

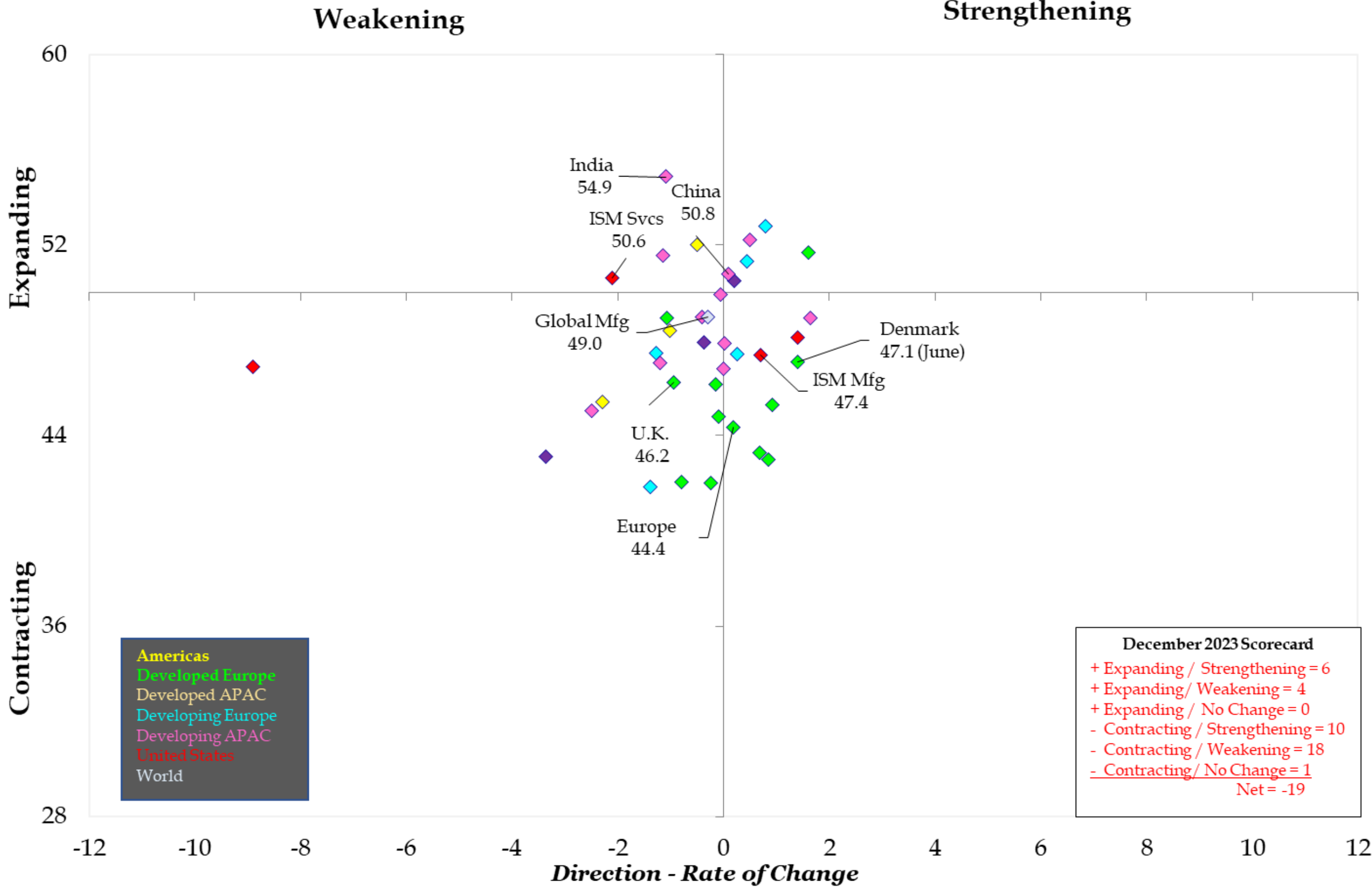
Economic & Market Outlook: It All Depends On Your Time Horizon

Linda A. Duessel, CFA® , CPA, CFP®
Senior Equity Strategist
Senior Vice President

February 2024

Can the globe skirt a recession?

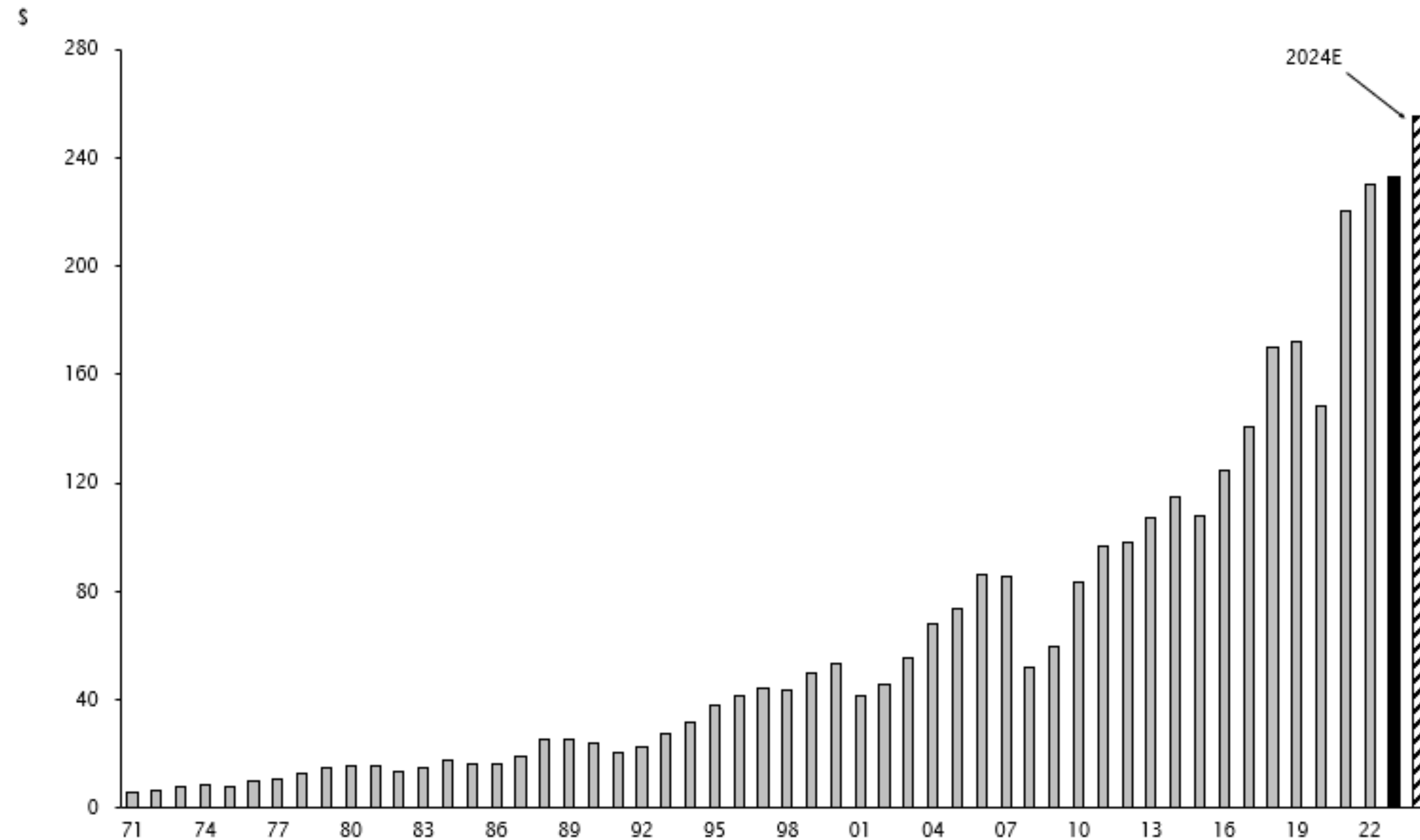
Global Economy Scorecard as of December 2023



Source: Strategas Research Partners. Data as of January 29, 2024

The earnings have been extraordinary

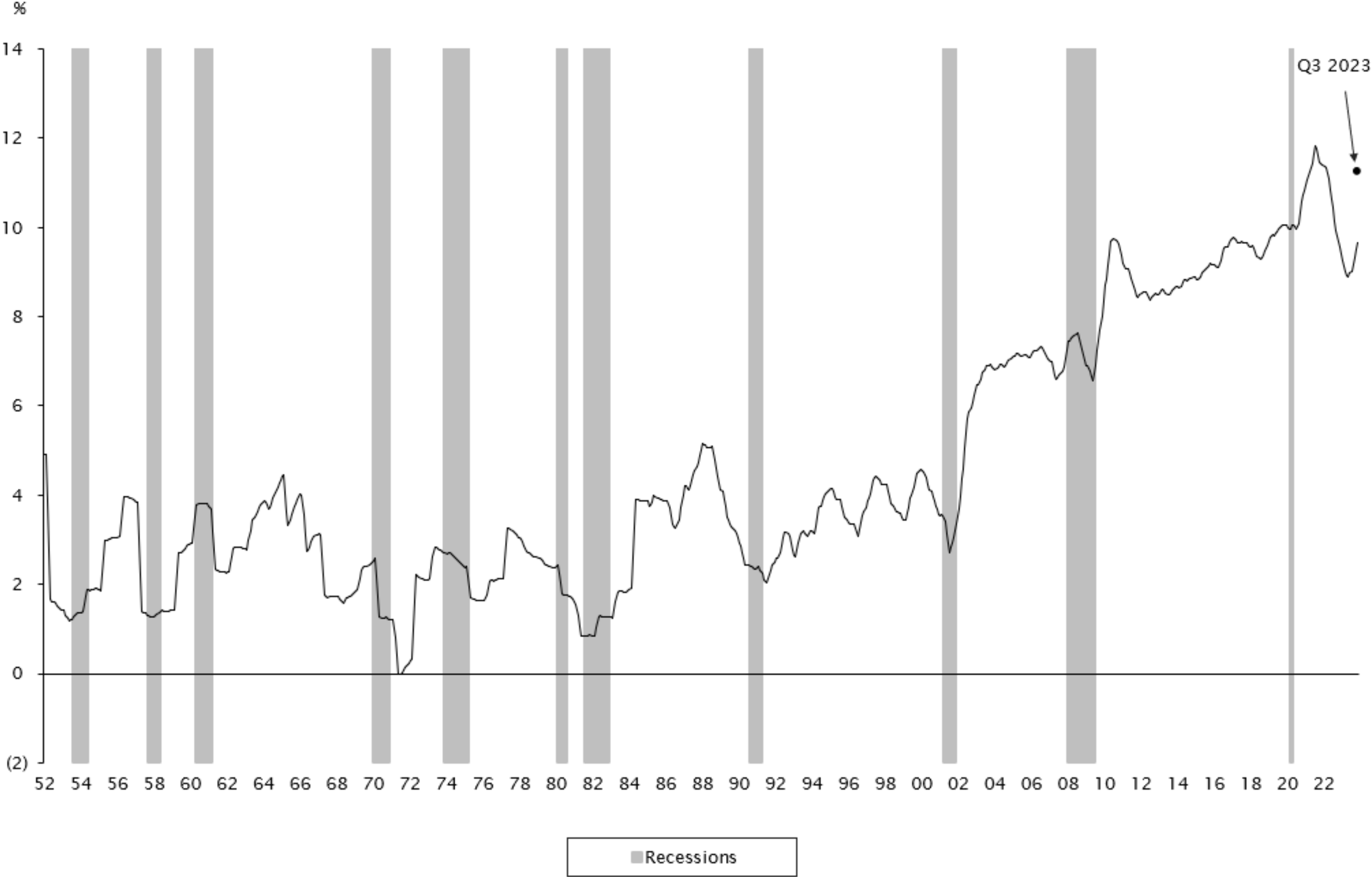
The S&P 500 Earnings Per Share *
1971 Through 2024E



Source: Empirical Research Partners Analysis and Estimates, December 21, 2023
*-Based on a roll-up of analyst estimates. Black bar designates 2023 year end.

