

SEVENS REPORT *alpha*

Webinar #18: Detecting Threats & Opportunities in Fixed Income

Date: Thursday, April 26, 2018

Presenter: Tom Essaye

**Guest: Bill Housey, Senior Portfolio Manager of First Trust's
Leveraged Finance Investment Team**

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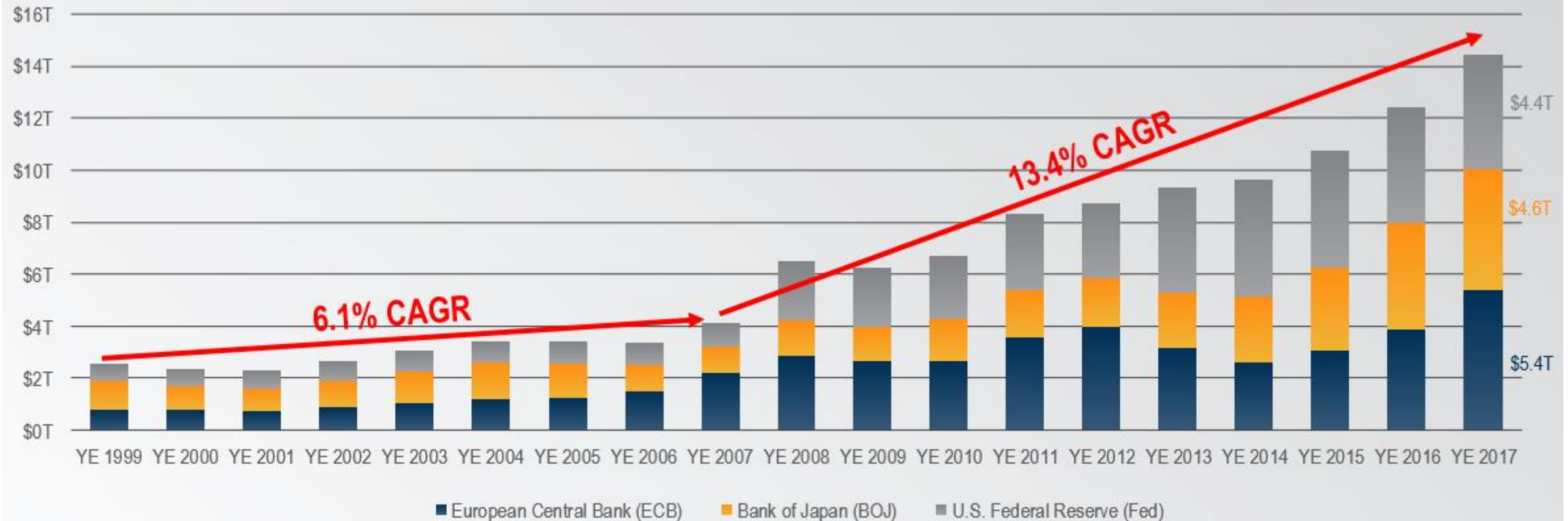
Goals for Today's Webinar

- Bill Housey, Senior Portfolio Manager of First Trust's Leveraged Finance Investment Team
 - Macro View on Interest Rates and the Economy
 - Perspective on Current State of Fixed Income Market
 - Biggest Threats
 - Best Opportunities
 - Active vs. Passive Debate

Central Bank Balance Sheets Have Expanded Significantly

GROWTH OF CENTRAL BANK BALANCE SHEETS (TOTAL ASSETS - USD)

