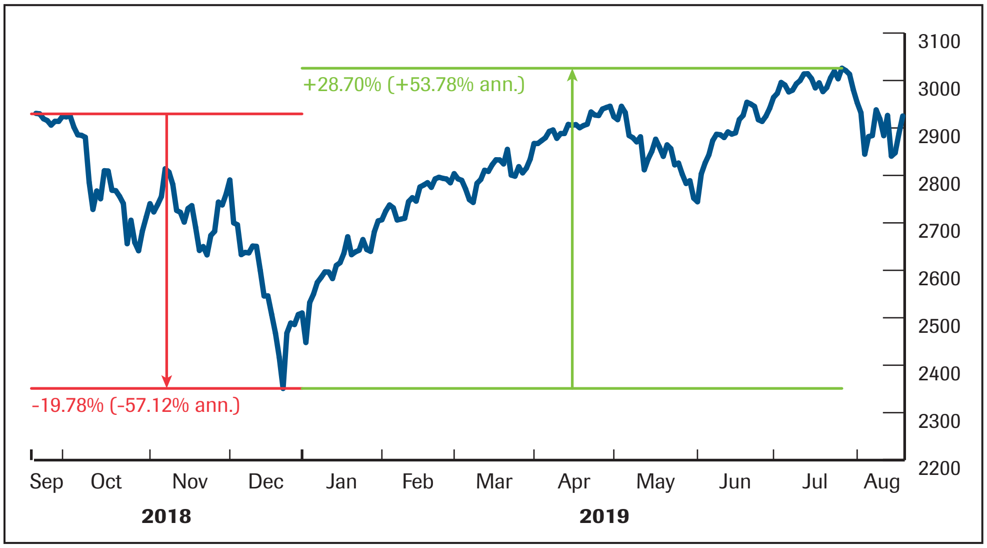
Patience is a Virtue

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 – 8/19/2019



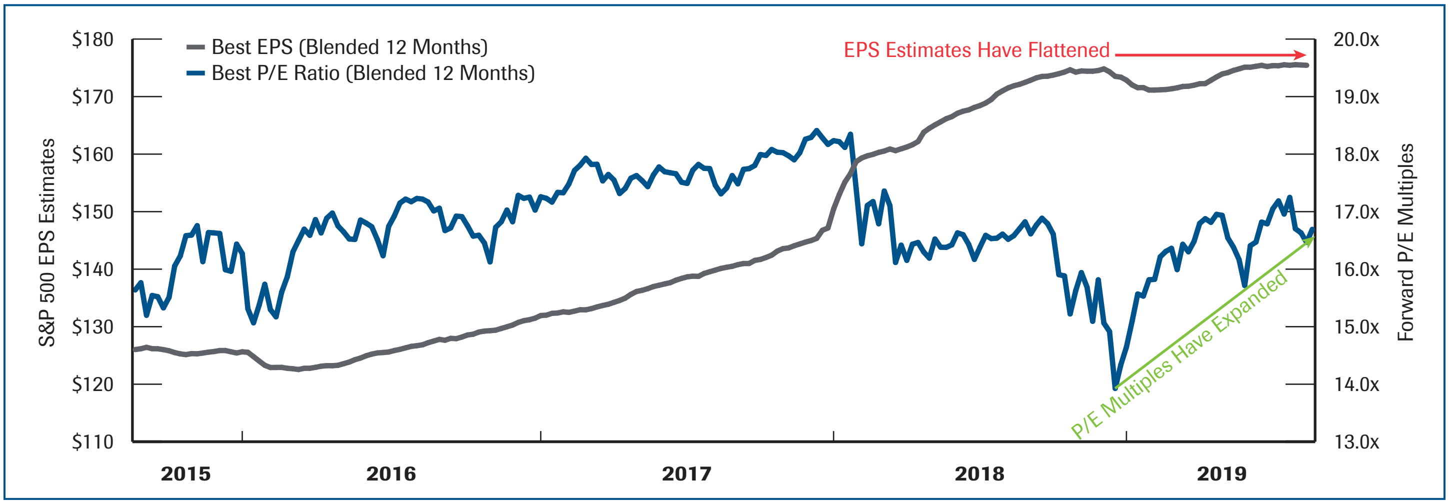
Source: Bloomberg, Federated Investors as of August 19, 2019

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

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 August 15, 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	17,000	06/2020
Inflation	Increase in core PCE	2.17%	2.37%	0.93%	1.90%	1.76%	2.54%	1.95%	0.70%	10/2020
Housing	Decline in housing starts	770,000	856,000	502,000	1,089,000	329,000	1,236,000	797,000	81,000	06/2020
Yield Curve	10-year Treasury yield – federal funds rate	-3.88%	-3.45%	-4.37%	-1.44%	-1.29%	-0.79%	-2.54%	-0.54%	09/2020
Spreads	Bloomberg Barclays Corp High Yield – 10-year Treasury yield	-	-	-	8.21%	9.34%	5.62%	7.72%	4.32%	11/2021
Manufacturing	ISM Index	57.8	44.8	46.7	45.1	42.3	50.1	47.8	51.2	04/2022
Average	-	-	-	-	-	-	-	-	-	**02/2021**

Source: Bloomberg, Federated Investors as of 8/14/19.

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.

A Closer Look at the Yield Curve

Curve Inverted	Lead Time	S&P 500 Return	Recession Started
Aug 1978	17 months	20%	Jan 1980
Sep 1980	10 months	9%	Jul 1981
Jan 1989	18 months	42%	Jul 1990
Jun 1998	33 months	6%	Mar 2001
Dec 2005	24 months	22%	Dec 2007
Average	**20 months**	**20%**	-

Source: Bloomberg, Federated Investors as of 4/11/19.

Timing matters. When the 10-year/federal funds curve inverts, the economy historically has continued to expand another 18-20 months on average, with the S&P 500 averaging a 14.5% return over that time period.[1] Based on this historical pattern, this one indicator suggests a recession is not likely before Q3 or Q4 2020. The six indicators combined give a similar signal, suggesting that a recession is not likely before Q1 2021.

Looking Ahead

Our base case remains that the U.S. economy will avoid recession this year and next, with global synchronized stimulus allowing GDP and earnings growth to reaccelerate and equity markets moving higher after a period of volatility. Ongoing risk and uncertainty around 2020 earnings were the prime drivers behind the PRISM committee's decision to reduce its equity weight by 500 basis points to a 3% overweight since late winter even as the markets were advancing to new highs in the spring and summer months.

As we sit here today, we remind investors that patience is a virtue. We will continue to monitor our recession indicators, the aforementioned risk factors and market activity, and are prepared to take advantage of opportunities as they present themselves or pivot to a more cautious stance if circumstances dictate.

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

[1]Source: Bloomberg, NBER. Based on the last 5 recessions.

Past performance is no guarantee of future results.

Views are as of 8/15/19 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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Federated Securities Corp.