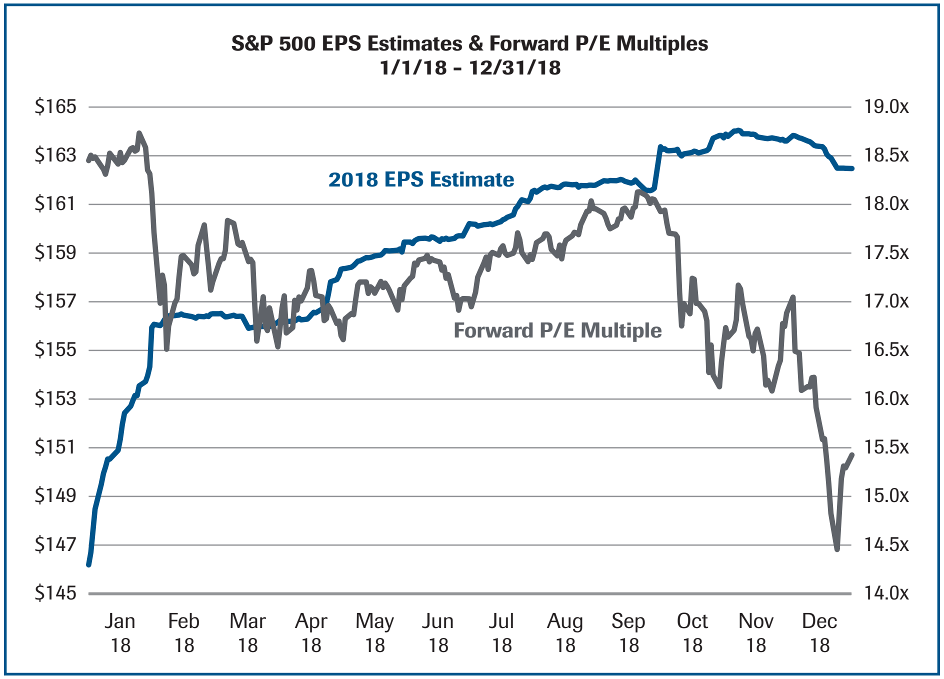
Volatility may not kill the Bull in 2019

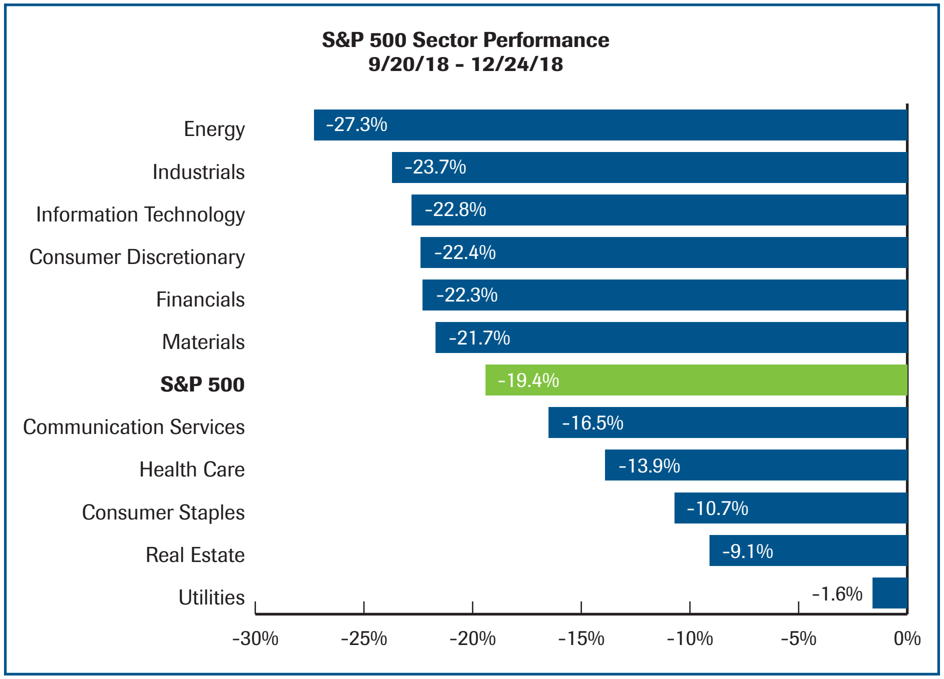
The steep equity sell-off in December appeared to suggest the market was pricing in a recession, with the forward price-earnings multiple falling to levels historically associated with an economic downturn. Indeed, the downdraft hit the cyclical sectors particularly hard, with energy, industrials, information technology, consumer discretionary, financials and materials all down more than 20% from their late September highs through the nadir reached on Christmas Eve.

