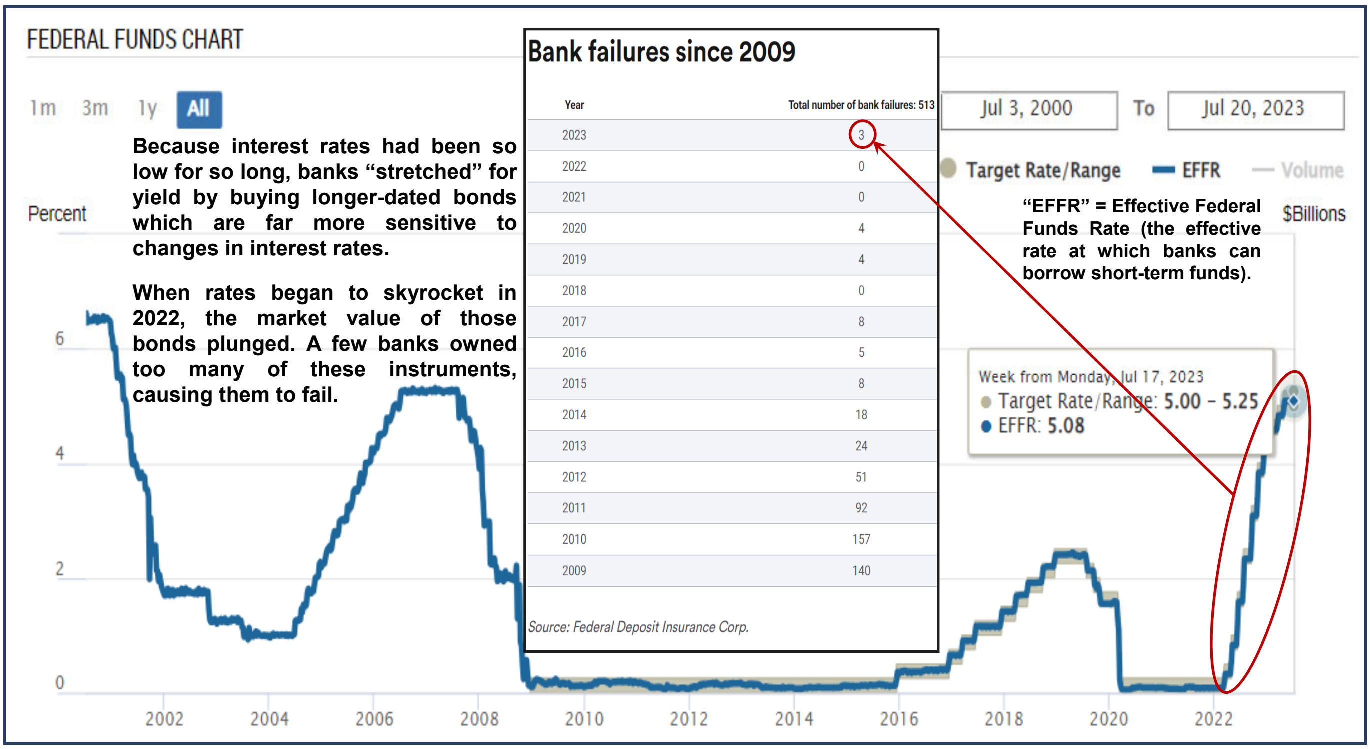
DOOMSAYERS GO 0 FOR 4, GDP REMAINS HEALTHY, STOCKS RISE, BUT MILD RECESSION SEEMS LIKELY

BANKING CRISIS CONTAINED (DOOMSAYERS GO 0 FOR 1)

The back-to-back failures of Silicon Valley Bank and Signature Bank and the later failure of First Republic Bank raised fears that a systemic collapse of the U.S. banking system had begun. Instead, those collapses were mostly the result of a low interest-rate environment that induced some banks to stretch for yield by owning instruments whose market value fell precipitously as the Federal Reserve embarked on its rush to normalize/raise interest rates to ward off inflation.



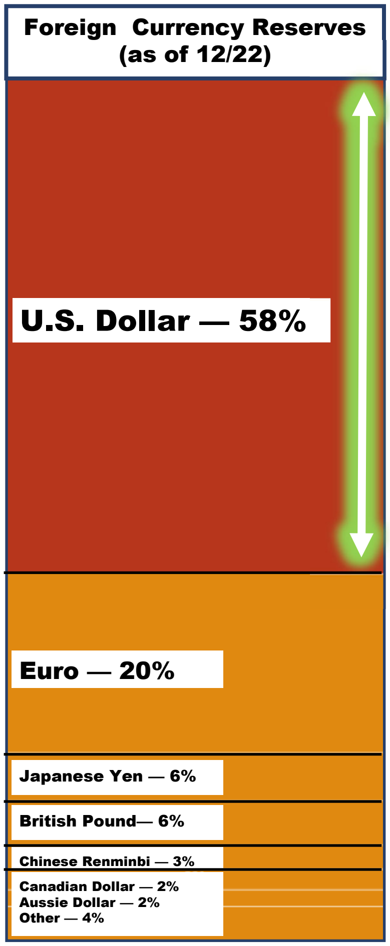
Year	Total number of bank failures: 513
2023	3
2022	0
2021	0
2020	4
2019	4
2018	0
2017	8
2016	5
2015	8
2014	18
2013	24
2012	51
2011	92
2010	157
2009	140

