Federated Hermes Strategic Value Dividend Fund Newsletter

September 2020

Very out of favor, great entry point, or both?

If you must play, decide upon three things at the start: the rules of the game, the stakes, and the quitting time – Chinese Proverb

2020 has been one for the history books: pandemic, economic shutdown, presidential election, apocalyptic wildfires. And yet, a narrow slice of the stock market—a small group of well-known, mega-cap growth stocks—has done exceptionally well. Their businesses have held up and their share prices have skyrocketed. The rest of the market has trailed to some degree or another, or even languished, despite business conditions beginning to stabilize. The result is a yawning gap, an epic mismatch, an off-the-charts differential in the valuations between our type of cash flow-generative stable businesses and the Fashionable-15 or so that have hogged all the attention.

That chasm is why we believe this is a good time to review and consider the oh-so-out-of-favor Strategic Value Dividend (SVD) franchise. While there are no sure things on Wall Street (or Main Street), over the long run, dividends have been a more reliable contributor to long-term returns than changes in P/E multiples (the driving force behind the recent market rally).[1] But the trading conditions of the past several years, and especially in 2020, have situated many high-quality dividend stocks at the intersection of decades-high dividend yields, and decades-low earnings multiples.

That relative attraction only holds if the dividends are delivered. On that front, the worst appears to be behind us. Early 2020 presented genuine challenges to the cash flow of many businesses, but through changes in the portfolio and the slow economic recovery, the currently indicated income stream seems attainable. There is always risk to a dividend payment—they are not guaranteed—but that risk has diminished in recent months. Business isn't returning to the old normal. It will be a new normal, but one that still relies on food, beverage, electricity, medicine, telecommunications, banking and even energy.

The fund's gross weighted average dividend yield was 5.05% as of 8/31/20—near the high end of its historical range—and we believe the majority of the companies in the portfolio have the ability to continue their dividend payments. The fund's calendar year 2020 dividend is expected to be down slightly from 2019, due to the events of the first half of the year, but following three strong years of dividend growth, we believe the fund will continue to offer dividend growth potential. And even during a pause in the annual growth, the Federated Hermes Strategic Value Dividend Fund (FSVF) has continued to pay generous income to "Grandma" every month in an environment in which the cash competition isn't much competition at all. The 10-year U.S. Treasury yield was 0.72% and the S&P 500 Index yield was 1.61% at 8/31/20. Many other so-called "dividend" products offer skimpy gross yields in the 2-3% range.[2] There remains a strong demand for income, and a scarcity of attractively-priced, high cash distribution vehicles.

With the benefits of Strategic Value Dividend's historically strong income stream being fairly clear in today's yield-starved environment, we have been having more discussions about share valuations—a topic that typically ranks third for our management team, behind dividend yield and the outlook for dividend growth. As you may be aware, our dividend strategy has not been popular from a total return perspective in 2020. Although we are well ahead of our nominal benchmark and relatively in line with our few genuine peers, we remain considerably behind the market.[3]

The S&P 500 Index returns have been driven by large, non- or minimal-dividend paying companies that have seen their share prices rise by 40% or 60% or 80% year-to-date. You know their names. That's why the yield of the S&P 500 Index keeps falling. It is being propelled by companies that are not part of our opportunity set. Outside of the S&P 500 Index, there is that electronic vehicle company that was up 450% at its peak this year, and the video conferencing company whose stock gained 550% through the end of August. Good for them; good for their investors.

