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 Strategic Value Dividend SMA's gross weighted average dividend yield was at 5.07% 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 portfolio'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 portfolio will continue to offer dividend growth potential. And even during a pause in the annual growth, the Strategic Value Dividend portfolio 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 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]

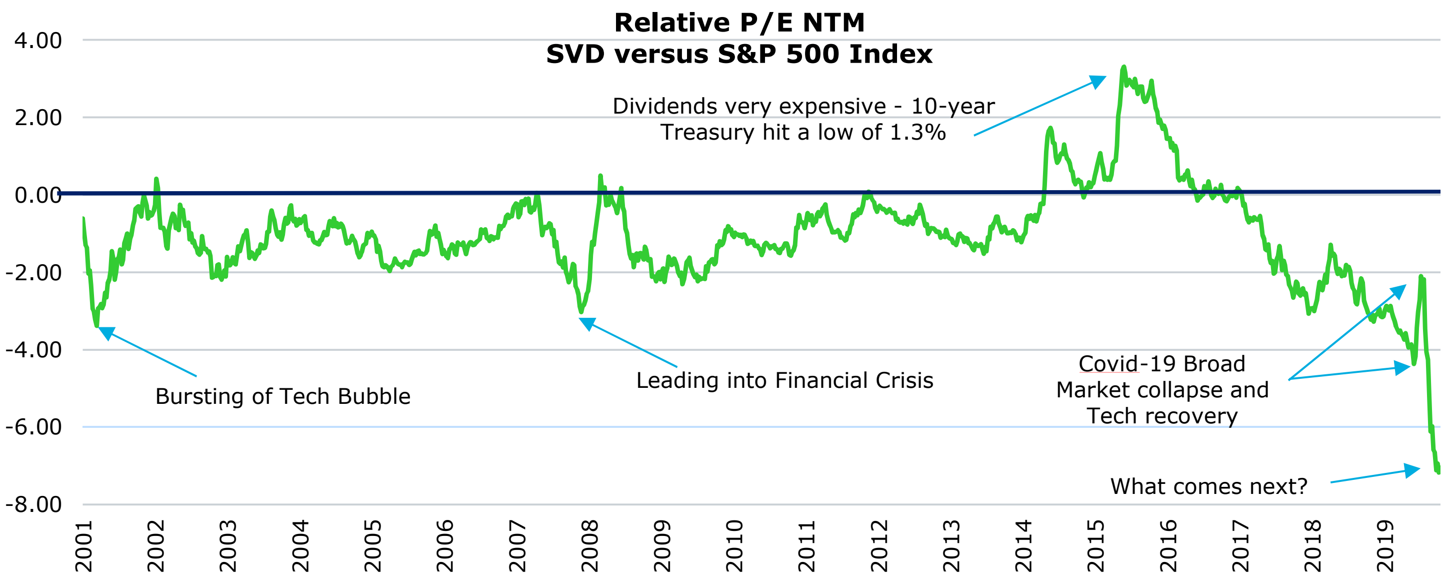
The S&P 500 Index returns have been driven by large, non- or minimal-dividend paying companies that have seen their share prices rise by 40% or 60% or 80% year-to-date. You know their names. That's why the yield of the S&P 500 Index keeps falling. It is being propelled by companies that are not part 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.

Information is supplemental to the attached GIPS report.

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, the SVD portfolio 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 Strategic Value Dividend complex, 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 strategy is 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.



On a forward P/E basis, SVD has only been this cheap versus the S&P 500 two other times in history, leading into the bursting of the Tech Bubble and 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. Information is supplemental to the attached GIPS report.

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.