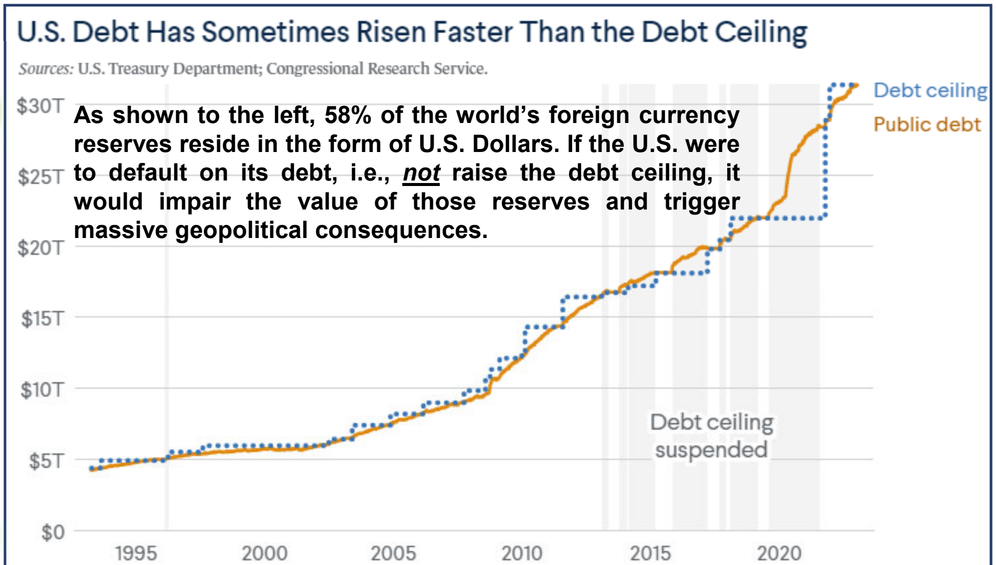
Banks typically "hide" these losses in their Available-for-Sale or Held-to-Maturity accounts, but if or when depositors begin to demand deposits, banks may be forced to sell those instruments at a loss or to borrow against their reduced market value. Either action causes those losses to become more apparent which further scares depositors, causing or exacerbating contagion.

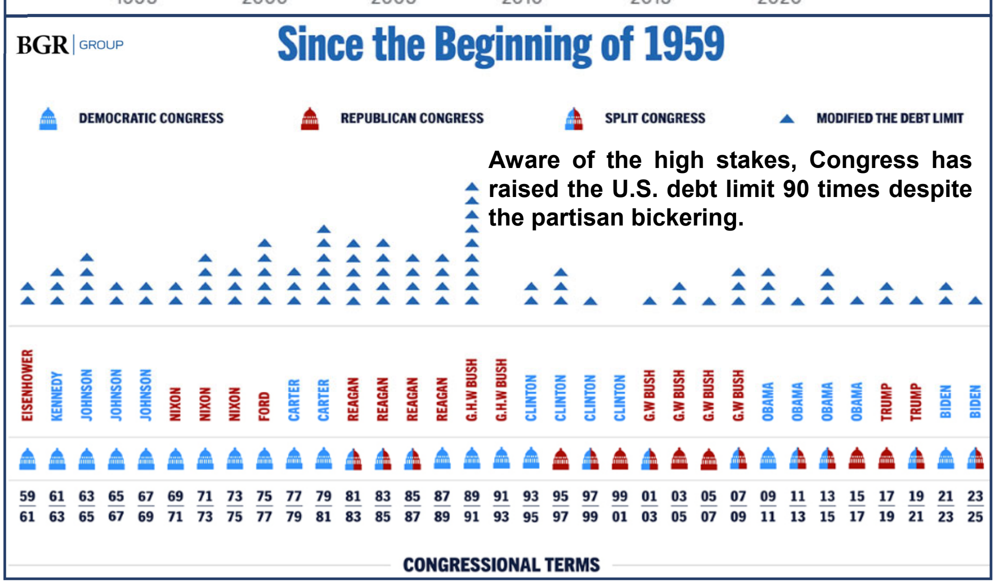
To avoid calamity, the FDIC made all Silicon Valley Bank and Signature Bank depositors whole, including uninsured depositors, and assessed the rest of the banking industry to recoup its losses. JP Morgan rescued First Republic Bank by buying it, and the Fed intervened with an emergency lending facility that now allows banks to borrow against depreciated collateral based on the collateral's *full, undepreciated* value. This change should help ward off future bank runs.

