# Federated Hermes Capital Income Fund Newsletter

**September 30, 2022**

## *Federated Hermes Capital Income Fund*

- Pursues current income and long-term capital appreciation over a market cycle.
- Seeks monthly income through a differentiated portfolio of primarily income producing stocks and a strategic mix of bond sectors: U.S. High-Yield, U.S. Investment Grade and Emerging Market bonds.
- Diversified across asset classes, sectors, and securities to reduce relative volatility, while balancing income and risk through active management.
- In the 3rd quarter, the Fund delivered a -4.66% total return (IS Class) and a 3.89% 12-month distribution yield (IS Class).

***Fund Ticker: IS: CAPSX; A: CAPAX***

***12 Month Distribution Yield-IS:*** *3.89%*

***30 Day SEC Yield-IS****: 3.13%*

***3 Year Beta (S&P 500):*** *0.58*

***Asset Allocation:*** *39% Eq/61%FI*

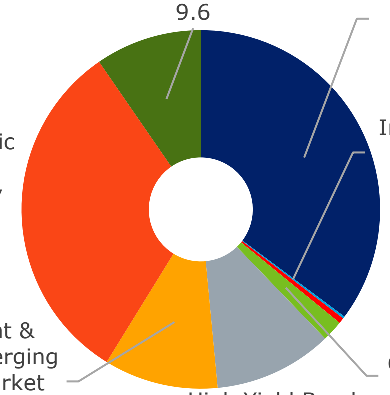
| | **Average annual total** returns % (as of 9/30/22)** 1-year | 5-year | 10-year | Since inception 5/27/88 | 30-Day Yield | Expense Ratio* Before Waivers | After Waivers |
|---|---|---|---|---|---|---|---|
| IS | -14.61 | 2.19 | 3.59 | 6.02 | 3.13 | 0.84 | 0.65 |
| A (NAV) | -14.85 | 1.93 | 3.34 | 5.97 | 2.86 | 1.09 | 0.90 |
| A (MOP) | -19.57 | 0.80 | 2.76 | 5.79 | 2.71 | 1.09 | 0.90 |

**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 charges of 5.5% for A Shares. See the prospectus for other fees and expenses that apply to a continued investment in the fund.**

## Market Comments

- As we enter the fourth quarter, we continue to have a cautious economic and earnings outlook, and are cognizant of the likelihood of continued market volatility. Our base case is a rocky landing scenario as the Fed works to bring inflation under control through a series of interest rate hikes.
- Concerns over inflation, slowing growth, continued geopolitical tensions, and the Fed's aggressive rate hikes have contributed to market volatility and losses across the board for most asset classes.
- In fixed income, inflationary measures continued to run high with core inflation, as measured by the Core PCE deflector holding in the 4.5% - 5.5% range. In response, the Fed had two 75 bps rate hikes during the quarter. The fed funds rate increased from 0% at the start of the year to 3.25% at the end of the quarter, making it the fastest one-year increase in 40 years. In September the Fed stopped its quantitative easing and is expected to reduce its US Treasury and mortgage-backed securities by approximately $1 trillion annually.

### Asset Allocation



## Positioning

- The Fund is positioned in line with our rocky landing outlook. The Fund is designed to be strategic in its asset allocation and take advantage of market movements and some level of self-correction in bonds. As such we have opportunistically reduced the equity allocation to 39%, have been strategic in the fixed income portfolio, and have an elevated cash level as we look for opportunities and entry point(s) back into the markets. We believe better opportunities will be a function of both time and price while the Fund's above average dividend continues to provide the opportunity for an income stream during the wait.

- The equity portfolio continues to be tilted toward higher quality defensive securities with strong balance sheets and potential for low volatility in their income stream. On the fixed income side we have continued upgrading the credit quality within the portfolio, opportunistically reducing exposure in the high yield and emerging markets to below benchmark and increasing exposure to the mortgage-backed and Treasury sectors. The duration and yield curve positioning are neutral relative to the benchmark.