Schedule of rates of return and statistics

Federated Hermes

Composite	Federated Hermes Strategic Value Dividend SMA
Index	Dow Jones Select Dividend (1/07) from Russell Midcap Value
Periods ending	06/30/2020

Annualized returns (%)

	Composite pure gross return^	Composite net return (assuming maximum fee)	Index
Q2 20	8.88	8.09	10.86
YTD	(16.39)	(17.68)	(21.68)
1 Year	(9.21)	(11.92)	(15.15)
3 Years (Annlzd)	(0.54)	(3.49)	(0.44)
5 Years (Annlzd)	4.27	1.19	5.43
7 Years (Annlzd)	6.08	2.96	7.35
10 Years (Annlzd)	9.78	6.56	10.82
15 Years (Annlzd)	6.12	2.99	6.51
Oct 01 - Jun 20 (Annlzd)^^	8.03	4.85	8.60

Annual returns %

	Composite pure gross return^	Composite net return	Index return	Composite* 3-yr std dev	Benchmark* 3-yr std dev	Number of portfolios	Dispersion**	Composite assets (mil)	Firm assets (bil)
2010	13.15	9.84	18.32	17.18	23.70	5818	0.31	1470.9	354.3
2011	16.85	13.44	12.42	14.33	19.86	5869	1.10	1678.9	363.9
2012	7.53	4.37	10.84	10.48	11.50	6300	0.47	1817.0	371.3
2013	21.59	18.05	29.06	8.53	9.36	7420	0.42	2444.2	366.8
2014	12.34	9.05	15.36	8.92	9.04	6412	0.23	2223.3	349.3
2015	4.00	0.93	(1.64)	9.97	9.91	6982	0.21	2303.9	343.4
2016	10.05	6.82	21.98	9.93	9.31	11970	0.25	3189.3	342.3
2017	15.64	12.26	15.44	9.11	7.69	13884	0.16	3918.8	354.7
2018	(7.89)	(10.64)	(5.94)	9.83	8.92	10330	0.21	2526.3	377.2
2019	20.43	16.91	23.11	9.64	10.68	11038	0.24	3037.4	503.1

^Pure gross returns are shown as supplemental and do not reflect the deduction of transaction costs.

^^Represents composite inception period. See additional notes to the schedule of rates of return and statistics

*Represents the 3-year annualized standard deviation for both the gross composite and the index returns. Statistic is used to measure the volatility of composite returns.

**Standard deviation is calculated using gross returns. Standard deviation is not applicable ("N/A") for any period if fewer than five accounts are in the composite for that period. (See footnote 5)

Please see the Notes to the Schedule of Rates of Return and Statistics.

This composite is comprised of all domestic portfolios investing in U.S. and foreign stocks that management believes will provide high yield, reasonable dividend growth and lower volatility in falling equity market environments, yet will provide potential participation in rising markets. Eligible portfolios are managed with wide latitude to choose the sectors and securities to fulfill the mandate. Within eligible portfolios, securities are selected based on a fundamental assessment of their financial strength, dividend yields, dividend growth rates, and performance during periods of market weakness. Portfolios in this composite implement the strategy using American Depositary Receipts (ADR) versus directly purchasing shares of companies on foreign exchanges. Investments in ADRs entail risks related to daily fluctuations in the value of currency, which may be more volatile in times of increased market risk. There are no guarantees that dividend-paying stocks will continue to pay dividends. The benchmark was changed January 2007 to the Dow Jones U.S. Select Dividend Index which proved to be more representative of the current strategy. The Dow Jones U.S. Select Dividend Index aims to represent U.S. leading stocks by dividend yield. One hundred stocks are selected to the index by dividend yield, subject to screens for dividend-per-share growth rate, dividend payout ratio and average daily dollar trading volume. Components are weighted by indicated annual dividend. The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap Index is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. Indexes are unmanaged and cannot be invested in directly. Effective July 2013, performance for this composite is calculated in U.S. dollars net of foreign withholding taxes on dividends, interest, and capital gains. Individual tax rates may vary dependent on individual residency. Effective January 2016 accounts previously assigned to a platform-restricted composite may be eligible for inclusion in this composite. Accounts deemed by the portfolio manager to have a category restriction shall be excluded from this composite. A category is defined as a collection of investments with similar attributes such as industry classification, business sensitivity, social theme, or security features. Separate accounts eligible for this composite generally have a minimum of $100,000 at the time of opening and are a part of an asset-based pricing program. Wrap fee accounts make up 100% of this composite for all time periods. This composite was created in December 2001. Federated Hermes has managed portfolios in this investment style since July 1997. Performance shown for 2001 is for a partial period starting on October 1, 2001. Federated Hermes claims compliance with the Global Investment Performance Standards ("GIPS®") and has prepared and presented this report in compliance with the GIPS® standards. Federated Hermes has been independently verified for the period of January 1, 1992, through March 31, 2020. The verification report is available upon request. A firm that claims compliance with the GIPS® standards must establish policies and procedures for complying with all the applicable requirements of the GIPS® standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS® standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. Performance results are presented both net and gross of total wrap fees and reflect the reinvestment of income. "Pure" gross returns are shown as supplemental and do not reflect the deduction of transaction costs. Net returns reflect the deduction of a maximum fee. A fee equal to the highest anticipated wrap fee that a client could pay (3.00% annually as charged by the program sponsor, inclusive of up to a maximum investment advisory fee of 0.70%) is used. This total wrap fee includes all charges for trading costs, portfolio management, custody and other administrative fees. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size.