DEFAULT ON U.S. DEBT (… 0 FOR 2)

In 1917, Congress implemented the debt ceiling as a means of establishing the maximum amount of outstanding federal debt the U.S. government can incur. However, Congressional action to raise or suspend the debt ceiling is legislated separately from the underlying spending decisions. Because Congressional spending typically requires the issuance of additional debt, spending decisions within the U.S. are divorced, both legislatively and temporally, from honoring debt that has already been incurred … which is a little like using a credit card and then debating whether the bill merits payment only *after* that bill arrives.





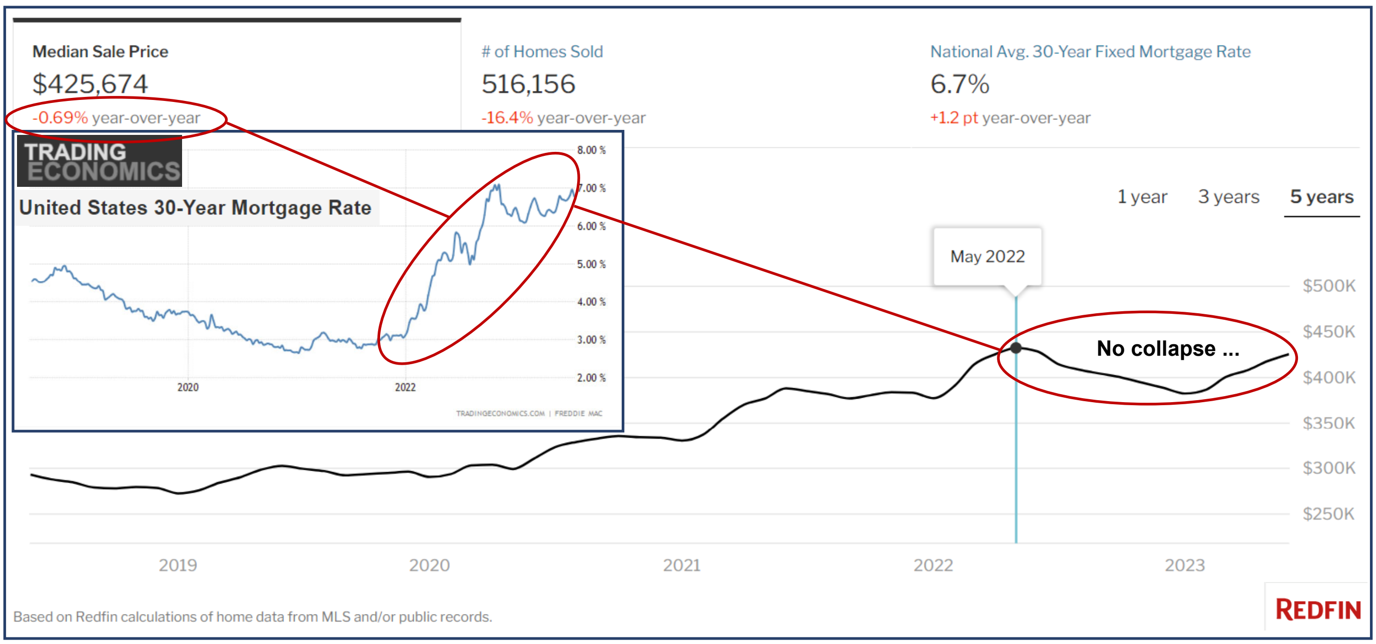


The Bipartisan Budget Act of 2019 suspended the debt ceiling until July of 2021 and Congress suspended it again this spring until January of 2025. With so much at risk if the U.S. were to default on its debt and with a history of Congress increasing the debt ceiling some 90 times since 1959, all parties are motivated to avoid calamity whether they acknowledge it, or not.