Profit margins have held up

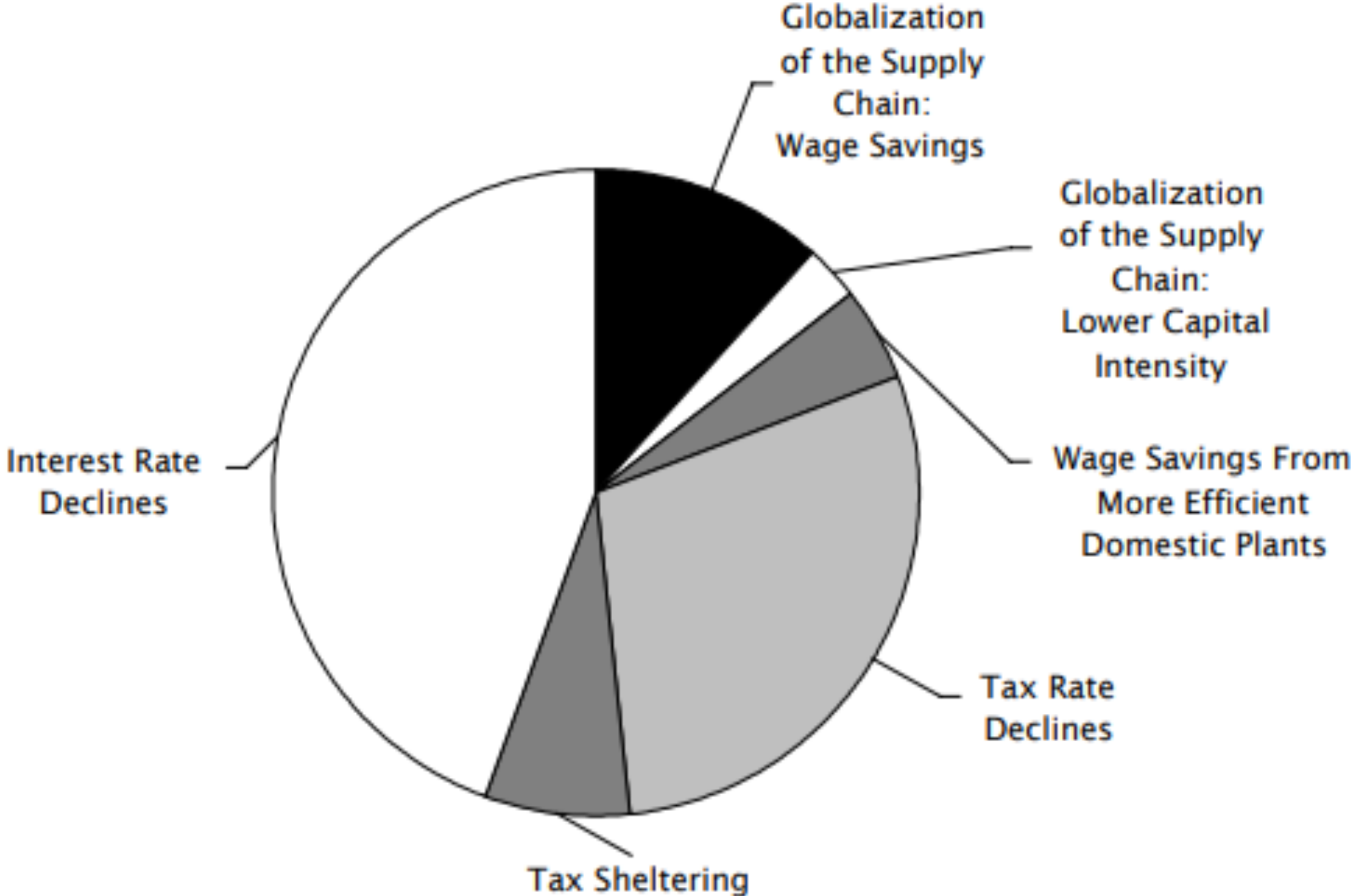
The Core of The Large-Cap Market* Free Cash Flow Margins
1952 Through November 2023



Source: Corporate Reports, National Bureau on Economic Research, Empirical Research Partners Analysis. December 21, 2023
*Excludes financials, REITs, utilities and energy; based on trailing four-quarter data.

Declines in interest and tax rates have been key

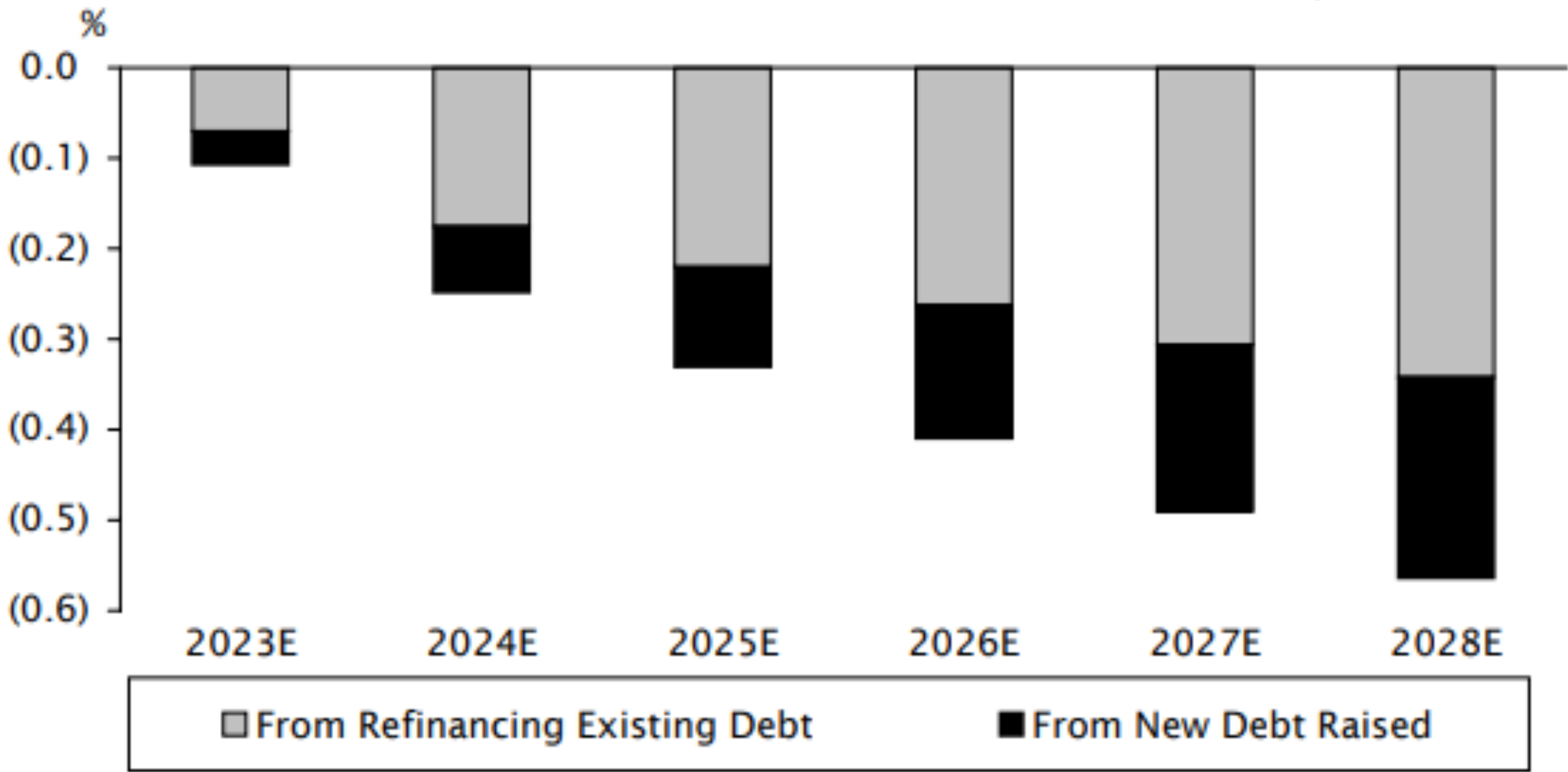
The S&P 500¹ Margin Expansion Dynamics
Four Quarters Ending Q3 2023 Versus 2010



Source: U.S. Census Bureau, U.S. Bureau of Labor Statistics, Corporate Reports, Empirical Research Partners Analysis. January 29, 2024
¹Excludes Financials and REITs.