- **The Fund has a focus on higher quality defensive stocks that are less inflation sensitive.** Healthcare and Utilities are representative of this defensive lean. We are overweight these sectors as we expect these companies to hold up well in the face of slowing consumer demand and earnings declines in other sectors.
  - **Health Care.** We continue to have an overweight in the sector, particularly to pharmaceuticals. During the quarter we took some profits across the board and added to Zimmer Biomet (ZBH), a quality company poised for further growth as we expect demand for orthopedic reconstructive products and procedures to continue.
  - **Utilities.** We continue to have conviction in the sector and like the valuation and dividend profiles of these companies. With the recent run in the sector, we will adjust the positions as market conditions warrant. As such, we reduced our allocation to Dominion (D) and added to NextEra Energy (NEE). In addition, we added American Water Works Company (AWK) to the portfolio.

**Current Equity Portfolio Themes**

- Health Care
- Utilities

**Equity Buys/Adds**

- Walmart
- Bank of America
- NextEra Energy

**Equity Trims/Sells**

- Signature Bank
- Micron

**Fixed Income Positioning**

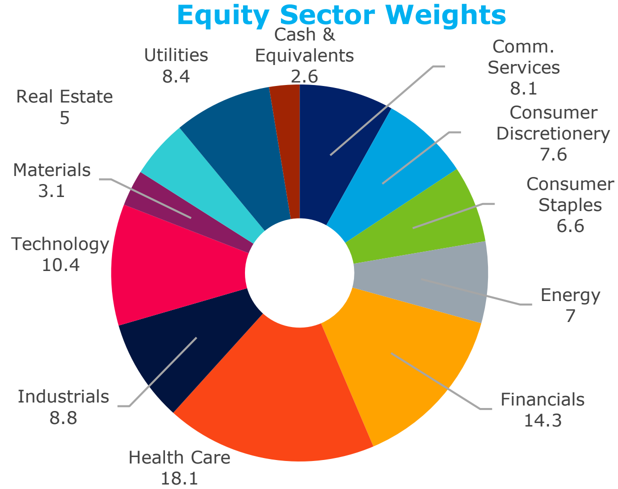
- Duration – 5.2 years
- Underweight High Yield and Emerging Markets
- Overweight High Quality

- **We continue to have conviction in Consumer Staples.** With inflationary concerns resulting in consumers being more price conscious, we have added to our position in Walmart (WMT) as they have pricing power with their suppliers and capture trade down consumers. With consumers staying at home and doing more at home entertaining, we added a new position in Constellation Brands (STZ). And we have also added to our position in Estee Lauder (EL) due in part to China reopening and consumer demand for cosmetics.

- **We have reduced our weight in Technology.** This has been a theme throughout the year and continued through the 3rd quarter. With concerns over chip supplies and company valuations, we have a near-term unfavorable outlook on semiconductors and sold our position in Micron (MU).

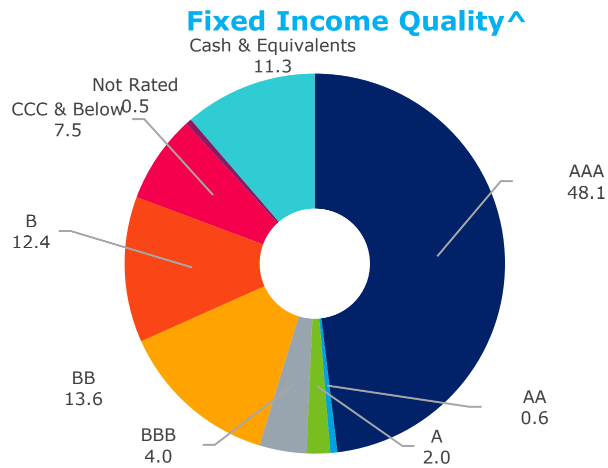
- **We have tilted more defensive in Financials.** With the Fed's recent and expected future rate hikes, we have taken profits and reduced our exposure to regional banks, and increased exposure to insurance and money center banks. In line with this view, we added to our positions in Bank of America (BAC) and Wells Fargo (WFC), as these companies are not as sensitive to consumer behavior and added to our position in Allstate (ALL). During the quarter we exited our position

**Equity Sector Weights**



in Signature Bank (SBNY) and decreased our allocation to Citizens Financial (CFG) based on their commercial and consumer banking and financing exposures.