HOUSING COLLAPSE (... 0 FOR 3)

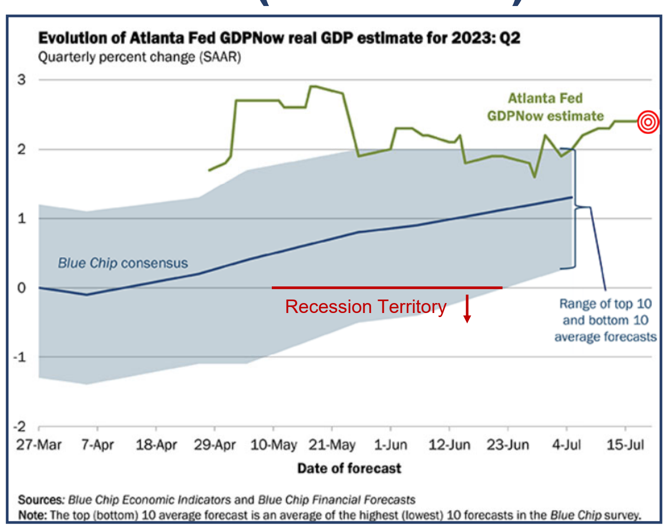
Many feared that as the Federal Reserve hiked interest rates to quell inflationary pressures, the associated increase in mortgage rates would cause housing prices to collapse. And because a home represents a major portion of a typical person's net worth, it was feared that a sudden disappearance of a material portion of this wealth would stymie future spending via what's often referred to as the Wealth Effect and push the U.S. toward or into recession.

Mortgage rates have increased markedly since the Fed began battling inflation and housing prices did wilt between May of 2022 and early 2023, but housing prices have rebounded and are now within 1% of where they were last May, so this calamity hasn't materialized, either.



U.S. RECESSION STILL HASN'T MATERIALIZED (... 0 FOR 4)

The Fed began hiking rates in a hurry in early 2022. By early 2023, the Fed had implemented seven separate rate hikes, yet the U.S. economy continued to trudge forward during the first quarter of 2023 by posting a respectable, annualized GDP growth rate of 2%. As of June of 2023, the Fed had hiked interest rates a total of 10 times and as of late July, the Fed's GDPNow model actually estimates second quarter GDP will _rise_ to 2.4% (nowhere near recession).



MEANWHILE, EQUITIES CONTINUE TO RECOVER

WEEK ENDING 6/30/2023 (CUMULATIVE TOTAL RETURNS)

Equities[1]		Week		YTD		1-Year	Close
S&P 500	▲	2.36%	▲	16.9%	▲	19.6%	4,450
DJIA	▲	2.02%	▲	4.9%	▲	14.2%	34,408
NASDAQ	▲	2.20%	▲	32.3%	▲	26.1%	13,788
Russell 2000	▲	3.75%	▲	8.1%	▲	12.3%	1,889
Foreign Stocks	▲	1.67%	▲	12.1%	▲	19.4%	
Emerging Markets	▲	0.00%	▲	5.1%	▲	2.2%	

HOWEVER, THE LEI® CONTINUES TO SIGNAL RECESSION

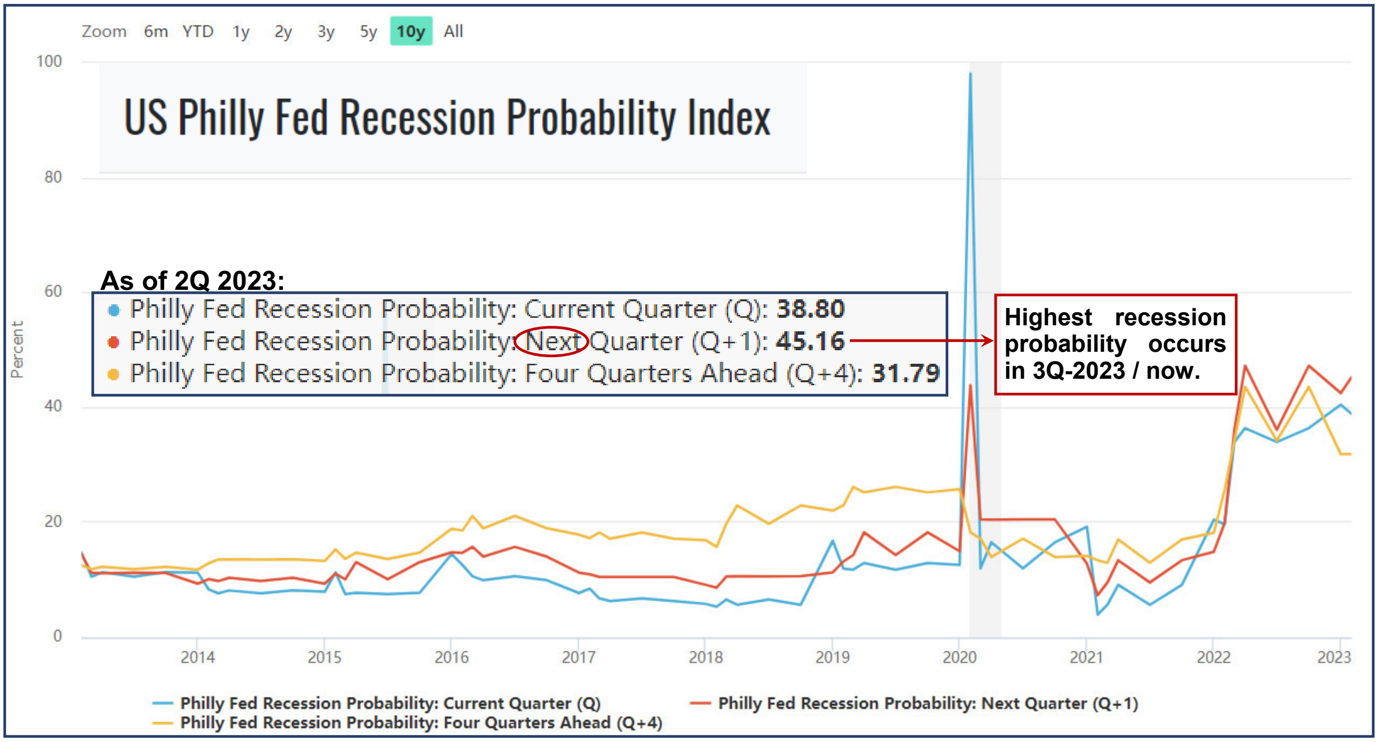
As per the May 2023 press release from the Conference Board, the publisher of the Leading Economic Index®, "The US LEI continued to fall in May as a result of deterioration in the gauges of consumer expectations for business conditions, Institute of Supply Management New Orders Index®, a negative yield spread, and worsening credit conditions. While we revised our Q2 GDP forecast from negative to slight growth, **we project that the US economy will contract over the Q3 2023 to Q1 2024 period**. The recession likely will be due to continued tightness in monetary policy and lower government spending."