December 1999 – December 2017



Source: Bloomberg

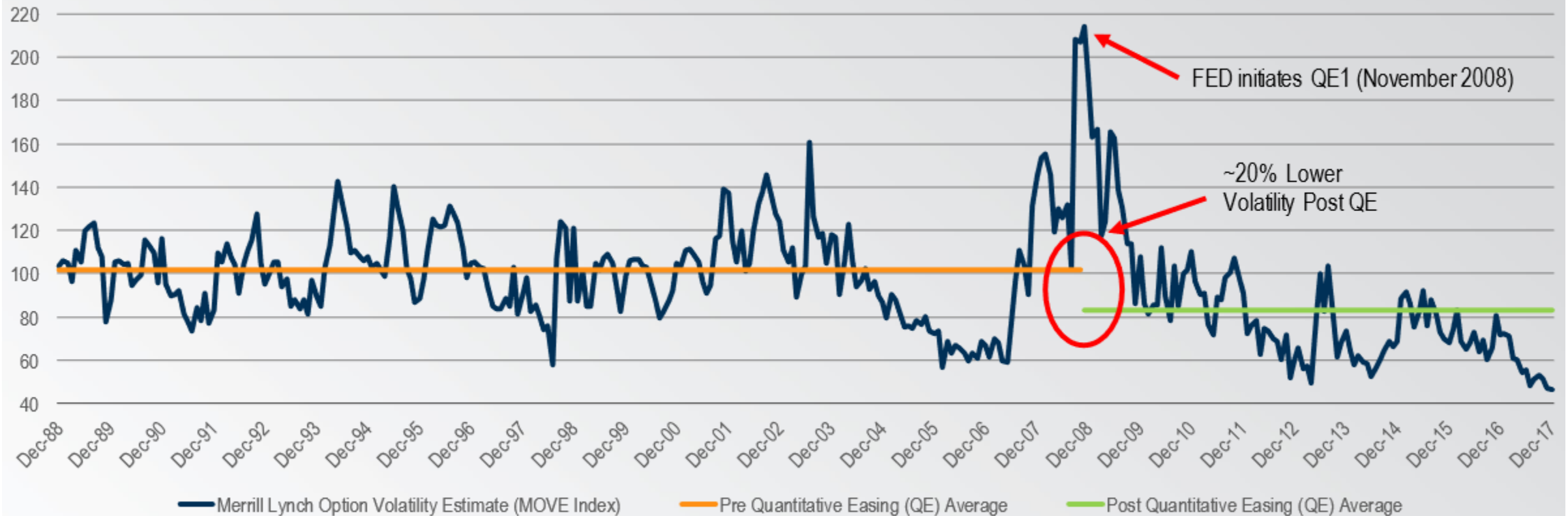
The chart is for illustrative purposes only. Past performance is no guarantee of future results. The U.S. Federal Reserve (the "Fed") initiated Quantitative Easing (QE) in November 2008.

Data through 12/29/2017

Rate Volatility Has Been Influenced by Central Banks

MERRILL LYNCH OPTION VOLATILITY ESTIMATE (MOVE INDEX)

December 1988 – December 2017



Source: Bloomberg

The chart is for illustrative purposes only. Past performance is no guarantee of future results. The U.S. Federal Reserve (the "Fed") initiated Quantitative Easing (QE) in November 2008.

Data through 12/29/2017

Larger Deficits May Lead to More Treasury Issuance

U.S. ANNUAL BUDGET BALANCE AND FORECAST (\$BN)