It will be some time until interest rates weigh heavily on earnings

The S&P 500¹
 After-Tax Impact of Aggregate Incremental Interest Expense on Net Profit Margins²
 Assuming a 4.5% Ten-Year Treasury Bond Yield³ and Net New Debt Issuance of 1.5% of Assets Per Year
 As of Early-November 2023



Source: Empirical Research Partners Analysis. January 29, 2024

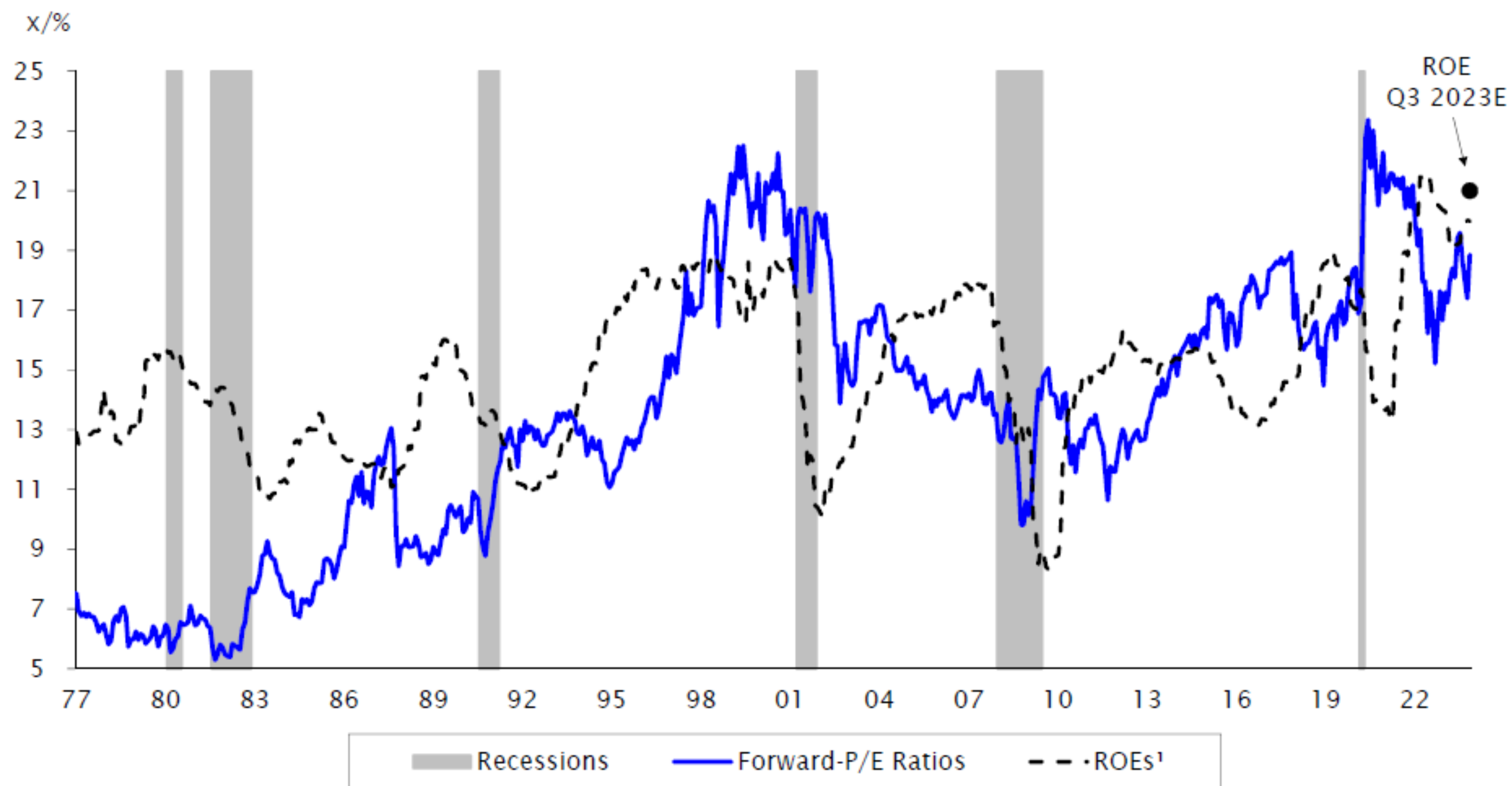
¹ Excludes Financials and REITs.

² Incremental interest expense assumes that all short-term and variable rate debt pays the new interest rate immediately and fixed-rate debt is rolled over at the new interest rate as it becomes due. All new debt raised is assumed to pay the new interest rate and new debt is added at a rate of 1.5% of assets per year.

³ The hypothetical borrowing cost is assumed to be the Treasury bond yields plus the current investment grade corporate spread of 1.3 percentage points. Interest tax shield based on the marginal all-in Federal and state corporate tax rate of 21.7%.

Is the stock market expensive?

The S&P 500 Forward- P/E Ratios and ROEs¹
1977 Through Late-November 2023

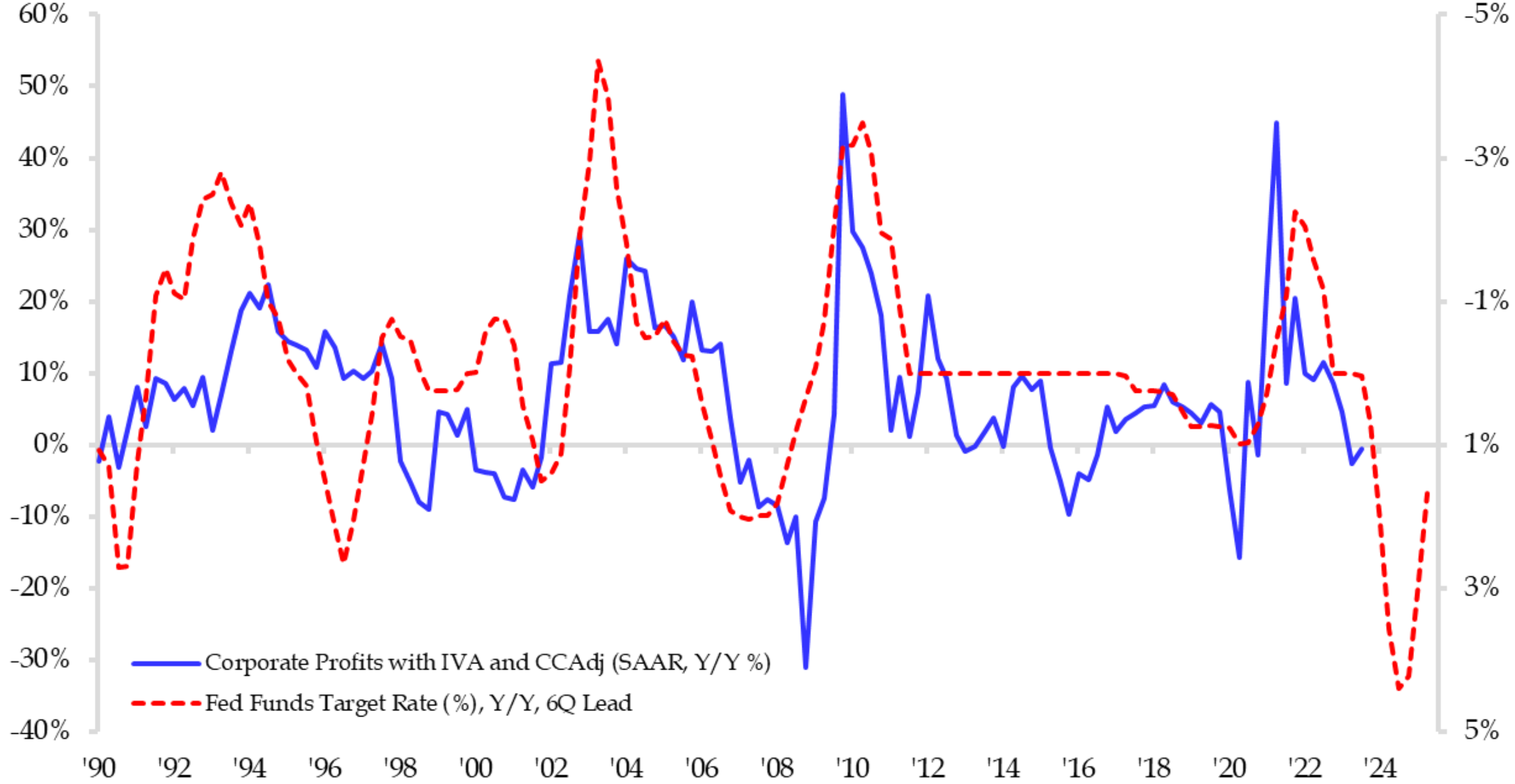


Source: Empirical Research Partners. November 30, 2023

¹ROE's constructed using trailing four-quarter aggregated data

Monetary policy works with a long and variable lag

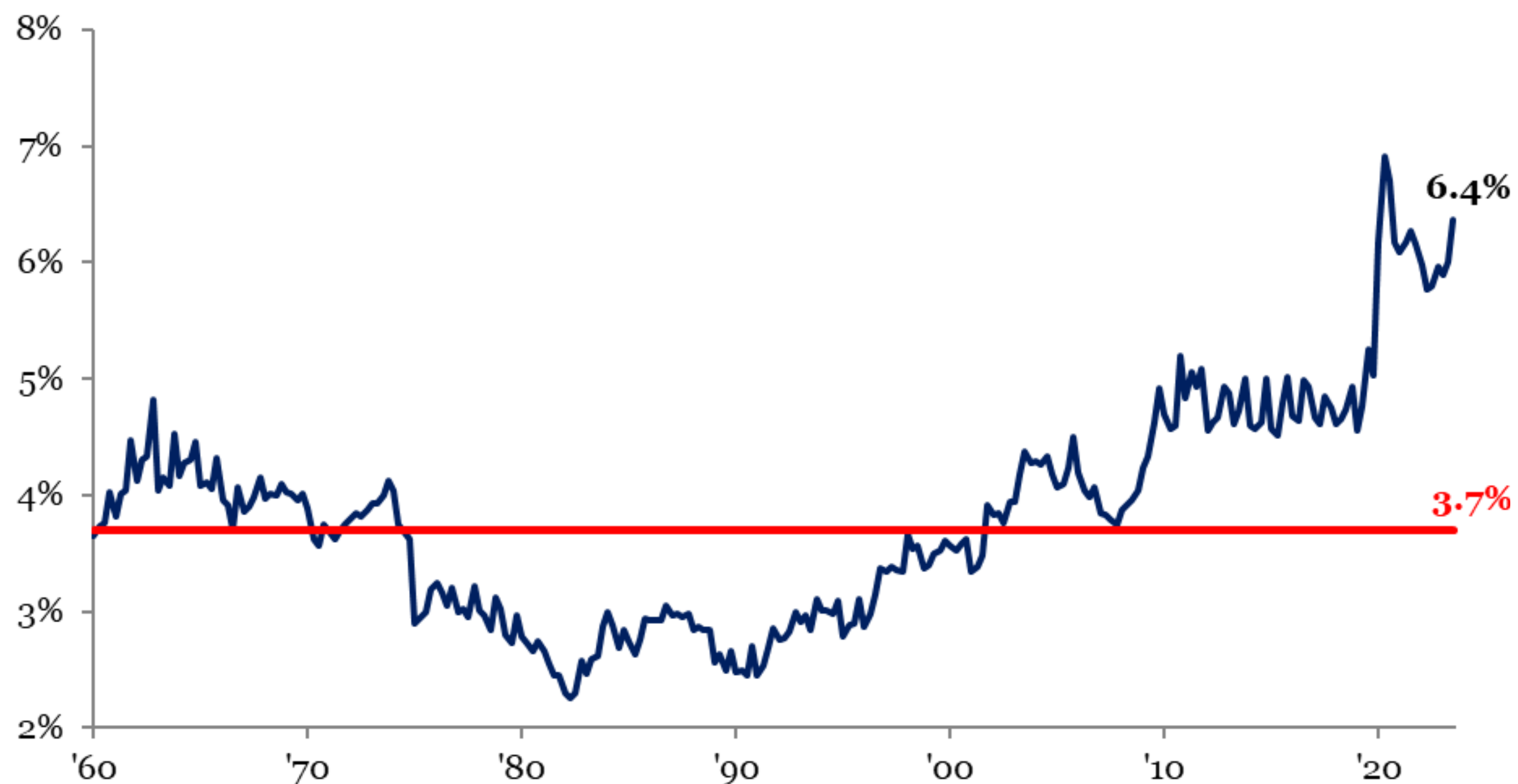
Corporate Profits vs. Fed Funds Change (Lead 6Q)