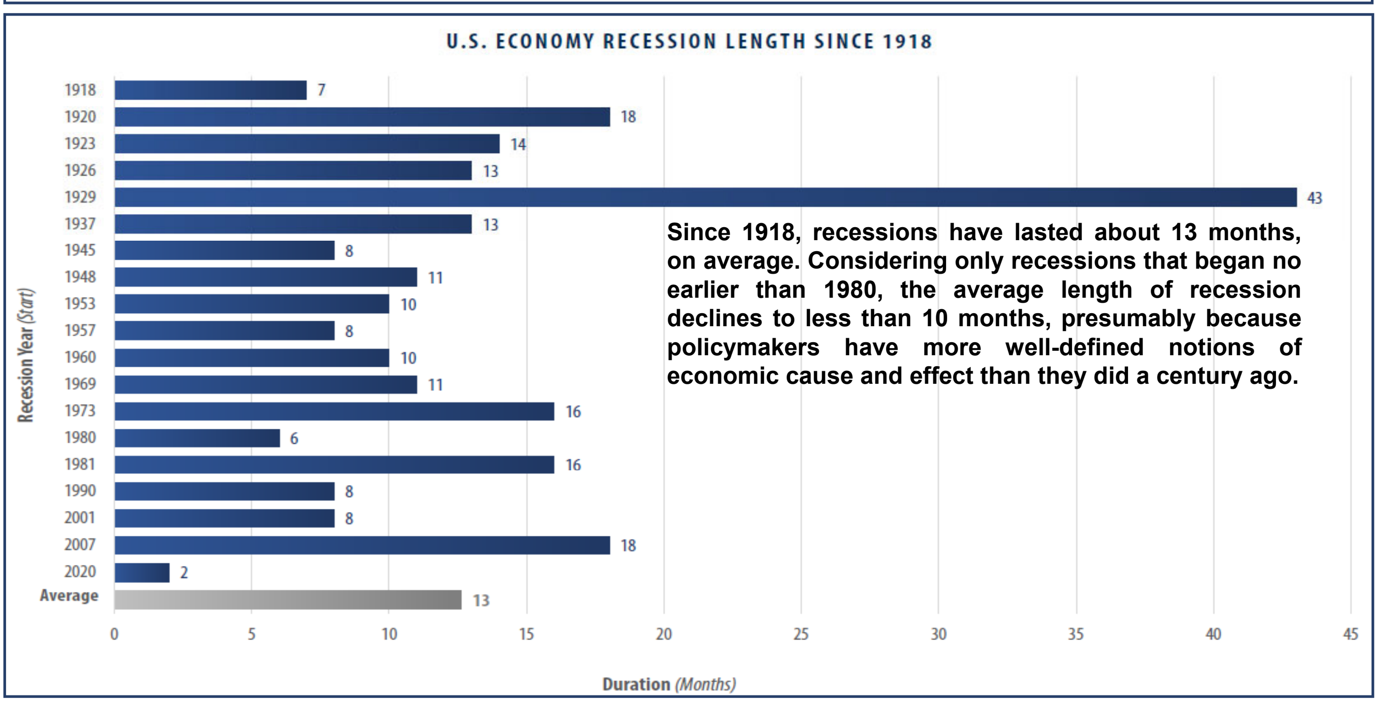
The US LEI continues to signal a recession within the next 12 months

As per the Conference Board, the LEI is a predictive variable that anticipates/leads turning points in the business cycle by approximately 7 months.