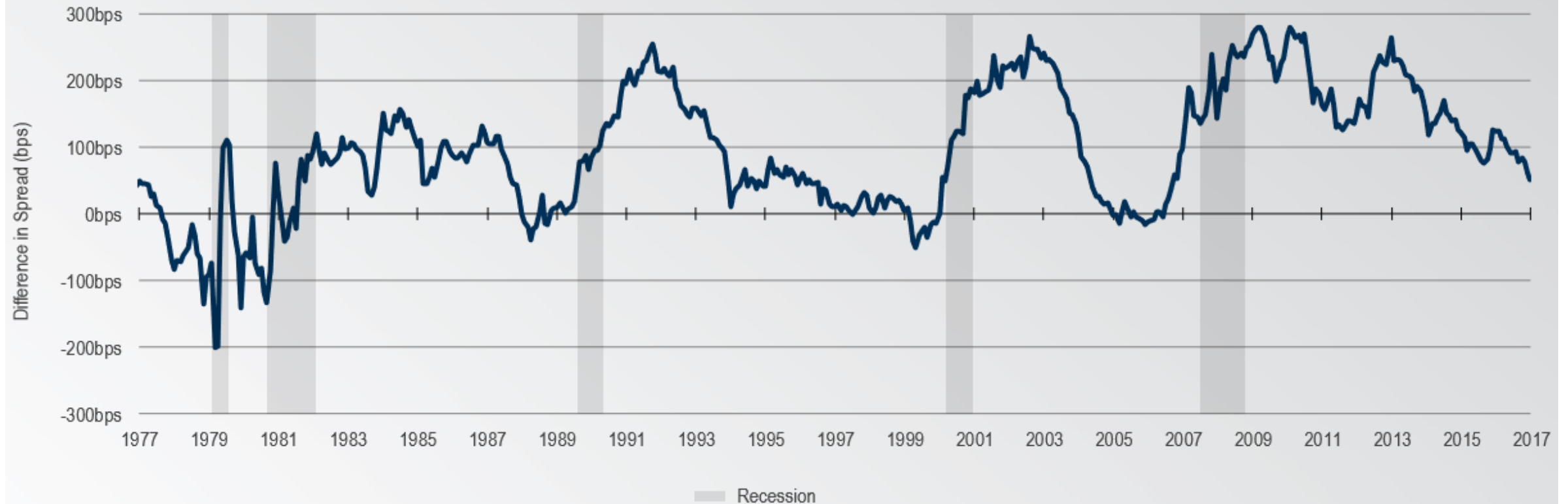
Source: JP Morgan, U.S. Treasury

The chart is for illustrative purposes only. There is no assurance that any forecast will be achieved.

*JPM forecast

Yield Curve Is Not Signaling a Recession

SPREAD BETWEEN 2 YEAR AND 10 YEAR U.S. TREASURIES



Source: Bloomberg

Grey areas denote prior economic recessions. This slide is for illustrative purposes only. Past performance is no guarantee of future results.

Data through 12/29/2017

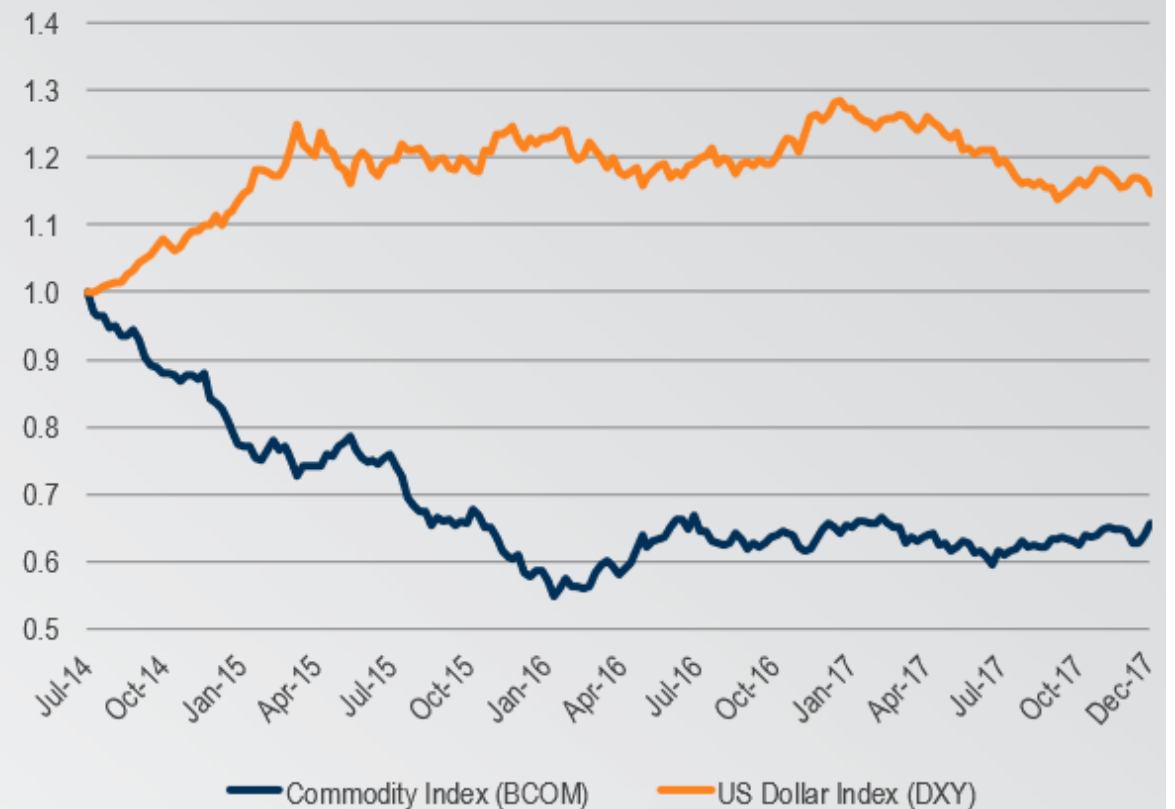
Keeping a Close Watch on the U.S. Dollar