Source: Strategas Research, BLS, Macrobond. January 29, 2024

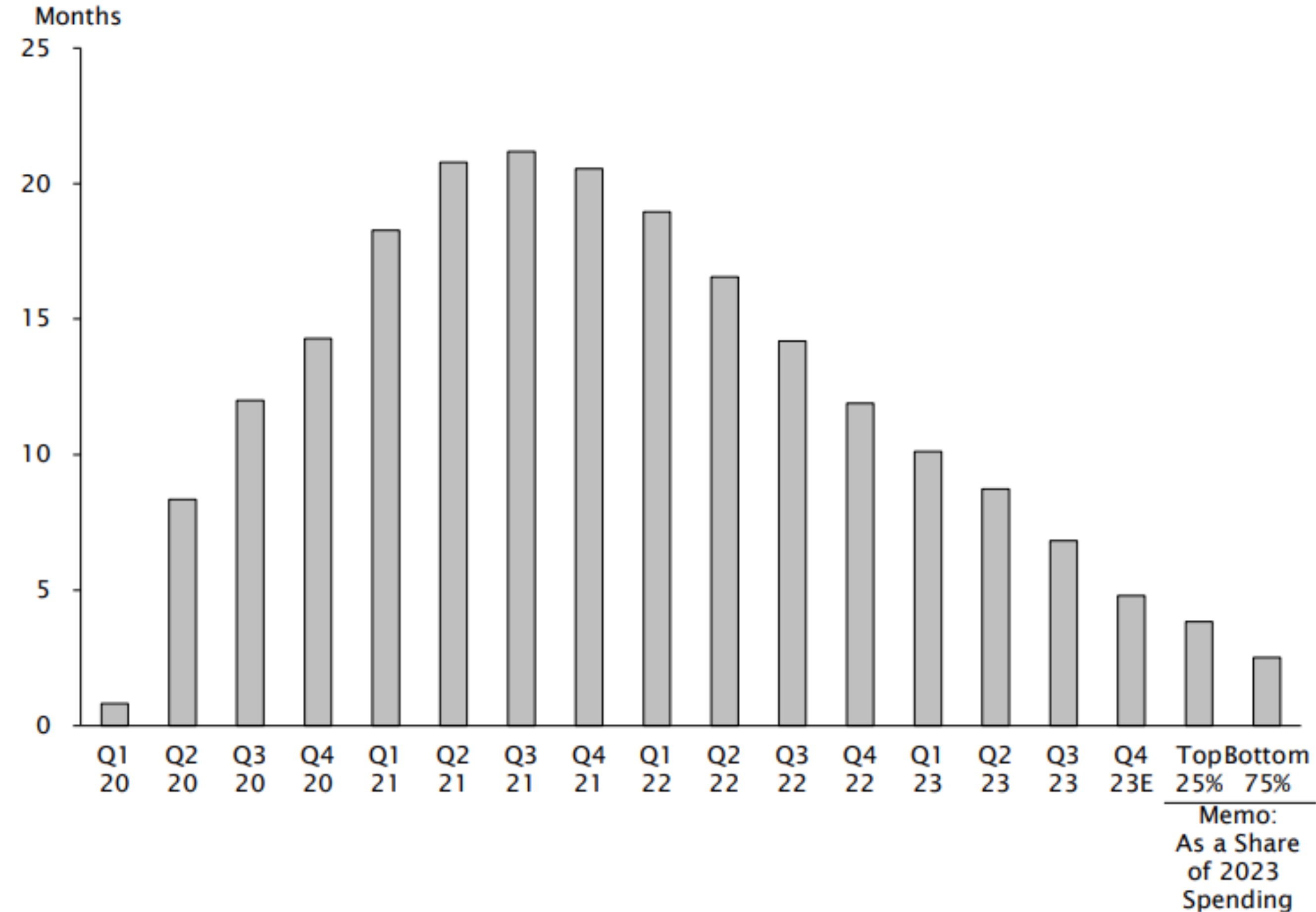
Corporate balance sheets in good shape

U.S. Non-Financial Corporations Cash Percent of Total Assets



Easy come, easy go

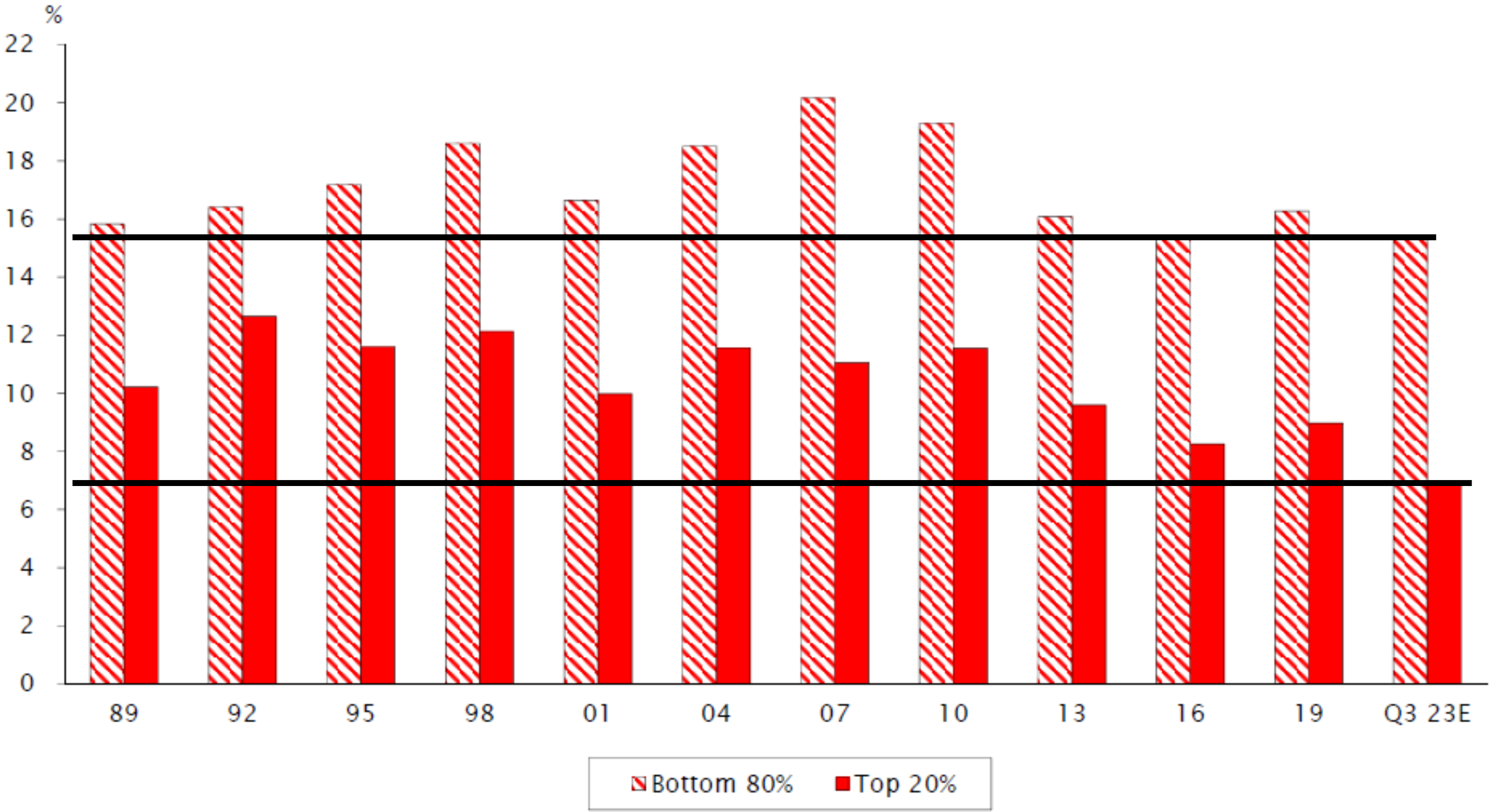
U.S. Consumers Cumulative "Excess" Savings Measured in Months of Typical Savings
Q1 2020 Through Q4 2023E



Source: Aladangady, A., Cho, D., Feiveson, L., and Eugenio Pinto, 2022. "Excess Savings During the COVID-19 Pandemic," FEDS Notes, U.S. Department of Commerce, Empirical Research Partners Analysis and Estimates. January 2024

Consumers' ability to service debt remains historically strong...