FIRST, SOME RECESSION PERSPECTIVE

In addition to the Conference Board's Leading Economic Index predicting the U.S. will lapse into recession within roughly 7 months of early 2023 (which is now-ish), the Federal Reserve Bank of Philadelphia endeavors to further quantify the probability of a recession materializing within the U.S. during the current quarter, the next quarter, and during the quarter four quarters hence. The Philadelphia Fed's second quarter 2023 estimates appear below.





MORE RECESSION PERSPECTIVE

Recessions: Before and After
S&P 500 Index

Except for the circled areas, market downdrafts occurring prior to and during recession have tended to be mild. Based on the data here, it's easy to see how trying to avoid them and guessing wrong could result in a lot of missed "green."

First Trust

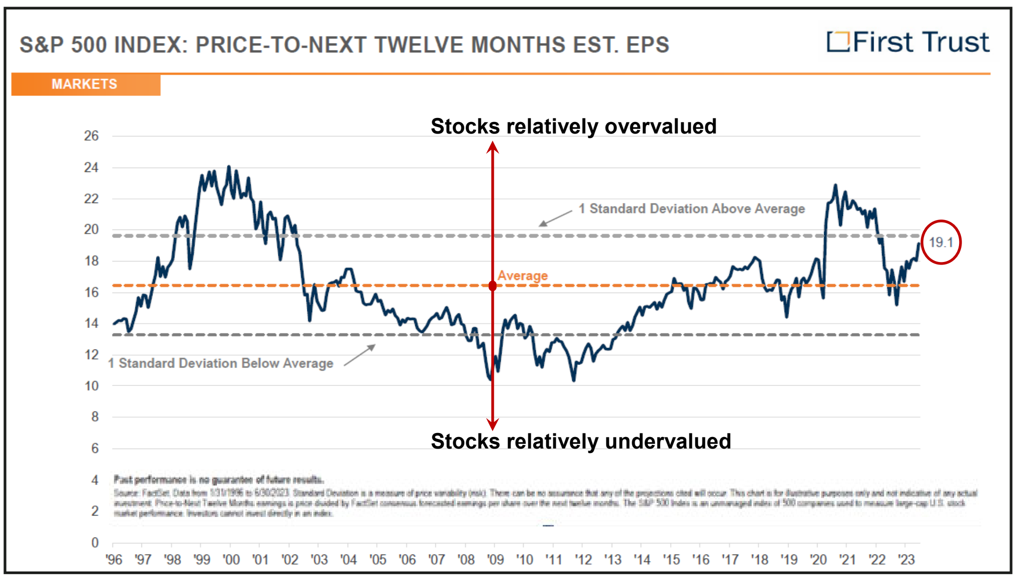
		Before		After			
Recession Start	Recession End	6 Months	During Recession	1 Year	3 Years	5 Years	10 Years
11/30/1948	10/31/1949	-8.99%	19.01%	35.06%	92.80%	177.83%	510.36%
7/31/1953	5/31/1954	-3.53%	22.94%	36.07%	83.74%	145.16%	295.53%
8/31/1957	4/30/1958	6.52%	-0.94%	37.23%	66.38%	89.85%	211.22%
4/30/1960	2/28/1961	-3.83%	19.74%	13.64%	35.15%	68.41%	112.23%
12/31/1969	11/30/1970	-4.14%	-1.92%	11.25%	20.58%	25.10%	146.56%
11/30/1973	3/31/1975	-7.63%	-7.80%	28.33%	22.08%	55.64%	253.47%
1/31/1980	7/31/1980	12.99%	9.58%	13.00%	56.07%	100.53%	344.64%
7/31/1981	11/30/1982	3.59%	14.23%	25.57%	66.79%	102.96%	350.21%
7/31/1990	3/31/1991	10.12%	7.94%	11.00%	29.79%	98.08%	284.21%
3/31/2001	11/30/2001	-18.75%	-0.91%	-16.51%	8.42%	34.29%	33.17%
12/31/2007	6/30/2009	-1.29%	-35.01%	14.42%	57.66%	136.88%	293.76%
2/29/2020	4/30/2020	1.91%	-1.12%	45.96%	50.11%	N/A	N/A
	Average	-1.08%	3.81%	21.25%	49.13%	94.06%	257.76%
	Median	-2.41%	3.52%	20.00%	53.09%	98.08%	284.21%

Source: Bloomberg. As of 6/30/2023. **Past performance is no guarantee of future results.** This chart is for illustrative purposes only and not indicative of any actual investment. The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. Index returns shown are total returns.

