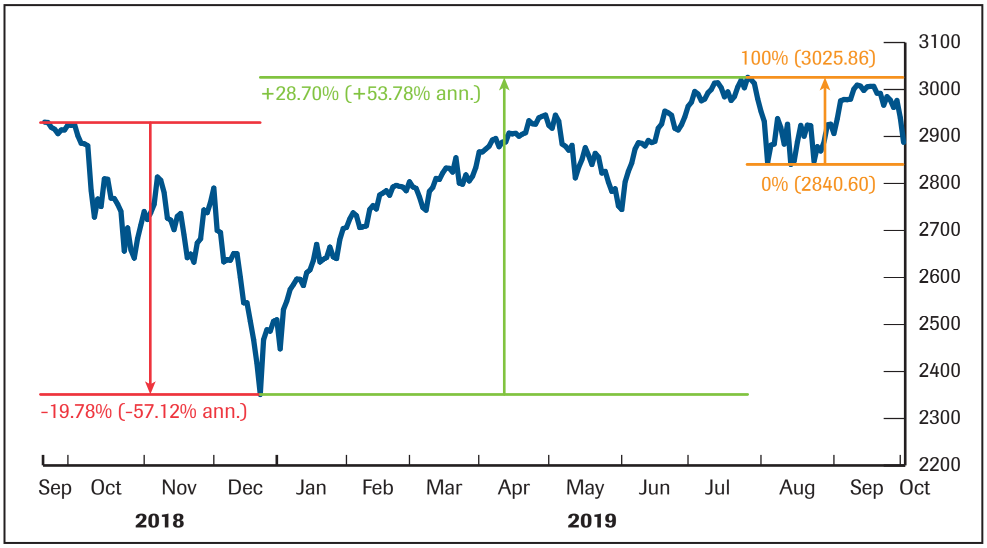
Patience is a Virtue

Optimistic but Mindful of Risks

Last December's steep equity sell-off gave way to the best start to a year for stocks in decades. However, a less-dovish-than-expected Fed and the threat of new tariffs against China have led to increased volatility in the third quarter, with the S&P 500 suffering a sell-off after hitting a record high in July. The question now is: where do we go from here?

S&P 500 9/20/2018 – 10/3/2019



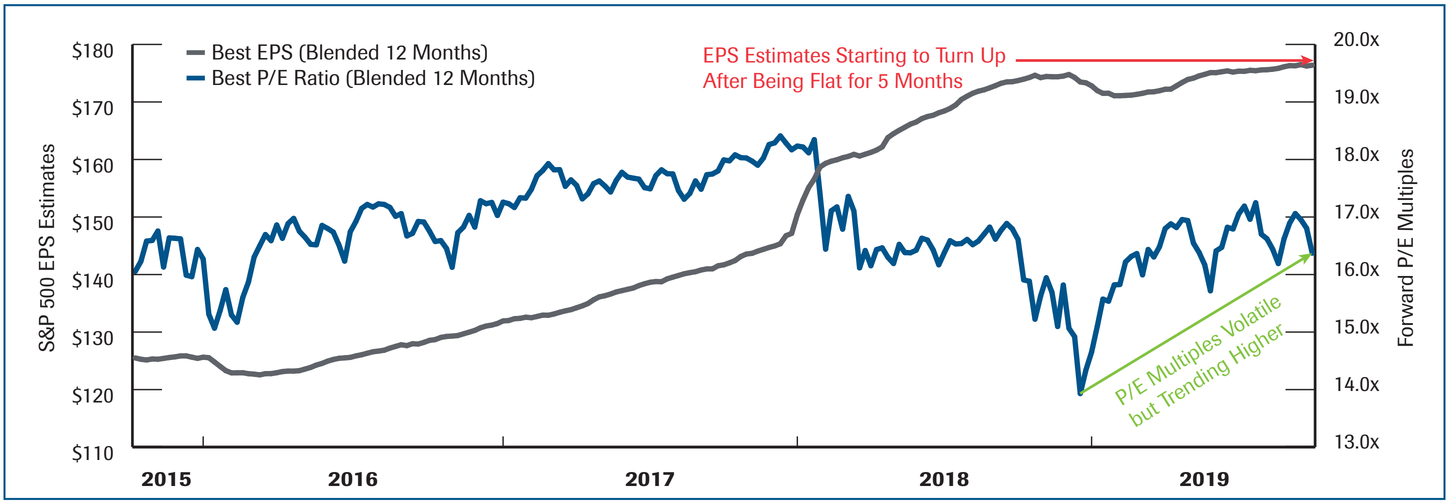
Source: Bloomberg, Federated Investors as of October 3, 2019

Key Facts

- December 2018 (-9.18%) was the worst single month since 2001 and the worst December since 1931
- Q4 2018 (-13.97%) was among the worst 7% of quarters since 1929
- Q1 2019 (+13.07%) was the best start to a year since 1998
- June 2019 (+7.05%) was the best June since 1938
- 1H 2019 (+18.54%) was the best first half since 1997
- Since the market top on 7/26/19, the market has been range bound between 2,840 and 3,025

Uncertainties such as the potential for more Fed cuts, heightened trade tensions and Brexit, along with what we viewed as skewed upside/downside market risk prompted the PRISM® asset allocation committee to pare our equity overweight in Federated's stock-bond models from 8% to 3% in May and June. This view has thus far been reinforced by reasonably good second-quarter earnings, but estimates for 2020 will once again need to rise in order to position the market for further upside.