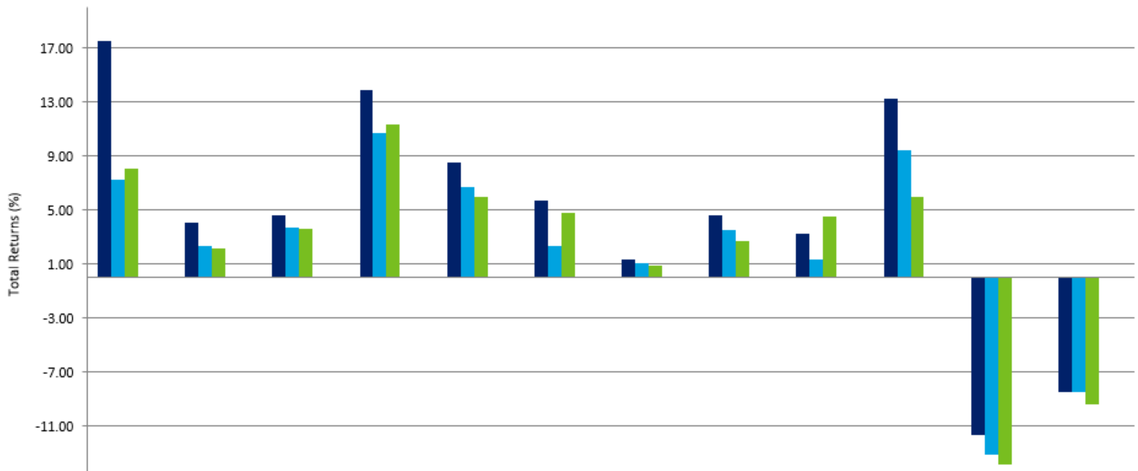
- **Fixed Income has a cautious outlook on credit** though feels it is starting to look more attractive in terms of absolute yield. The Fed will likely continue to hike rates through the end of 2022 and then potentially pause in 2023. They feel most of the policy tightening has been priced into the bond market. We have further reduced our high yield position with the proceeds going to cash, MBS, and Treasuries. We currently sit near the low end of both our high yield and emerging markets exposure and at the higher end of domestic high quality relative to history.




- Credit spreads began the year at historically tight levels and have continued to widen as investors pulled money from the market in anticipation of a Fed induced economic slowdown and subsequent increase in defaults. Additionally, emerging markets have been hit by the strengthening dollar and geopolitical issues. While yields are now more attractive in high yield and emerging markets, we believe there is a good probability of further spread widening as a recession becomes more likely in 2023 and will look for better entry points before putting capital back to work.

## Performance During Rising Rate Environments

The combination of dividend paying equities and higher yielding fixed income has resulted in outperformance during periods of rising rates and this latest example is no different. When the 10-year Treasury yield increased by more than 50 bps, the Fund outperformed its Morningstar 30-50% Equity category in all periods and a blend of broad-based fixed income and equity indices, in all but one time-period.




| | 03/16/2004 - 06/28/2006 | 12/04/2006 - 06/12/2007 | 10/08/2010 - 02/08/2011 | 10/03/2011 - 03/19/2012 | 07/26/2012 - 03/11/2013 | 05/02/2013 - 12/31/2013 | 01/30/2015 - 06/10/2015 | 07/08/2016 - 03/13/2017 | 09/07/2017 - 11/08/2018 | 08/04/2020 - 03/31/2021 | 08/03/2021 - 6/14/2022 | 8/01/22- 9/27/22 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Federated Hermes Capital Income Fund (IS) | 17.54 | 4.04 | 4.64 | 13.87 | 8.53 | 5.70 | 1.39 | 4.60 | 3.25 | 13.30 | -11.68 | -8.43 |
| Morningstar Allocation 30%-50% Equity Category Avg. | 7.23 | 2.36 | 3.74 | 10.73 | 6.74 | 2.38 | 1.04 | 3.53 | 1.38 | 9.44 | -13.09 | -8.48 |
| 60% Bbberg US Agg / 40% S&P 500 | 8.07 | 2.14 | 3.67 | 11.36 | 5.99 | 4.79 | 0.86 | 2.71 | 4.57 | 5.96 | -13.82 | -9.34 |
| S&P 500 Index | 16.88 | 6.96 | 14.38 | 29.62 | 16.16 | 17.40 | 6.38 | 13.06 | 16.40 | 21.45 | -14.44 | -11.19 |
| Bloomberg U.S. Aggregate Index | 2.26 | -1.06 | -3.09 | 0.34 | -0.41 | -3.04 | -2.77 | -3.78 | -2.96 | -3.70 | -13.77 | -8.11 |
| 10-Year Treasury Change (bps) | 156 | 87 | 135 | 62 | 62 | 140 | 84 | 127 | 120 | 123 | 230 | 138 |

