce volatility, compared to similar cap-weighted indexes.

INDEX-BASED BETA ETFs

- Intraday Liquidity
- Fully Invested
- Tax Efficient
- Transparent

ACTIVELY MANAGED FUNDS

- Select and weight stocks based on investment merit
- Potential to provide alpha

ALPHADEX®

Select and weight stocks based on merit, not size

Potential for excess returns and positive alpha

Not FDIC Insured | Not Bank Guaranteed | May Lose Value
The indexes which provide the basis for the AlphaDEX® exchange-traded funds start with a broad-based index and are enhanced through the use of the patented AlphaDEX stock selection methodology. This methodology is designed to use fundamental valuation factors to select and weight stocks based on their investment merit. The methodology used to select the stocks for the domestic equity AlphaDEX ETFs is described in the chart below.

1. Begin with the constituents of a broad-based index and rank all stocks on growth and value factors to determine a growth and value score.

2. Based on style designations, determine each stock's selection score. Stocks designated as core or blend receive the better of their growth or value score.

3. Rank all stocks by their final selection score and eliminate from consideration the lowest 25%.

4. Place the remaining stocks into quintiles based on their selection score rank. The top quintile stocks get a total weight of 5/15ths, the second quintile stocks get a total weight of 4/15ths, etc. Each stock is equally-weighted within its quintile.

5. Repeat the process quarterly, rebalancing and reconstituting the index.

**ETF Characteristics**

Investors buying or selling fund shares on the secondary market may incur customary brokerage commissions. 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 a fund by authorized participants, in very large creation/redemption units. If a 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 may invest in small capitalization and mid capitalization companies. Such companies may experience greater price volatility than larger companies.

A fund containing securities of non-U.S. issuers is subject to additional risks as non-U.S. issuers are subject to higher volatility than securities of U.S. issuers. Risks may be heightened for securities of companies located in, or with significant operations in, emerging market countries. Non-U.S. dollar denominated securities may lose money if the local currency depreciates against the U.S. dollar.

A fund may invest in depositary receipts which may be less liquid than the underlying shares in their primary trading market. A fund may effect a portion of creations and redemptions for cash, rather than in-kind securities. As a result, a fund may be less tax-efficient.

First Trust Advisors L.P. (FTA) is the adviser to the funds. FTA is an affiliate of First Trust Portfolios L.P., the funds’ distributor.

Please be aware that each fund listed is subject to various risks depending on the fund’s investment objectives. For a complete description of relative risks for a specific fund, please obtain and carefully read the appropriate First Trust prospectus by visiting www.ftportfolios.com or calling 1-800-621-1675.
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 the fund. The prospectus or summary prospectus should be read carefully before investing.

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.

“AlphaDEX®” is a registered trademark of First Trust Portfolios L.P. First Trust Portfolios L.P. has obtained a patent for the AlphaDEX® stock selection methodology from the United States Patent and Trademark Office. Alpha is a statistical measure of the portion of a return arising from non-market risk.