S&P 500 EPS Estimates & Forward P/E Multiples



Source: Bloomberg, Federated Investors as of October 4, 2019

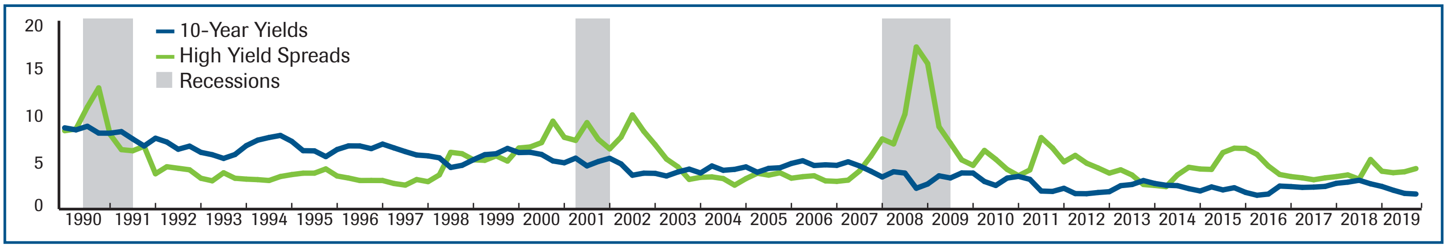
Recession Indicators: Current vs. Prior Recessions

Indicators	Measure	1974	1980	1981	1991	2001	2008	Average	Current	Earliest Implied Recession Date*
Labor market	Increase in claims	32,000	90,000	68,000	80,000	125,000	50,000	74,167	21,000	6/2020
Inflation	Increase in core PCE	2.17%	2.37%	0.93%	1.90%	1.76%	2.54%	1.95%	0.87%	10/2020
Housing	Decline in housing starts	770,000	856,000	502,000	1,089,000	329,000	1,236,000	797,000	0	1/2022
Yield Curve	10-year Treasury yield – federal funds rate	-3.88%	-3.45%	-4.37%	-1.44%	-1.29%	-0.79%	-2.54%	-0.26%	9/2020
Spreads	Bloomberg Barclays Corp High Yield – 10-year Treasury yield	–	–	–	8.21%	9.34%	5.62%	7.72%	3.97%	11/2021
Manufacturing	ISM Index	57.8	44.8	46.7	45.1	42.3	50.1	47.8	47.8	4/2022
Average	–	–	–	–	–	–	–	–	–	**5/2021**

Source: Bloomberg, Federated Investors as of October 1, 2019.

The yield curve has historically been a good indicator of recession, as lower longer-term yields generally reflect market expectations for slower growth in the future. That said, it is unclear if this yield curve inversion reflects expectations for recession or if long-term bond yields are just artificially low given unprecedented global central bank rate policies and the fact that $15 trillion of international debt currently carries a negative interest rate. This is why the yield curve is just one of six recession indicators that we monitor. Currently, none of the other five indicators (unemployment claims, core PCE, housing starts, high yield spreads, ISM manufacturing) are confirming the signal coming from the yield curve.

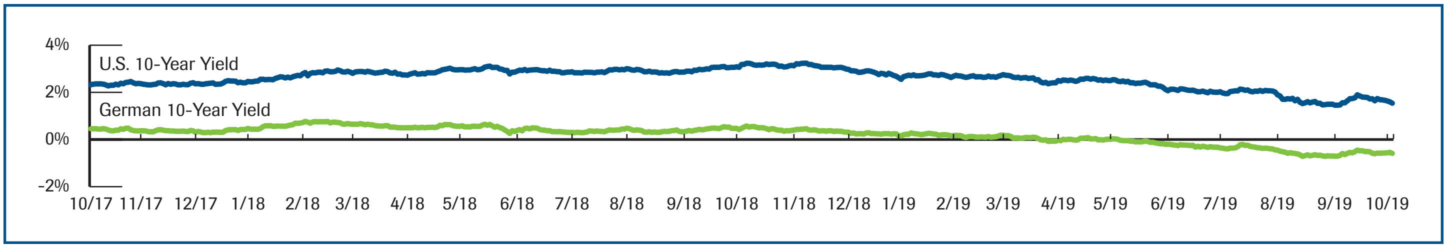
We Do Not Think That the Bond Market is Forecasting a Recession



Source: Bloomberg, Federated Investors. Data as of October 3, 2019.

- Historically, when the bond market prices in a recession, it does so through multi-year lows in 10-year yields and multi-year highs in high yield spreads
- While bond yields have recently reached record low levels, high yield bond spreads have remained tight near multi-year low levels. It strikes us as unlikely that the bond market would price in a recession in the risk-free bond and not in the more risky high yield sector.
- Instead, we think that the low 10-year yields and the corresponding yield curve inversion are a function of negative rates overseas and not a forecast for impending recession.

Yields Being Dragged Down by Negative Rates Overseas Not Growth Expectations



Source: Bloomberg, Federated Investors. Data as of October 3, 2019.

**Based on Avg. Days from Key Level Recession*

Past performance is no guarantee of future results.

Views are as of 10/4/19 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.

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

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

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Federated Securities Corp.