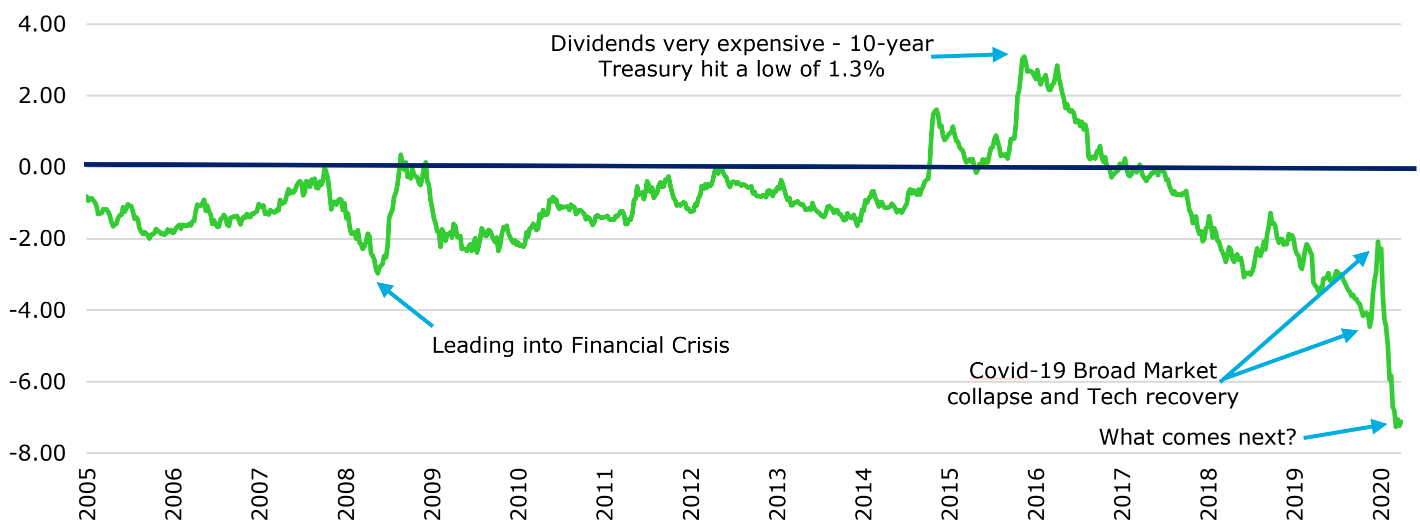
Past performance is no guarantee of future results.

And the news for growth investors, in general, has been exceptionally good. Growth stocks have outperformed Value on both sides of 2020's stock market "V", leaving investors asking "are tech stocks the new defensives?" The result has been a remarkable gap between Value and Growth stock valuations unseen since the bursting of the tech bubble two decades ago.

Many SVD holdings are now so out of favor that investors might just want to consider what the market's next step will likely be. At the beginning of September, FSVF was a stunning 25% behind the S&P 500 Index, year-to-date.[4] To the best of our knowledge, that has never happened before. The conclusion is obvious to us. Even if you are not buying dividend stocks for the income potential, now is the time to closely consider the Federated Hermes Strategic Value Dividend Fund, not in the spring of 2016, when the strategy was exceptionally popular (and its yield was exceptionally low), but in the autumn of 2020 when the stocks in the portfolio are exceptionally cheap versus the market (and the portfolio yield is exceptionally high).

During the intervening four years, there has been a pronounced shift in market sentiment away from our dividend stocks. Several of the non-dividend areas of the S&P 500 have gotten very expensive. And while our security prices have been virtually flat since 2016, three years of earnings growth and robust dividend growth have back-filled the valuation of the dividend stocks. Our investments are no longer expensive; in fact, we think they are extremely undervalued.

Relative P/E NTM
Federated Hermes Strategic Value Dividend Fund versus S&P 500 Index



On a forward P/E basis, SVD has only been this cheap versus the S&P 500 one other time in history, heading into the Financial Crisis.
P/E (NTM - Next Twelve Months) in calculating this, individual holdings with values greater than 60 are capped at 60 in accordance with Morningstar's methodology for calculating P/E.
Source: FactSet Research Systems & Federated Hermes, June 2020.
Past performance is no guarantee of future results.

Please note the market rotation from growth/technology stocks into value/dividend names that our CIO Stephen Auth, CFA called out in his latest Insight, published 9/11/2020. While we share the same view, the specific trajectory of the stock market continues to be a guessing game. While we can speculate on the portfolio's potential total returns over the next several years, we don't have to say "let's wait and see what the yield or dividend income looks like." That question can be answered right now. SVD has provided robust income. The market and many so-called "income" products have not. But even for the stock market's growth-oriented investors, we are open for business. In the nearly 20 years we've been managing the Strategic Value Dividend portfolio, we've never seen it trade near the valuation discount to the market that exists today. And total return expectations for high-quality dividend stocks are so low today that the odds may just be in our favor. As total return-minded clients reflect back on their 2020 win streak, it may be hard for them to resist the conventional gaming wisdom: "never walk away from a heater." But consider the odds, the stakes and the hour. It may just be time to try a different game.