DXY CURRENCY

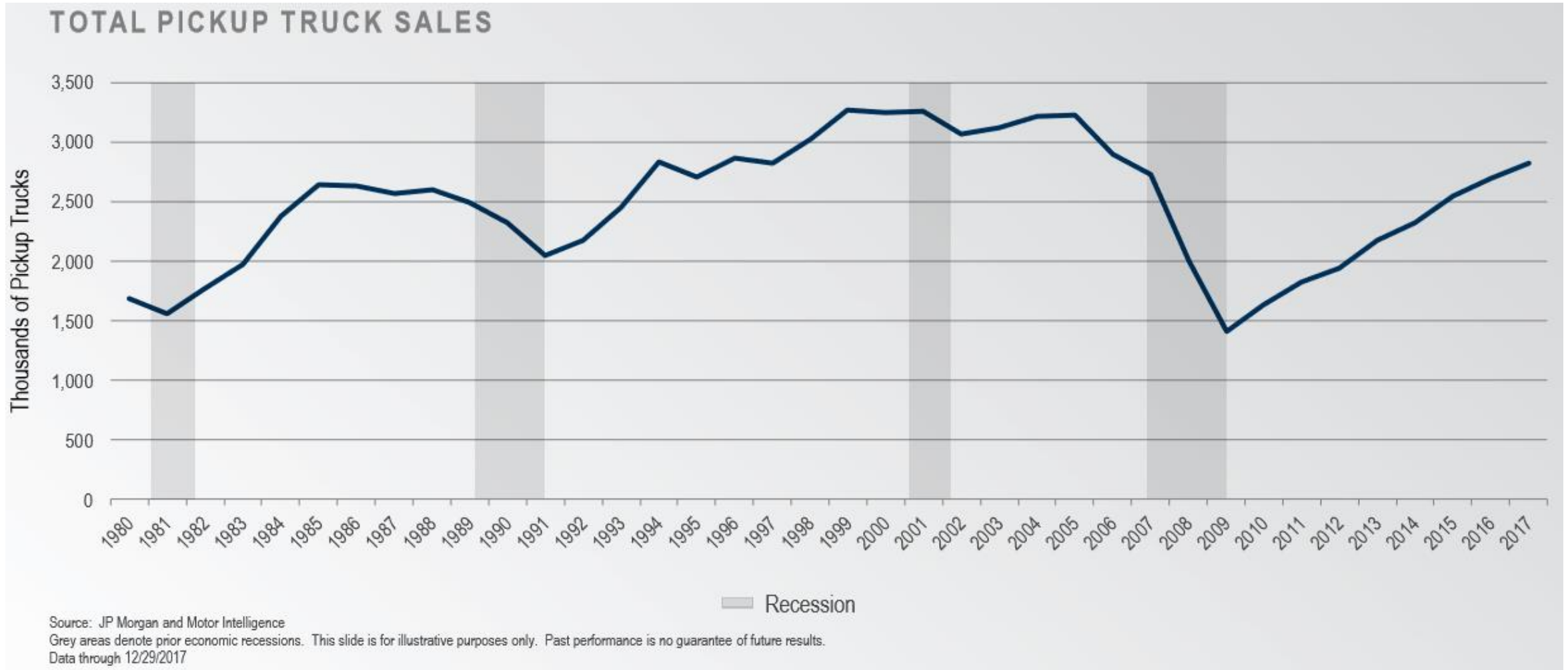


Source: Bloomberg
The charts are for illustrative purposes only. Past performance is no guarantee of future results.
Data through 12/29/2017

