Closed End Funds: Access vs. alpha

First Trust

First Trust CEF Income Opportunity ETFs

LAUNCHED SEPTEMBER 27, 2016

First Trust CEF Income Opportunity ETF (ticker: FCEF)

- Objective: To provide current income with a secondary emphasis on total return

First Trust Municipal CEF Income Opportunity ETF (ticker: MCEF)

- Objective: To provide current income

FCEF and MCEF were the first <u>actively managed</u> ETFs using CEFs as their primary investment strategy

ETF: Access vs. alpha

ETFs originated as trading vehicles to provide **ACCESS** (think SPDR - S&P 500)

- Efficient areas of the market offer little opportunity for **ALPHA**
- Provided traders with a cash vehicle

Over time as most **ACCESS** plays have been covered, ETF origination moved toward **ALPHA** opportunities

- Less efficient areas of the markets where managers have an “expertise” or can exploit an inefficiency
- Replication of popular mutual fund strategies have launched or the managers of such mutual funds have been hired on as sub-advisors

CEFS: ACCESS VS. ALPHA

Modern closed-end funds originated as **ALPHA** vehicles

- High income potential through the CEF wrapper
- Leverage offering the ability to take advantage of the yield curve
- Captured asset base allowing ability to invest in illiquid and/or inefficient asset classes

In recent years, sponsors have created **ACCESS** plays which utilize CEFs

- UITs
- ETFs

CEFS: ACCESS VS. ALPHA

The time has come to take the next steps:

- Utilizing the ETF wrapper – ACCESS
- With the CEF value add – ALPHA
- Not all CEFs were created equal and they are more than just a trade

Proof of concept:

- SMAs of CEFs
- Traditional Mutual Funds of CEFs
- Retail advisers/investors are beginning to discover the benefit

CEFS: ACCESS VS. ALPHA

- It is time to stop thinking about ACCESSING CEFs through the ETF structure

- The time has come to look for the ALPHA that CEFs can potentially provide through ETFs

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FIRst trust goes far beyond potentially biggest yield and biggest discount

Distribution policy
Sources of distribution
UNII and earnings ratio trends
NAV and share price total return
Leverage
Liquidity
Credit quality
Duration
Bond call exposure
Fund sponsor
Assess holdings ownership
Activist presence and activity

ETF Characteristics and RISk considerations

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 a fund. The prospectus or summary prospectus should be read carefully before investing.

ETF Characteristics
The funds list and principally trade their shares on The Nasdaq Stock Market LLC.

Investors buying or selling fund shares on the secondary market may incur customary brokerage commissions. Market prices may differ to some degree from the net asset value of the shares. 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 a fund's net asset value and possibly face delisting.

Risks
A fund's shares will change in value and you could lose money by investing in the funds. The funds are subject to management risk because the advisor will apply investment techniques and risk analyses that may not have the desired result. There can be no assurance that a fund's investment objectives will be achieved.

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

Income from municipal bonds could be declared taxable because of, among other things, unfavorable changes in tax laws, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliant conduct of a bond issuer. All or a portion of the funds' otherwise exempt-interest dividends may be taxable to those shareholders subject to the federal alternative minimum tax.

Because the shares of CEFs cannot be redeemed upon demand, shares of many CEFs will trade on exchanges at market prices rather than net asset value, which may cause the shares to trade at a price greater than NAV (premium) or less than NAV (discount). There can be no assurance that the market discount on shares of any CEF purchased by the funds will ever decrease or that when the funds seek to sell shares of a CEF they can receive the NAV for those shares. The funds may also be exposed to higher volatility in the market due to indirect use of leverage through their investment in CEFs. CEFs may issue senior securities in an attempt to enhance returns.

An underlying fund may invest in small and/or mid capitalization companies. Such companies may experience greater price volatility than larger, more established companies.

An investment in an underlying 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.

FCEF may be subject to covered call risk which is the risk that an underlying fund will forgo, during an option's life, the opportunity to profit from increases in the market value of the security covering the call option above the sum of the premium and the strike price of the call, but has retained the risk of loss should the price of the underlying security decline.

Senior loans are usually rated below investment grade but may also be unrated. As a result, the risks associated with these 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.