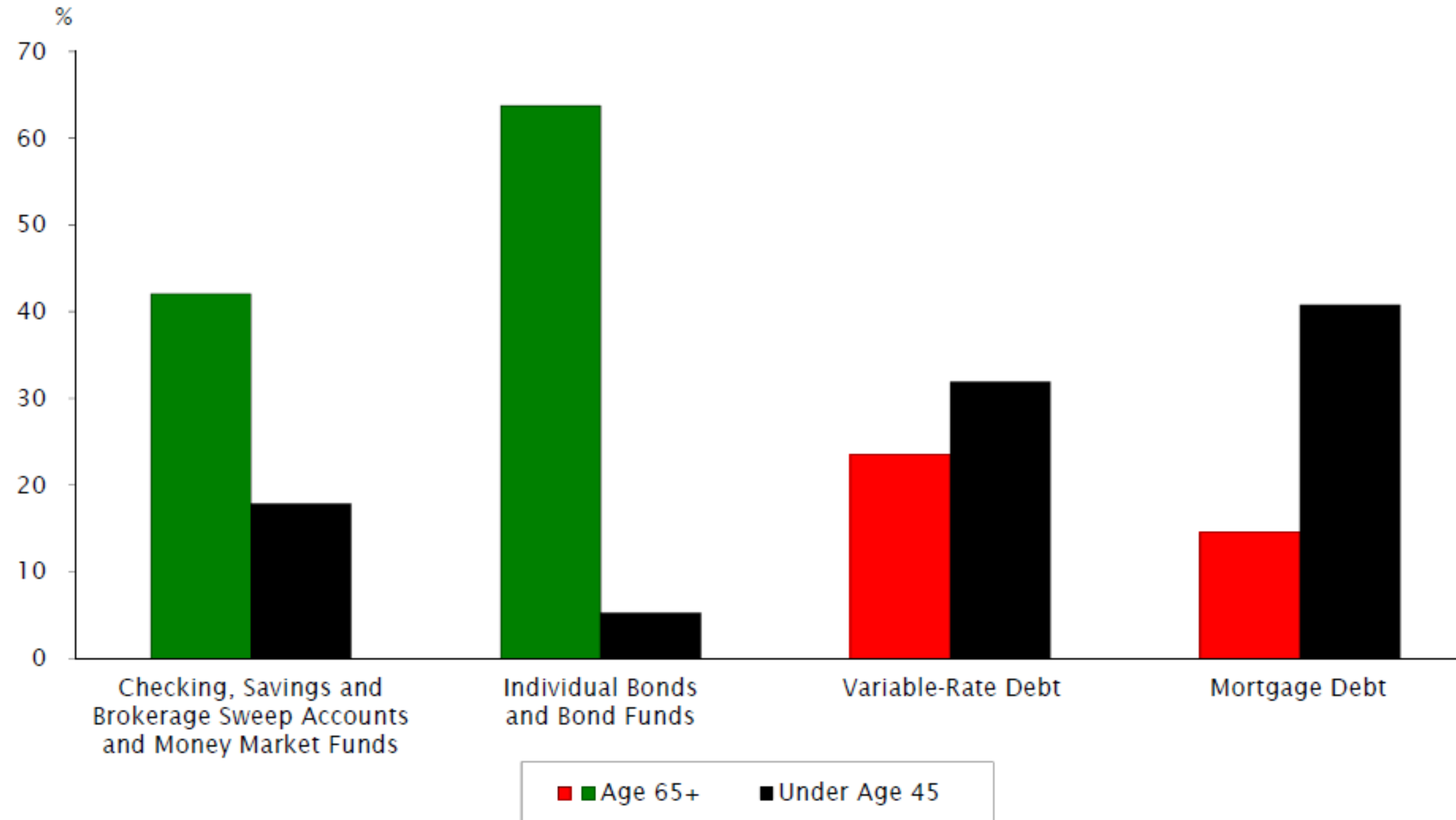
U.S. Consumers-The Bottom 80% and Top 20% of Earners
Debt Service Ratios 1989 Through Q3 2023E



Source: Empirical Research Partners. November 30, 2023

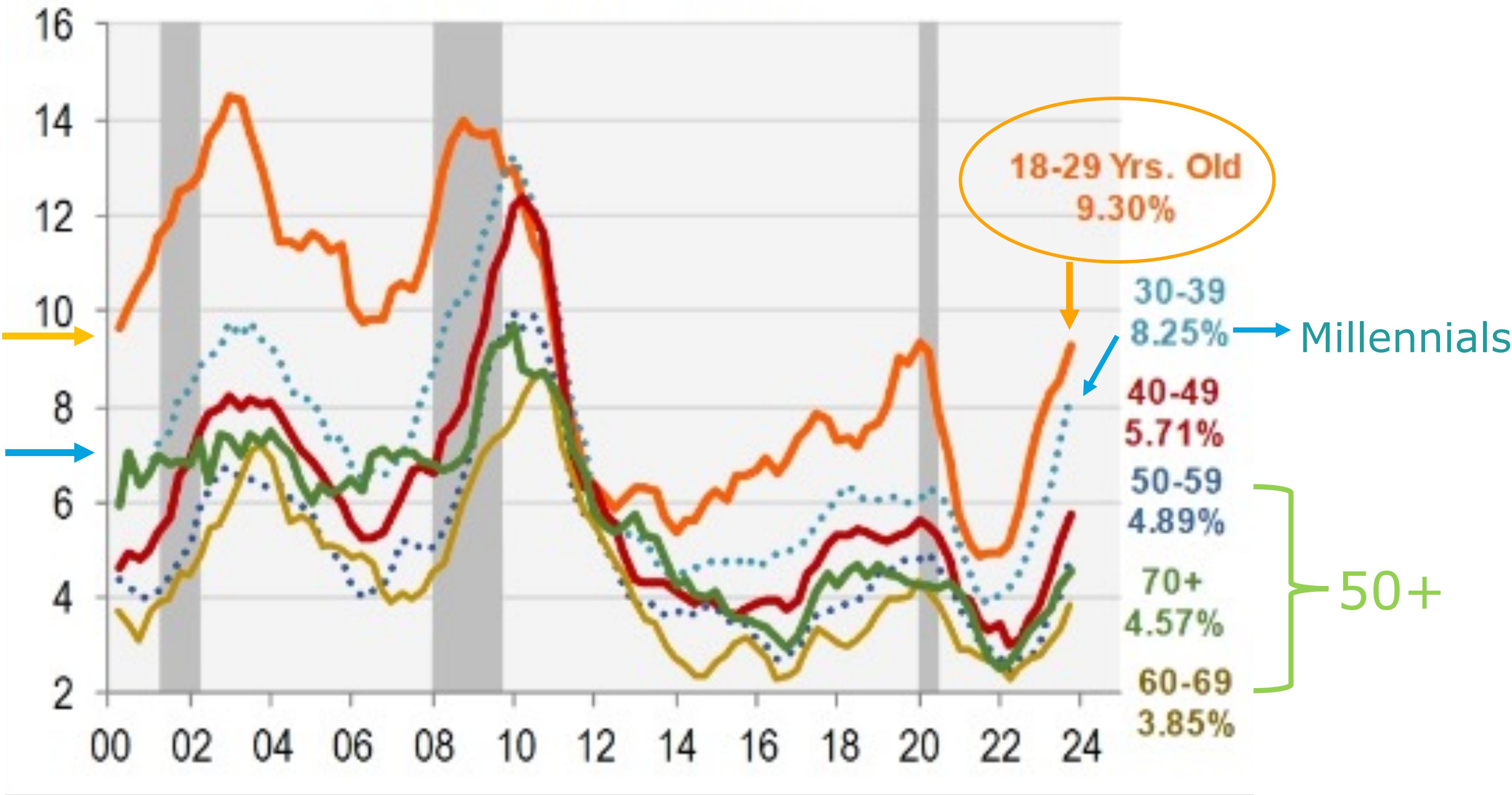
...Although the demographic divide is striking

U.S. Consumers- Ages 65 and Over and Under 45
Share of All Household Assets and Liabilities 2022



Delinquencies rising for Millennials and Gen Z

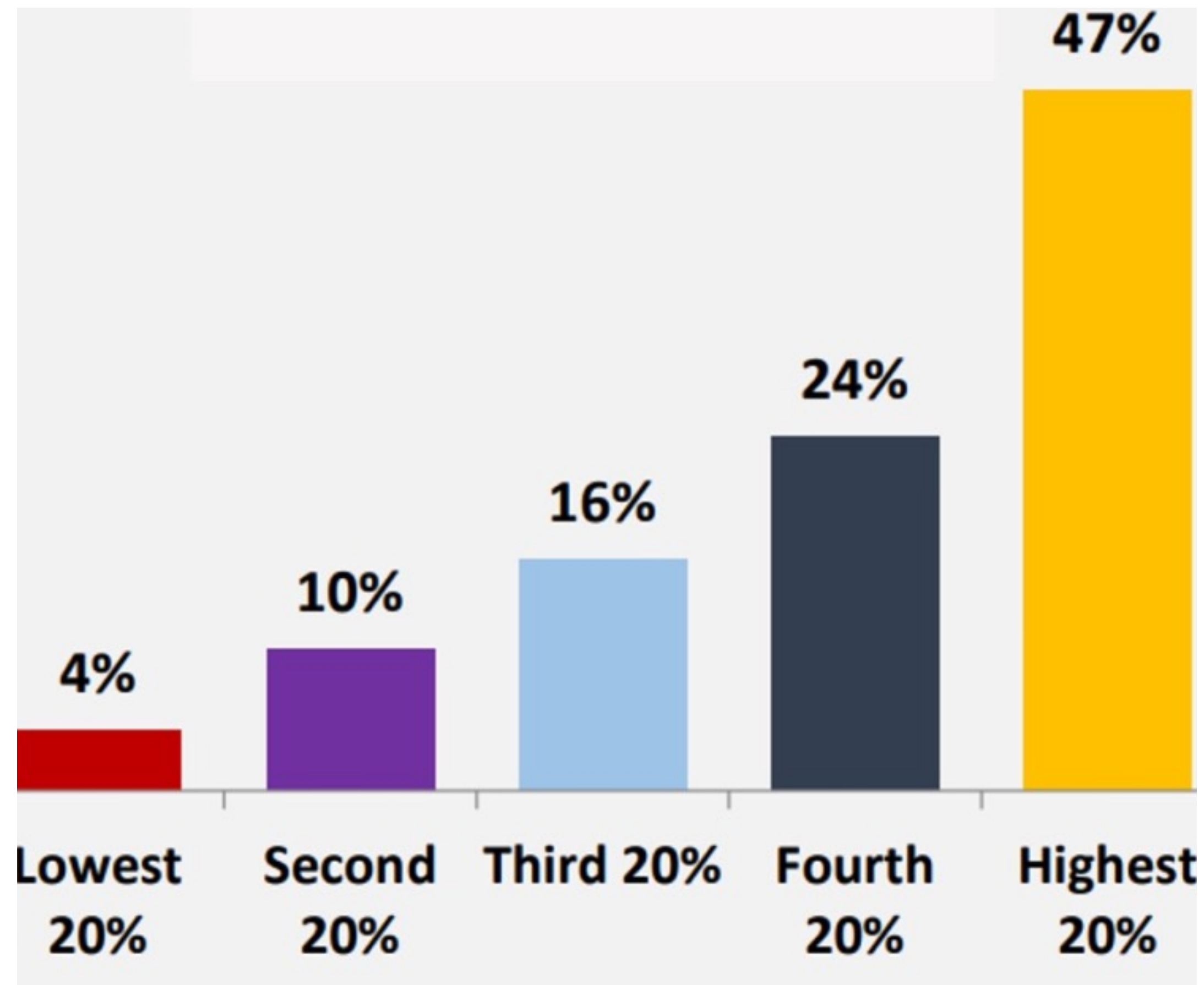
U.S. Credit Card Debt, % 90+ Days Delinquent (NY Fed) 4 Qtr. Sum 2023:Q3