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 professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

BY HISTORICAL STANDARDS, EQUITIES ARE RICHLY VALUED

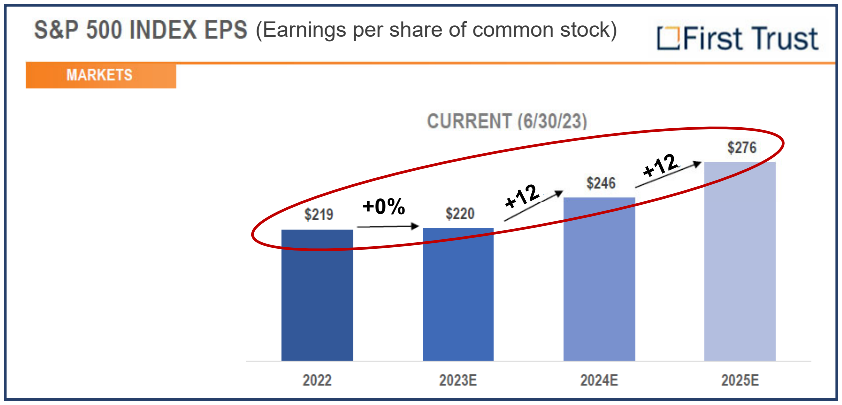
As shown here, stocks that comprise the S&P 500 are trading at about 19 times earnings per share estimated for the next 12 months. For reasons too complicated for this note, the recent spike in interest rates causes this premium to be *larger* than it appears.



EARNINGS STAGNATION ALMOST OVER

I don't like the odds associated with the prognostication business because there is an almost infinite number of ways get things wrong and only limited ways to be right. However, I'll hazard a guess that the recent surge in stock prices may come to a halt for a quarter or so while the corporate earnings that drive stock prices catch up to existing valuations and while investors grapple with the anxiety associated with the likelihood and severity of any forthcoming recession.

If analysts are right and corporate earnings per share were to rise 12% during 2024, equity valuations would approximately fall back to their historical average of 17 times earnings per share (EPS) from their current level of 19.1 times current EPS (circled on previous page).



S&P 500 SECTOR INDEX VALUATION AND EST. EPS GROWTH

First Trust

MARKETS

Growth in earnings per share (EPS) looks set to resume in 2024 in almost every sector.

	PRICE TO NTM EPS			EST. EPS GROWTH			PRICE-TO-BOOK			EST. RETURN ON EQUITY	
S&P 500 Sector Index	6/30/23	10-Yr. Median	Ratio to Median	2023	2024	2025	6/30/23	10-Yr. Median	Ratio to Median	2023	2024
Communication Services	17.2	14.2	121%	16%	18%	13%	3.5	3.2	112%	17.7%	18.5%
Consumer Discretionary	26.9	20.1	134%	24%	19%	17%	9.7	5.9	165%	29.6%	29.7%
Consumer Staples	20.0	19.6	102%	3%	9%	9%	6.3	5.4	117%	28.4%	29.1%
Energy	10.7	16.8	64%	-27%	0%	3%	2.2	1.9	116%	19.4%	18.3%
Financials	13.4	13.0	104%	-2%	10%	14%	1.7	1.3	129%	12.1%	12.4%
Health Care	17.2	16.1	107%	-10%	9%	11%	4.7	4.1	114%	24.2%	23.9%
Industrials	18.8	16.5	114%	13%	14%	14%	5.5	4.6	119%	25.6%	25.8%
Information Technology	27.6	18.4	150%	1%	16%	11%	10.8	6.0	178%	33.4%	33.3%
Materials	17.5	16.0	109%	-18%	6%	8%	2.9	3.0	96%	15.4%	15.3%
Real Estate	17.1	18.3	93%	-3%	6%	6%	2.9	3.3	89%	16.7%	18.0%
Utilities	17.0	17.5	97%	6%	8%	7%	2.0	2.0	100%	10.8%	11.1%

"NTM" = Next 12 Months; Figures > 100% suggest overvalued condition. Figures < 100% suggest undervalued condition.

Past performance is no guarantee of future results.

Source: FactSet. As of 6/30/2023. This chart is for illustrative purposes only and not indicative of any actual investment. There can be no assurance that any of the projections cited will occur.