The market for high yield securities is smaller and less liquid than that for investment grade securities. Distressed Municipal Securities are speculative and involve substantial risks. Lower- quality debt tends to be less liquid than higher-quality debt.

Participation interests in municipal leases pose special risks because many leases and contracts contain "non-appropriation" clauses that provide that the governmental issuer has no obligation to make future payments under the lease or contract unless money is appropriated for this purpose by the appropriate legislative body.

Certain underlying funds are subject to credit risk, income risk, interest rate risk, call risk, prepayment risk and zero coupon bond risk. Credit risk is the risk that an issuer of a security will be unable or unwilling to make dividend, interest and/or principal payments when due and that the value of a security may decline as a result. Credit risk is heightened for floating-rate loans and high-yield securities. Income risk is the risk that income from fixed income investments could decline during periods of falling interest rates. Interest rate risk is the risk that the value of the securities in the fund will decline because of rising market interest rates. Call risk is the risk that performance could be adversely impacted if an issuer calls higher-yielding debt instruments. 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 an underlying fund's income. Zero coupon bond risk is the risk that zero coupon bonds may be highly volatile as interest rates rise or fall because they do not pay interest on a current basis.

An underlying fund may invest in inverse floating rate securities which create effective leverage and thus, the value of the inverse floater will increase and decrease to a significantly greater extent. Custodial receipt trusts may issue inverse floater securities and if an underlying fund were to hold inverse floaters issued by custodial receipt trusts, the underlying fund would be subject to the risks of inverse floaters.

Preferred securities combine some of the characteristics of both common stocks and bonds. Preferred securities are typically subordinated to bonds and other debt instruments in a company's capital structure, in terms of priority to corporate income, and therefore will be subject to greater credit risk than those debt instruments.

The risks of owning an ETF generally reflect the risks of owning the underlying securities, although lack of liquidity in an ETF could result in it being more volatile and ETFs have management fees that increase their costs.

Certain of the underlying funds may invest in distressed securities and many distressed securities are illiquid or trade in low volumes and thus may be more difficult to value.

Illiquid securities involve the risk that the securities will not be able to be sold at the time desired by the funds or at prices approximately the value at which the funds are carrying the securities on its books.

MLPs are subject to certain risks, including price and supply fluctuations caused by international politics, energy conservation, taxes, price controls, and other regulatory policies of various governments. In addition, there is the risk that a MLP could be taxed as a corporation, resulting in decreased returns from such MLP.

Certain of the fixed-income securities held by certain underlying funds may not have the benefit of covenants which could reduce the ability of the issuer to meet its payment obligations and might result in increased credit risk.

The market values of convertible bonds tend to decline as interest rates increase and, conversely, to increase as interest rates decline. A convertible bond's market value also tends to reflect the market price of the common stock of the issuing company.

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.

The funds currently intend to effect a significant portion of creations and redemptions for cash, rather than in-kind securities. As a result, the funds may be less tax-efficient.

The use of options or other derivatives can lead to losses because of adverse movements in the price or value of the underlying asset, index or rate, which may be magnified by certain features of the derivatives. If a counterparty defaults on its payment obligations, the funds will lose money and the value of fund shares may decrease.

Because the funds' NAV is determined on the basis of U.S. dollars and the funds' invest in non-U.S. securities, you may lose money if the local currency of a non-U.S. market depreciates against the U.S. dollar.

The funds currently have fewer assets than larger funds, and like other relatively new funds, large inflows and outflows may impact the funds' market exposure for limited periods of time.

The funds are classified as "non-diversified" and may invest a relatively high percentage of their assets in a limited number of issuers. As a result, the funds may be more susceptible to a single adverse economic or regulatory occurrence affecting one or more of these issuers, experience increased volatility and be highly concentrated in certain issuers.

The funds' investment in CEFs is restricted by the Investment Company Act of1940 and the funds' associated exemptive relief which limits the amount of any single CEF that can be owned by the funds.

First Trust Advisors L.P. is the adviser to the funds. First Trust Advisors L.P. is an affiliate of First Trust Portfolios L.P., the funds' distributor.

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1-866-848-9727
www.ftportfolios.com

An investor 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 a fund. The prospectus or summary prospectus should be read carefully before investing.