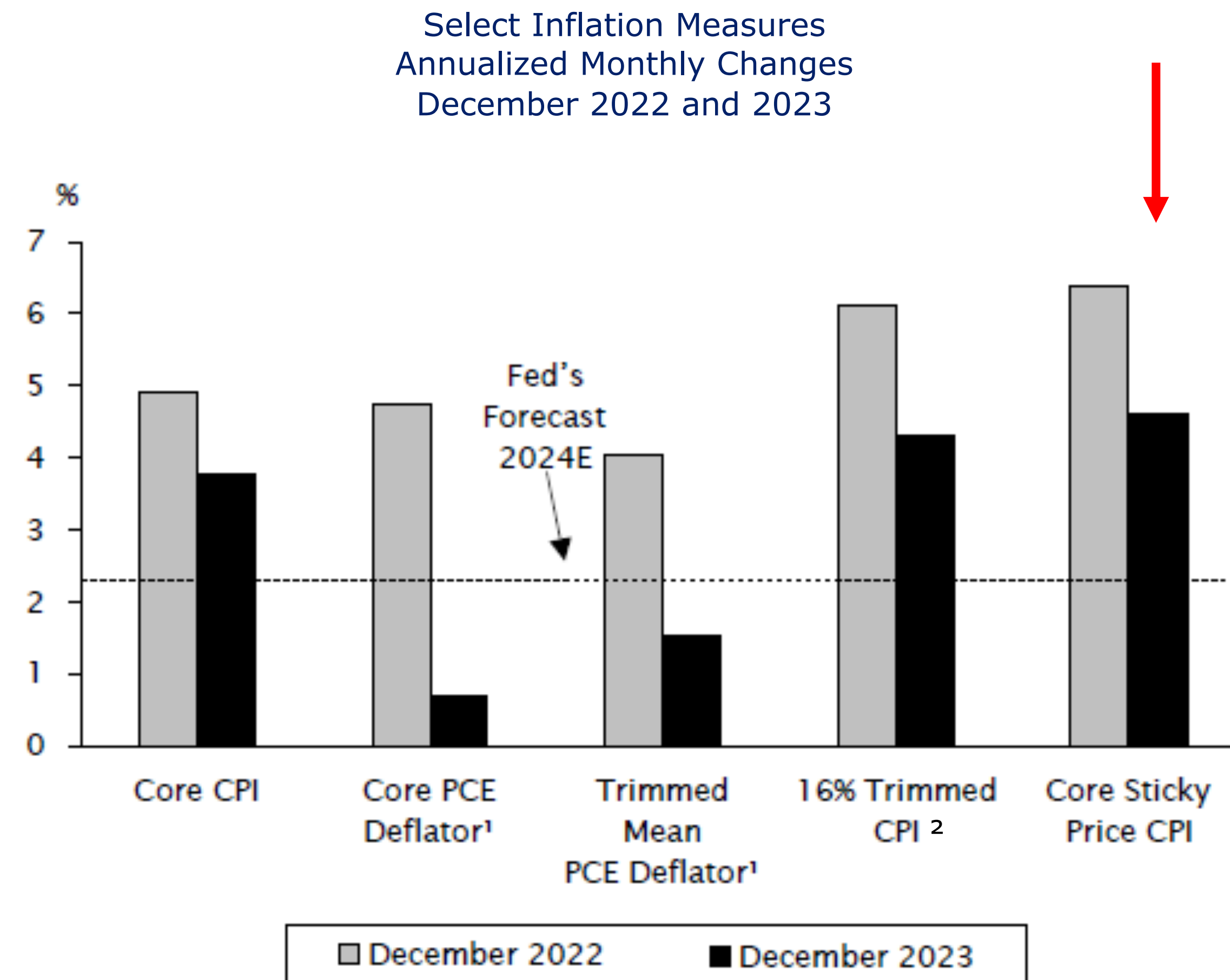
Source: Piper Sandler Research. November 16, 2023
 Note: Shaded areas represent recessions.

The wealth effect has the biggest impact on the high end

Share of Aggregate Expenditures (By Quintile Pre-Tax Income, 2021)



Inflation has come down



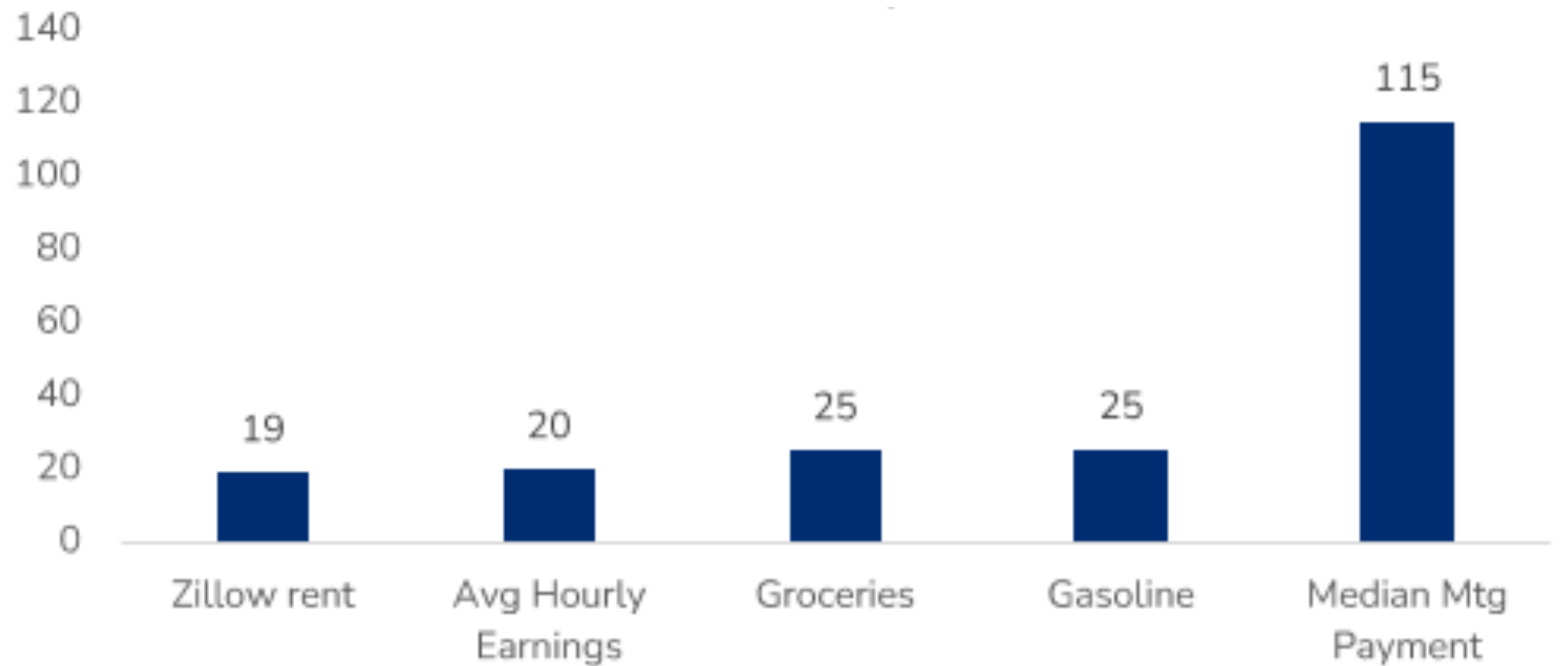
Source: Bureau of Labor Statistics, Federal Reserve Bank of Cleveland, Federal Reserve Bank of Dallas, Federal Reserve Bank of Atlanta, Bureau of Economic Analysis. Empirical Research Partners. January 29, 2024

¹Through November 2023. Trimmed Mean PCE Deflator is an alternative measure of core inflation in the PCE index.

² 16% Trimmed CPI is a measure of core inflation calculated by excluding the most volatile CPI components.

Housing is “sticky” inflation

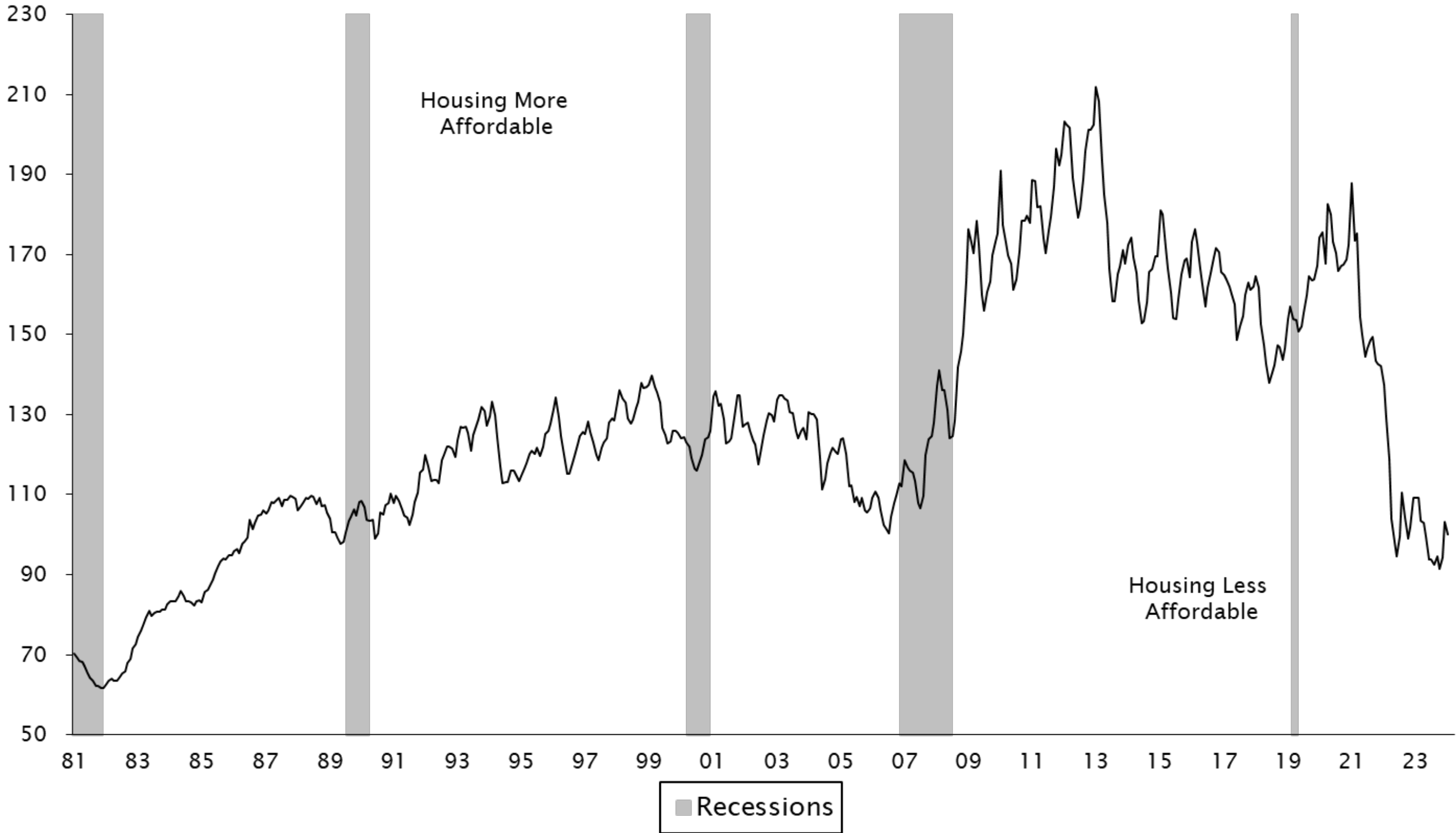
Cumulative Change in Price Since January 2020 (%)



Source: Wolfe Research, Haver Analytics. December 19, 2023. Data as of November 30, 2023. Includes mtg est. through December.