THE U.S. DOLLAR'S NEGATIVE CORRELATION WITH COMMODITY PRICES

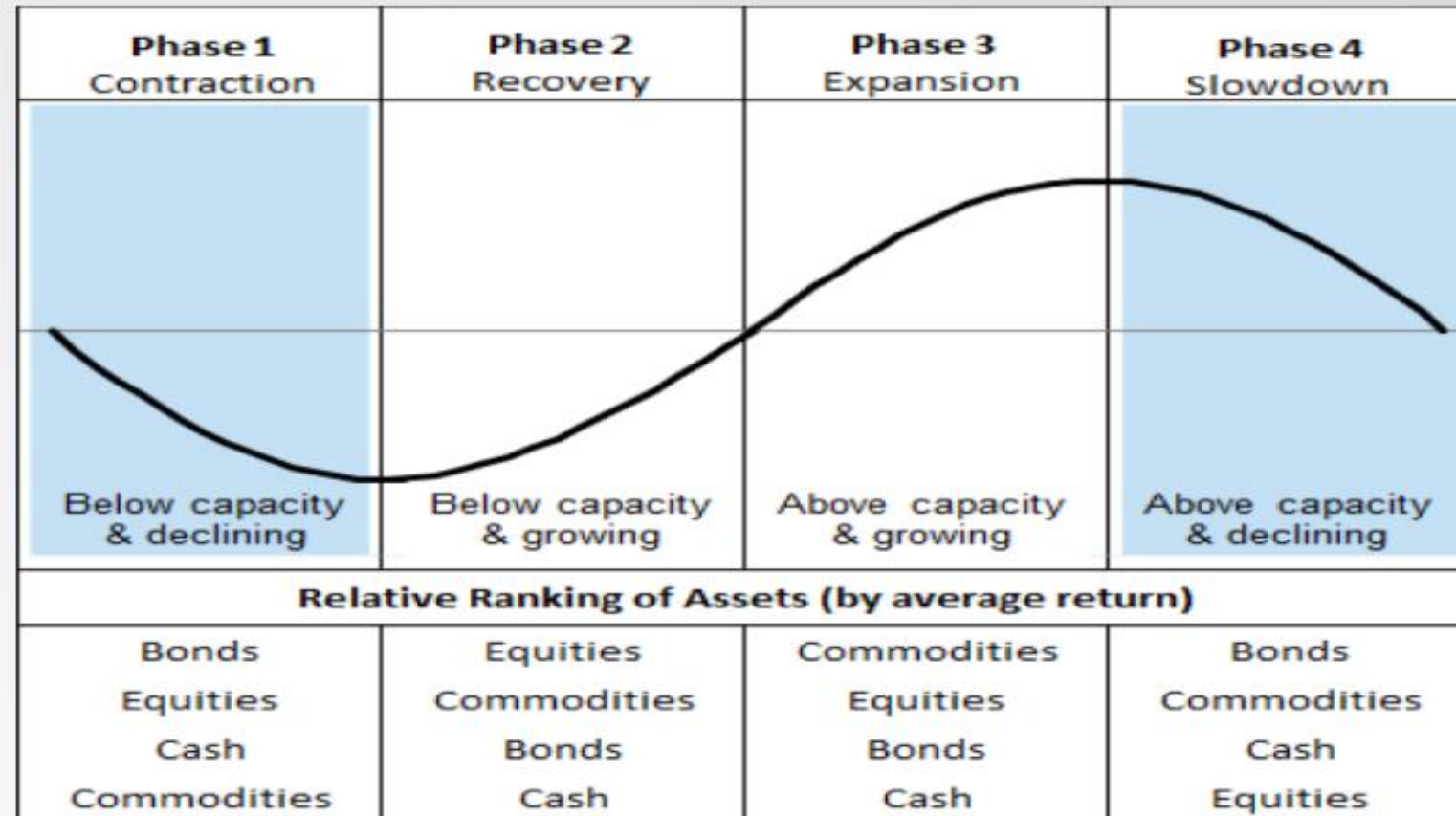


Checking the Pulse of the Economy



The Business Cycle

WHERE ARE WE NOW?