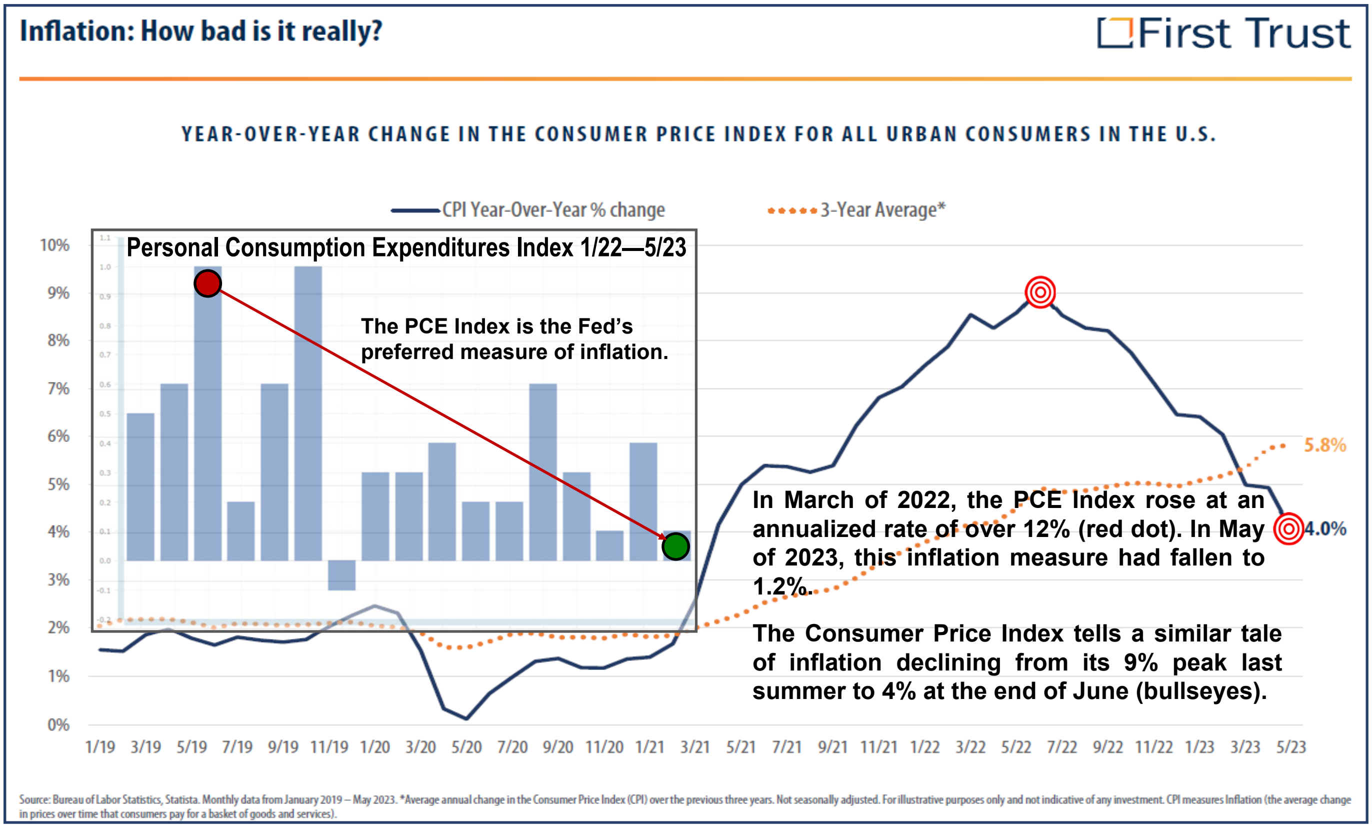
The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance, while the 11 major S&P 500 Sector Indices are capitalization-weighted and comprised of S&P 500 constituents representing a specific sector. Investors cannot invest directly in an index. Indices do not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown.

Price-to-Book ratio - Share price divided by book value of equity per share. **Est. Return on Equity (ROE)** - Estimated return on common equity utilizing FactSet consensus estimated earnings per share in calendar year divided by equity per share. **Est. EPS Growth** - Expected year-over-year growth in FactSet consensus forecasted Earnings Per Share. **Price to NTM EPS** - Price divided by FactSet consensus forecasted earnings per share over the next twelve months.

As of 9/28/18, GICS was reconstituted, and the Telecommunications Services sector was renamed Communication Services. GICS sector information for periods prior to 9/28/18 may not necessarily be comparable to the reconstituted sectors.

FED HAVING SOME SUCCESS TAMING INFLATION

The Consumer Price Index (CPI) and the Personal Consumption Expenditures (PCE) Index are two commonly cited measures of inflation. In March of 2022, the Fed began hiking interest rates in its quest to tame inflation before it became too entrenched in our collective behavioral patterns (where businesses automatically raise prices simply because they begin to expect everyone else will). The panel below suggests that the Fed's actions are working.



Equity valuations appear to be stretched and a slowdown may be around the corner, but inflation has relaxed markedly since last summer, corporate earnings seem set to resume their growth next year, and those looking for interest income have plenty of options to obtain yields that outpace inflation.

Things could be a lot worse.

— Glenn Wessel