First-time homebuyers priced out

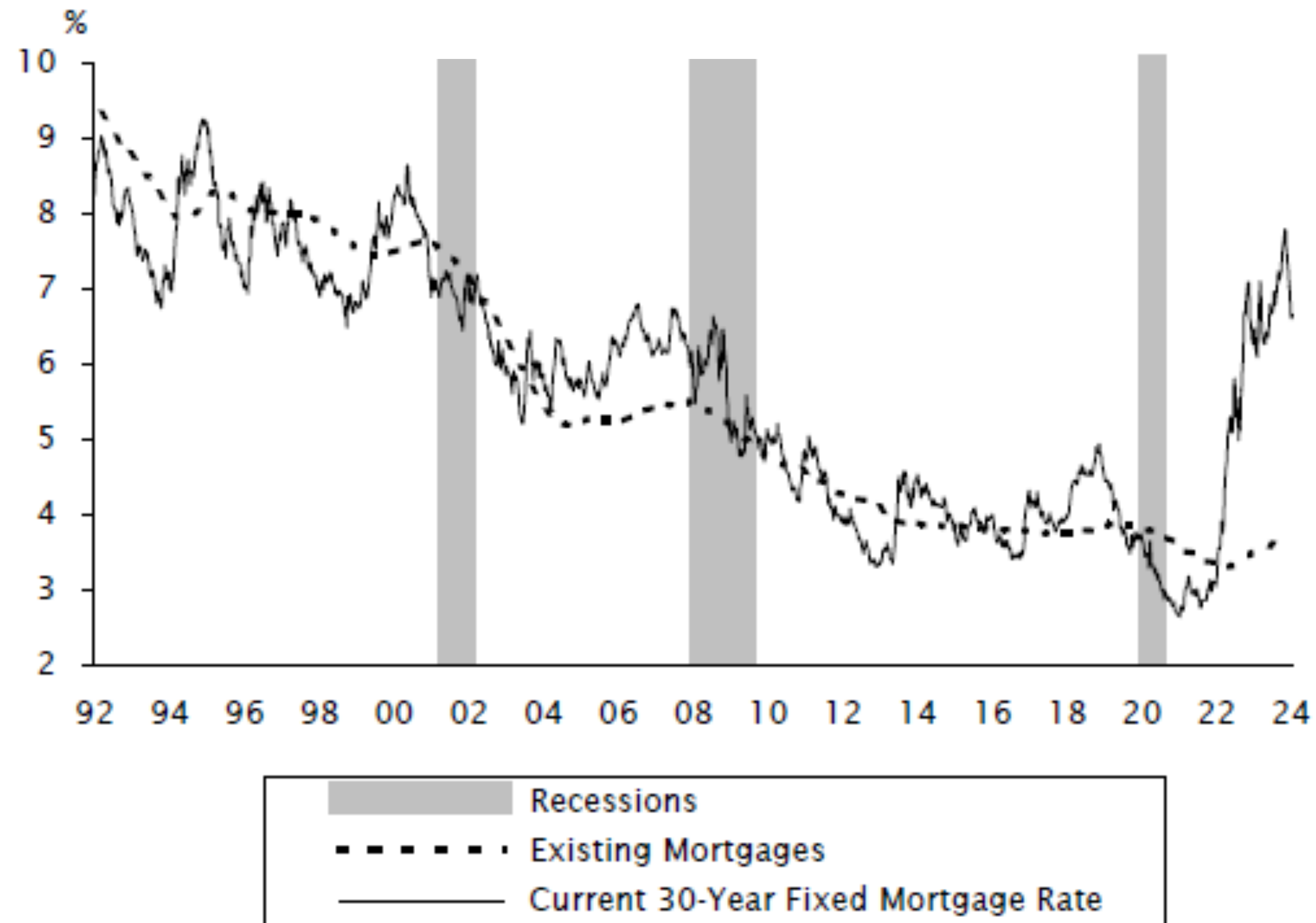
Housing Affordability Index* 1981 Through January 2024E



Source: Bloomberg L.P., National Association of Realtors, National Bureau of Economic Research, Empirical Research Partners Analysis and Estimates. February 7, 202. Data through January 31, 2024.
* A value of 100 indicates the qualifying income based on median home prices and 30-year fixed mortgage rates equals the median income throughout the U.S. A 20% down payment and 25% of income devoted to mortgage interest and principal are assumed.

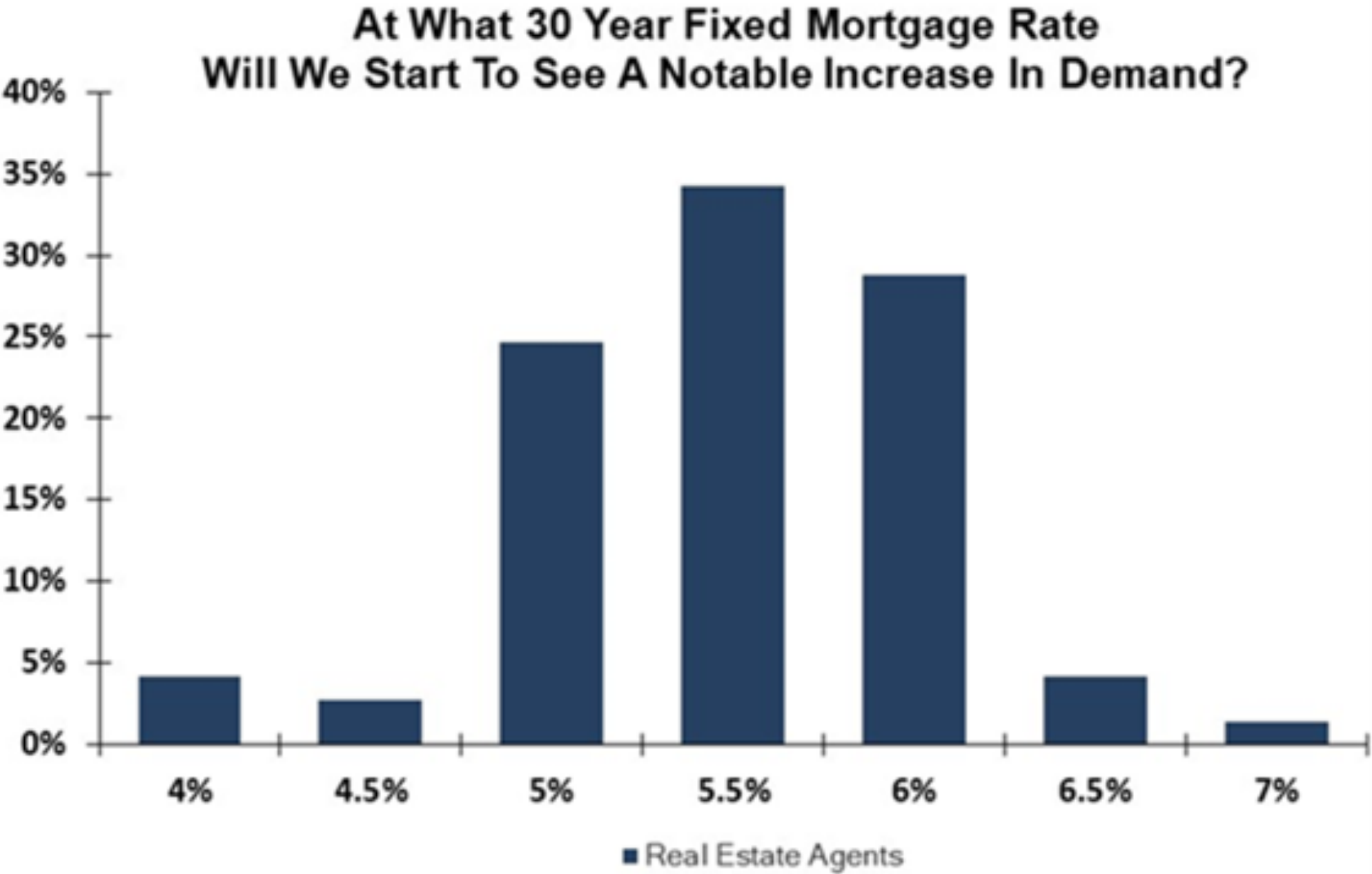
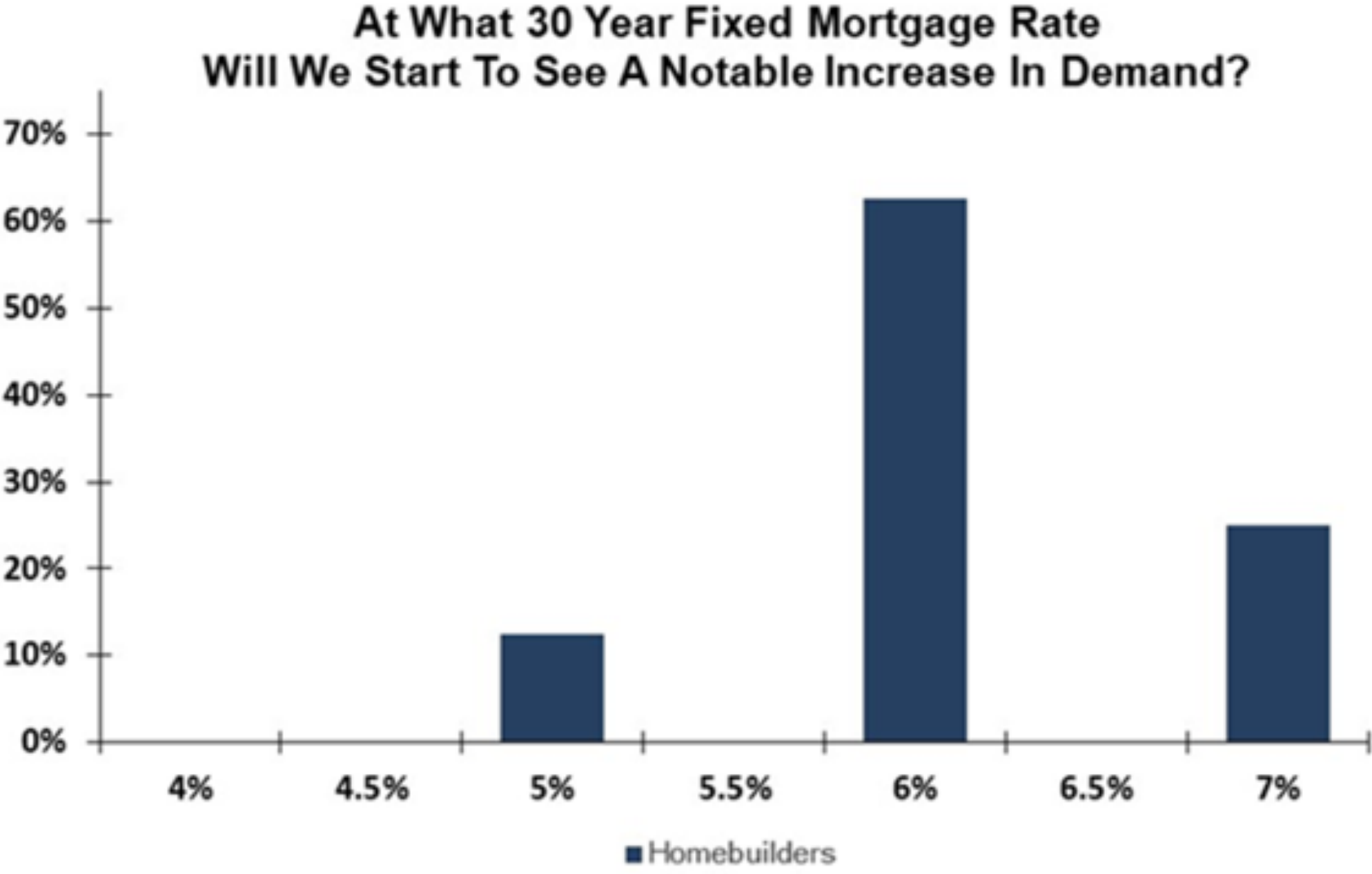
It's no wonder mortgage applications are the lowest since 1995