Notes to the Schedule of rates of return and statistics

1. Federated Hermes is a global, independent, multi-strategy investment management firm with offices in Pittsburgh, New York, Boston, Cleveland, and London. For GIPS® purposes, Federated Hermes is defined to include the assets of registered investment companies, separate (or private) accounts, managed accounts (including wrap accounts) and commingled or collective trusts that are advised or sub-advised by the various Federated Hermes advisory companies. In 2018 Federated Investors announced the acquisition of a majority interest in Hermes Fund Managers Limited and is in the process of integrating those assets into one combined firm. Effective February 3, 2020, the name of the firm was officially changed to Federated Hermes. Firm assets on this report exclude the advisory-only, model-based assets that may be included in other reports providing total firm assets.
2. Interest income and dividends are recognized on an accrual basis. Returns include the reinvestment of all income.
3. All market values and performance information are valued in U.S. dollars unless currency is denoted in composite title.
4. Annual composite dispersion is measured and presented using the asset weighted standard deviation of the returns of all of the portfolios included in the composite over the entire year. Quarterly dispersion is measured using all portfolios included in the composite for that quarter. Prior to March, 2020 with regard to Federated Clover Investment Advisors composites, annual dispersion was measured using the equal weighted standard deviation of the returns of all the portfolios included in the composite over the entire year.
5. Composite dispersion does not measure the risk of the product presented, it simply measures the return variance among portfolios managed in a similar fashion. This variance can be affected by variations in cash flow or specific client parameters among the portfolios comprising the composites, as well as by execution of strategy across accounts.
6. See the composite description language on the prior page for a discussion on appropriate fees currently applied to calculate composite performance. With regard to the institutional composites not managed by the MDT Advisers teams, for the period July 1, 1992 through September 30, 2009, net of fee performance was calculated monthly by reducing the gross composite return by the highest actual fee of any account in the composite for that month, regardless of investment vehicle. Prior to July 1992, the maximum management fee for third quarter 1992 was used to calculate net of fee performance historically to inception of the composite. In addition, further fee information can be obtained from the firm's respective Forms ADV Part 2 Brochure Item 5.
7. Additional information regarding the policies for valuing investments, calculating performance, and preparing GIPS reports, as well as a complete list and description of the firm's composites and pooled funds is available upon request.
8. Past performance is not indicative of future results.
9. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.
10. See disclosures on the Schedule of Rates of Return and Statistics Reports for additional information.

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[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 3.3% 12-month distribution yield before fees as of 8/31/2020.

[3] At 8/31/2020, the gross YTD return of Strategic Value Dividend was -12.87%, 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 gross YTD return of Strategic Value Dividend was -12.06%, S&P 500 Index returned 12.29%.

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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.

Gross returns do not include management and other fees. Deduction of fees and expenses over time reduces a client's return.

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.

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.

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.

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.

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.

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