Source: Bloomberg, Morningstar, Inc

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This is for a select time period. Performance for other share classes and over longer time periods will vary.

*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 2/01/23 or the date of the fund's next effective prospectus.*

**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.

**Disclosures**

^The ratings agencies that provided the ratings are Standard and Poor's, Moody's and Fitch. When ratings vary, the highest rating is used. Credit ratings of A or better are considered to be high credit quality; credit ratings of BBB are good credit quality and the lowest category of investment grade; credit ratings BB and below are lower-rated securities ("junk bonds"); and credit ratings of CCC or below have high default risk. The credit quality breakdown does not give effect to the impact of any credit derivative investments made by the fund.
There are no guarantees 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.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Diversification does not assure a profit nor protect against loss.

High-yield, lower-rated securities generally entail greater market, credit/default and liquidity risks, and may be more volatile than investment-grade securities.

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 for IS shares would have been 2.89% and the 30-day yield for the A shares would have been 2.65% at NAV and 2.50% at MOP.

The fund's Institutional Shares commenced operations on March 30, 2012. For the period prior to the commencement of operations of the Institutional Shares, the performance information shown is for the fund's A Shares. The performance of the A Shares has not been adjusted to reflect the expenses of the Institutional Shares, since the Institutional Shares had a lower expense ratio than the expense ratio of the A Shares. The performance of the A Shares has been adjusted to reflect the absence of sales charges and adjusted to remove any voluntary waiver of fund expenses related to the A Shares during the period prior to the commencement of operations of the Institutional Shares.

Current and future portfolio holdings are subject to risk. Value stocks may lag growth stocks in performance, particularly in late stages of a market advance.

Holdings referenced within this newsletter and their percentages as of 9/30/22 are as follows: Walmart (0.8%), NextEra Energy (0.8%), Bank of America (0.9%), Dominion Energy (0.6%), American Water Works (0.2%), Constellation Brands (0.2%), Estee Lauder (0.2%), Zimmer Biomet (0.3%), Microchip Technology (0.2%), Wells Fargo (0.7%), Allstate (0.5%), Citizens Financial (0.2%). The holdings percentages are based on net assets at the close of business on the dates above and may not necessarily reflect adjustments that are routinely made when presenting net assets for formal financial statement purposes. Because this is a managed portfolio, the investment mix will change.

Beta analyzes the market risk of a fund by showing how responsive the fund is to the market. The beta of the market is 1.00. Accordingly, a fund with a 1.10 beta is expected to perform 10% better than the market in up markets and 10% worse in down markets. Usually the higher betas represent riskier investments.

12-month Distribution Yield: The sum of a fund's total trailing 12-month interest and dividend payments divided by the last month's ending share price (NAV) plus any capital gains distributed over the same period.

Duration is a measure of a security's price sensitivity to changes in interest rates. Securities with longer durations are more sensitive to changes in interest rates than securities of shorter durations.

S&P 500 Index is an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.
Bloomberg US Aggregate Bond Index is an unmanaged index composed of securities from the Government/Corporate Bond Index, Mortgage Back Securities Index and the Asset Back Securities Index.

All information is as of 9/30/2022 unless stated otherwise.

International investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards. Prices of emerging-market securities can be significantly more volatile than the prices of securities in developed countries, and currency risk and political risks are accentuated in emerging markets.

Other classes of shares are available whose performance will vary due to different charges and expenses.

**This material must be preceded or accompanied by a prospectus.** Federated Securities Corp., Distributor 50769-IM (11/22)