The Market Appears to Have Been Pricing in a Recession in 2019...



Source: Bloomberg, Federated Investors as of 12/31/18.

...Particularly in the Cyclical Sectors



Source: Bloomberg, Federated Investors as of 12/31/18.

We, However, Do Not See a Recession in 2019…

The problem is the macro fundamentals are signaling at best a soft patch, nothing worse. By virtually every indicator – jobless claims, inflation, factory activity, etc. – the economy continues to chug along, albeit at a slower pace than earlier in 2018. All the handwringing over a flattening yield curve nearing inversion misses a key point: it hasn't even inverted yet, and recessions historically don't come until well after inversion.

Recession Indicators: Current vs. Prior Recessions

Indicators	Measure	1974	1980	1981	1991	2001	2008	Average	Current
Labor Market	Increase in Claims	32,000	90,000	68,000	80,000	125,000	50,000	74,167	13,000
Inflation	Increase in Core PCE	2.17%	2.37%	0.93%	1.90%	1.76%	2.54%	1.95%	1.06%
Housing	Decline in Housing Starts	770,000	856,000	502,000	1,089,000	329,000	1,236,000	797,000	78,000
Yield Curve	10 Year Treasury Yield – Federal Funds Rate	-3.88%	-3.45%	-4.37%	-1.44%	-1.29%	-0.79%	-2.54%	0.31%
Spreads	BarCap Corp High Yield – 10 Year Treasury Yield	-	-	-	8.21%	9.34%	5.62%	7.72%	4.54%
Manufacturing	ISM Manufacturing	57.8	44.8	46.7	45.1	42.3	50.1	47.8	54.1

Source: Bloomberg, Federated Investors as of 12/31/18.

Is the Yield Curve a Good Predictor of Recessions?

Curve Inverted	Lead Time	S&P 500 Returns	Recession Started
Aug 1978	1 year, 5 months	20% ⬆	Jan 1980
Sep 1980	10 months	9% ⬆	Jul 1981
Jan 1989	1 year, 6 months	42% ⬆	Jul 1990
Jun 1998	2 years, 9 months	6% ⬆	Mar 2001
Dec 2005	2 years	22% ⬆	Dec 2007

Source: Bloomberg, Federated Investors as of 12/31/18.

A Non-Recessionary Pullback is More Likely

So what's the message for investors? Opportunity. History suggests that when the market prices in recession when there subsequently isn't one, returns off the market low can be significant. This is why Federated is holding at a substantial equity overweight in its PRISM® stock-bond recommended portfolio allocation models.

Non-Recessionary Pullbacks

Dates	Max Decline	Duration (Months)	12-Month Forward Return
Aug 1987 - Dec 1987	-32.8%	3	26.0%
July 1998 - Oct 1998	-19.2%	3	39.8%
Apr 2011 - Oct 2011	-18.6%	5	35.0%
May 2015 - Feb 2016	-12.8%	9	29.3%
Average	-20.9%	5	32.5%
9/20/18 - Current	-19.4%	3	?

Source: Bloomberg, Federated Investors as of 12/31/18.

Past performance is no guarantee of future results.

Views are as of 1/18/19 and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

S&P 500 Index is an unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Indexes are unmanaged and cannot be invested in directly.

The value of equity securities will rise and fall. These fluctuations could be a sustained trend or a drastic movement.

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