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Average annual total returns (%) as of 9/30/2020

	1-year	3-year	5-year	10-year	Since inception 3/30/2005	30-day dist. yield (%)	30-day yield (%)	Expense ratio* Before waivers	After waivers
A Shares (NAV)	-12.40	-1.98	4.06	7.54	5.70	4.54%	4.22	1.18	1.06
A Shares (MOP)	-17.28	-3.81	2.89	6.93	5.32	4.29%	3.98	1.18	1.06
IS Shares	-12.11	-1.73	4.34	7.80	5.98	4.79%	4.48	0.93	0.81

Performance quoted represents past performance, which is no guarantee of future results. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than what is stated. To view performance current to the most recent month-end, and for after-tax returns, contact us or visit FederatedInvestors.com. Maximum offering price figures reflect the maximum sales charge of 5.5% for A Shares.

***The fund's expense ratio is from the most recent prospectus. The expense ratio may reflect voluntary fee waivers and/or expense reimbursements determined by the fund's Advisor and its affiliates. The voluntary waivers and/or reimbursements, if applicable, are in effect up to but not including the later of 1/1/21 or the date of the fund's next effective prospectus.**

[1] Source data: Robert Shiller database, Yale University, http://www.econ.yale.edu/~shiller/data.htm and Federated Hermes, Inc.

[2] The Lipper Equity Income Funds Peer group had an average 2.5% 12-month distribution yield as of 8/31/2020.

[3] At 8/31/2020, the YTD total return of FSVF was -13.93% (IS Shares), while over the same period the Dow Jones Select Dividend Index returned -17.84% and the S&P 500 Index returned 9.74%.

[4] At 9/2/20, the YTD return of FSVF was -13.04% (IS Shares), S&P 500 Index returned 12.29%.

Views are as of 9/14/20, 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.

Because this is a managed portfolio, the investment mix will change and the holdings are not indicative of future portfolio composition. Marketplace conditions fluctuate suddenly and frequently, and investment manager's opinions may change.

30-day yield (also known as "SEC yield") is a compounded and annualized figure calculated according to a formula set by the SEC. The formula requires use of a specific methodology for calculating dividends and interest earned, and expenses accrued, during the period, and reflects the maximum offering price per fund share. The standardized computation is designed to facilitate yield comparisons among different funds. In the absence of temporary expense waivers or reimbursements, the 30-day yield would have been 4.41% for R6 Shares, 4.34% for Institutional Shares, 4.09% for A Shares, and 3.32% for C Shares.

The 30-day distribution yield reflects actual distributions made to shareholders. It is calculated by dividing the monthly annualized dividend by the average 30-day offering price.

Total return represents the change in value after reinvesting all income and capital gains. Total return would have been lower in the absence of certain fund expense waivers or reimbursements. In addition, as of 9/30/20 the 30-day unsubsidized yield for A Shares would have been 4.09% at NAV, 3.85% at maximum offering price and 4.34% for Institutional Shares.

The dividend yield represents the average yield of the underlying securities within the portfolio. The average yield is a weighted average calculated by assigning a weight to each of the underlying securities in the portfolio based upon the portion of total assets of the portfolio each underlying security represents.

Dow Jones U.S. Select Dividend Index universe is defined as all dividend-paying companies in the Dow Jones U.S. Total Market Index that have a non-negative historical 5-year dividend-per-share growth rate, a 5-year average dividend earnings-per-share ratio of less than or equal to 60%, and 3-month average daily trading volume of 200,000 shares. Current index components are included in the universe regardless of their dividend payout ratio. The Dow Jones U.S. Total Market Index is a rule-governed, broad-market benchmark that represents approximately 95% of the U.S. market capitalization.

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.

A word about risk

Because the portfolios may allocate relatively more assets to certain industry sectors than others, the performance may be more susceptible to any developments which affect those sectors emphasized by the portfolios.

There is no guarantee that dividend paying stocks will continue to pay dividends. In addition, dividend paying stocks may not experience the same capital appreciation potential as non-dividend paying stocks.

International investing involves special risks including currency risk, increased volatility, political risks and differences in auditing and other financial standards.

Value stocks may lag growth stocks in performance, particularly in late stages of a market advance.

Stocks offer higher return potential, but their prices are more volatile than those of bonds. Unlike stocks, Treasury bonds are guaranteed as to the payment of principal and interest.

This must be preceded or accompanied by a prospectus for Federated Hermes Strategic Value Dividend Fund.

20-30461 (10/20)

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