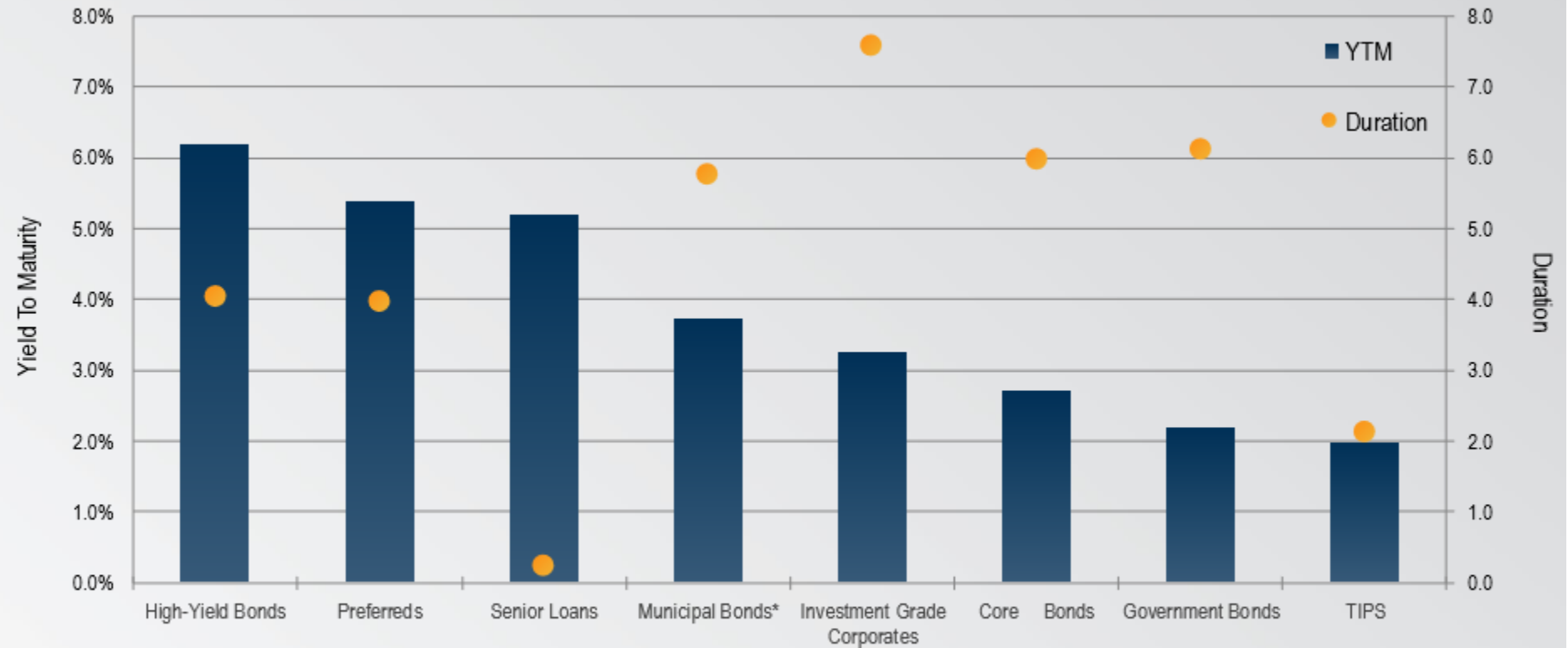


Source: Goldman Sachs Global Investment Research

Where Is the Opportunity? Where Is the Greatest Risk?

In a persistently low interest-rate environment, we believe investors have few options to generate a high level of income without assuming significant interest rate risk.

FIXED INCOME OPPORTUNITY SET – DURATION/YTM



Source: Barclays, S&P LCD, and Bloomberg. The chart is for illustrative purposes only and not indicative of any fund. Past performance is no guarantee of future results. Data through 12/29/2017

*Municipal Bonds are represented by the Bloomberg Barclays Municipal Bond Index and the YTM represents the Tax-Equivalent Yield (TEY) for the highest tax bracket of 37%.

Today's Active Vs. Passive Debate Is Lopsided

MARKET-CAP WEIGHTED HIGH-YIELD AND SENIOR LOAN INDEX ETFs

Traditional Cap-Weighting Approach

An issuer's weight in the index is a function of the quantity and current price of its outstanding debt.



TRADITIONAL MARKET-CAP WEIGHTED HIGH YIELD AND SENIOR LOAN INDEX ETFs

Two factors determine which high yield bonds or senior loans are selected, and how they are weighted within the underlying index:

- Quantity of corporate issues
- Price of bonds/loans

INVESTMENT IMPLICATIONS:

- Investors lend more to the most indebted borrowers, and less to the least indebted borrowers, irrespective of their relative ability to repay their debt.
- Greater exposure to issuers that are either more heavily indebted or overvalued may result in an unnecessary drag on investment returns.