Average Rate on existing Mortgages and The 30-Year Fixed Mortgage Rate
1992 Through Mid-January 2024



Source: Bureau of Economic Analysis, Federal Reserve Bank of St. Louis, National Bureau of Economic Research, Empirical Research Partners Analysis. January 29, 2024

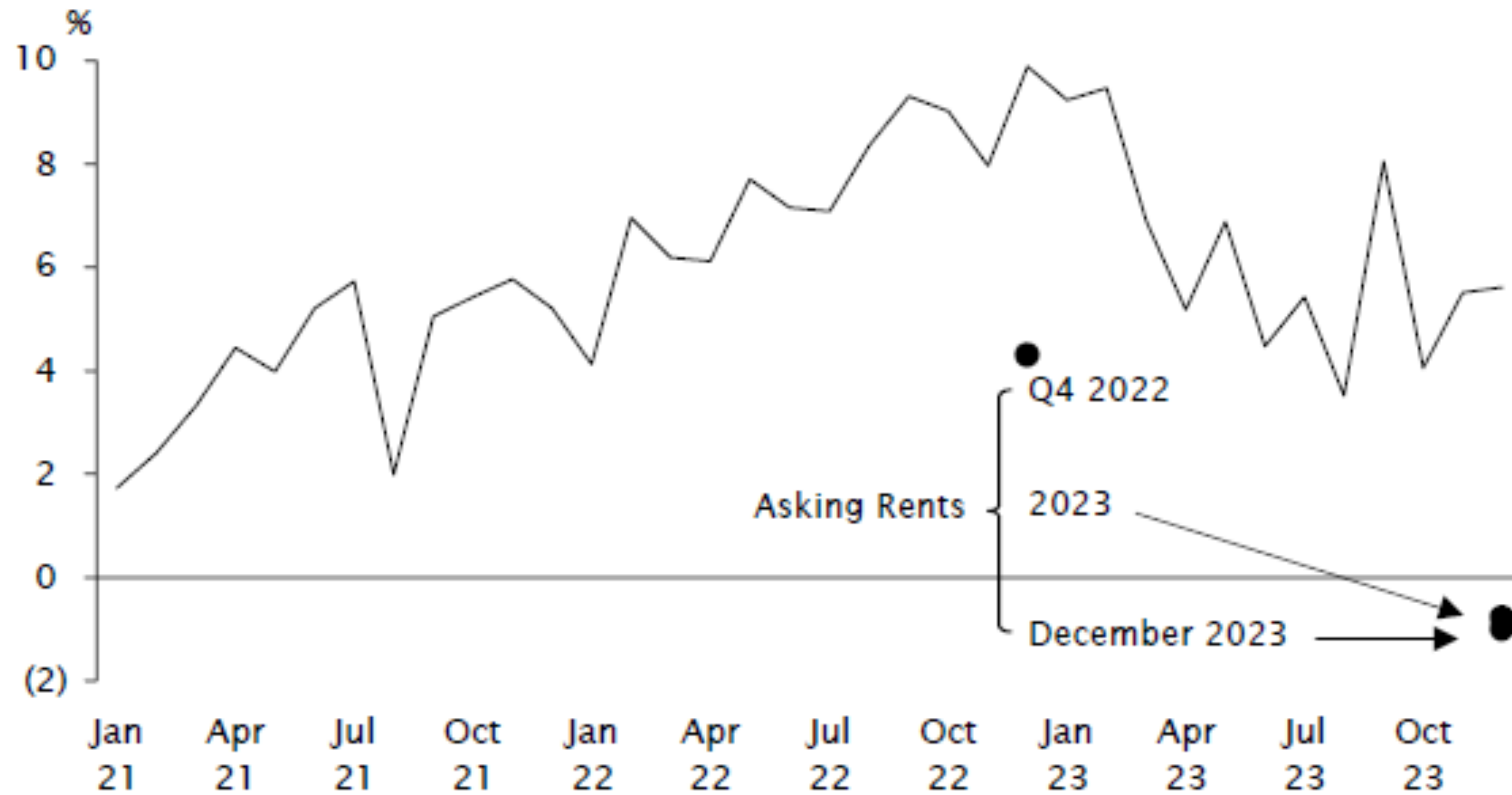
Rooting for a 6% mortgage rate



Source: Evercore ISI Research. December 6, 2023.

At least rents are coming down

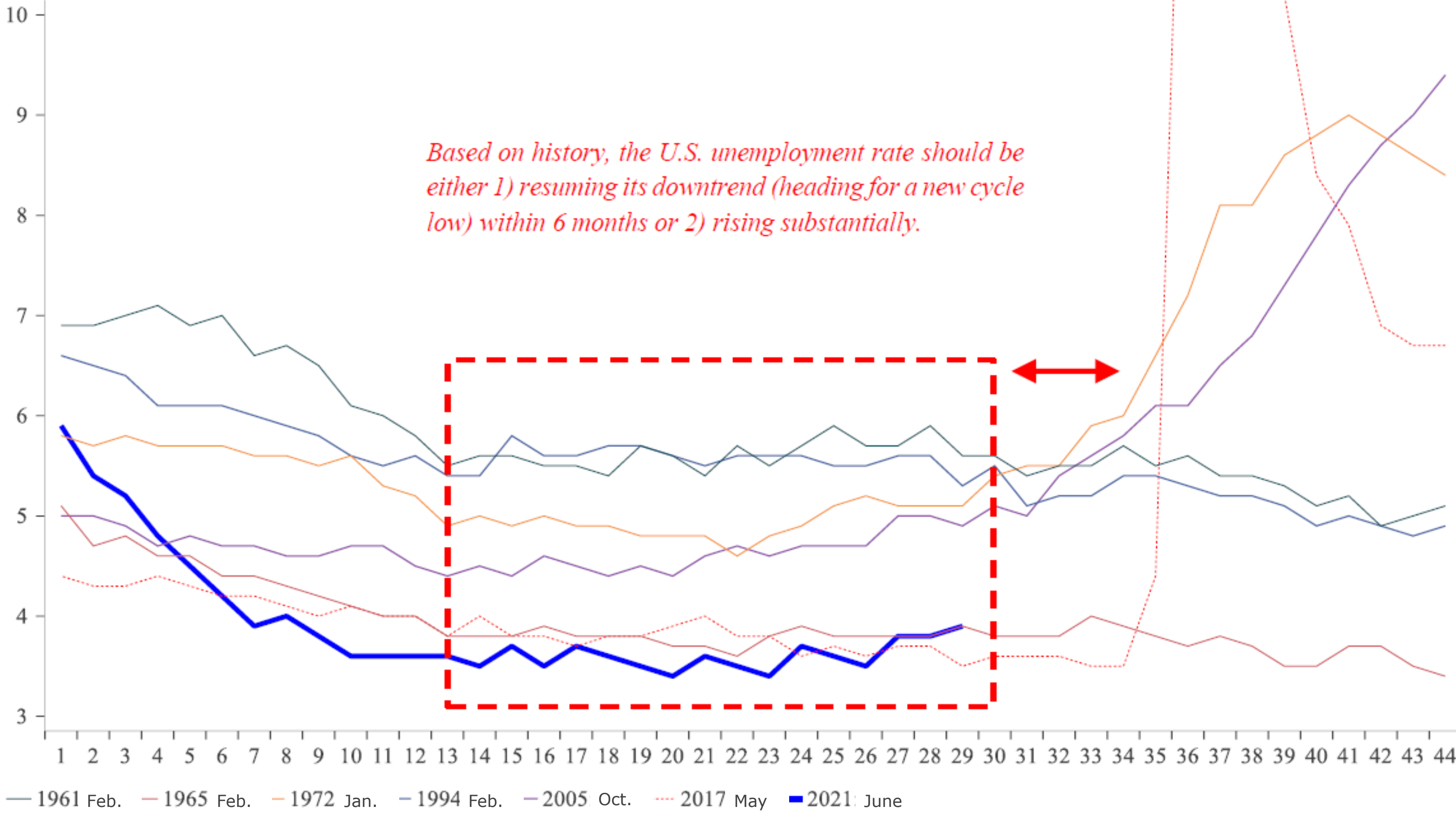
The Shelter Component of the CPI and Asking Rents
Month-Over-Month Annualized Changes
2021 Through December 2023



Source: Bureau of Labor Statistics, Apartment List, Empirical Research Partners Analysis. January 29, 2024

Wither the unemployment rate?

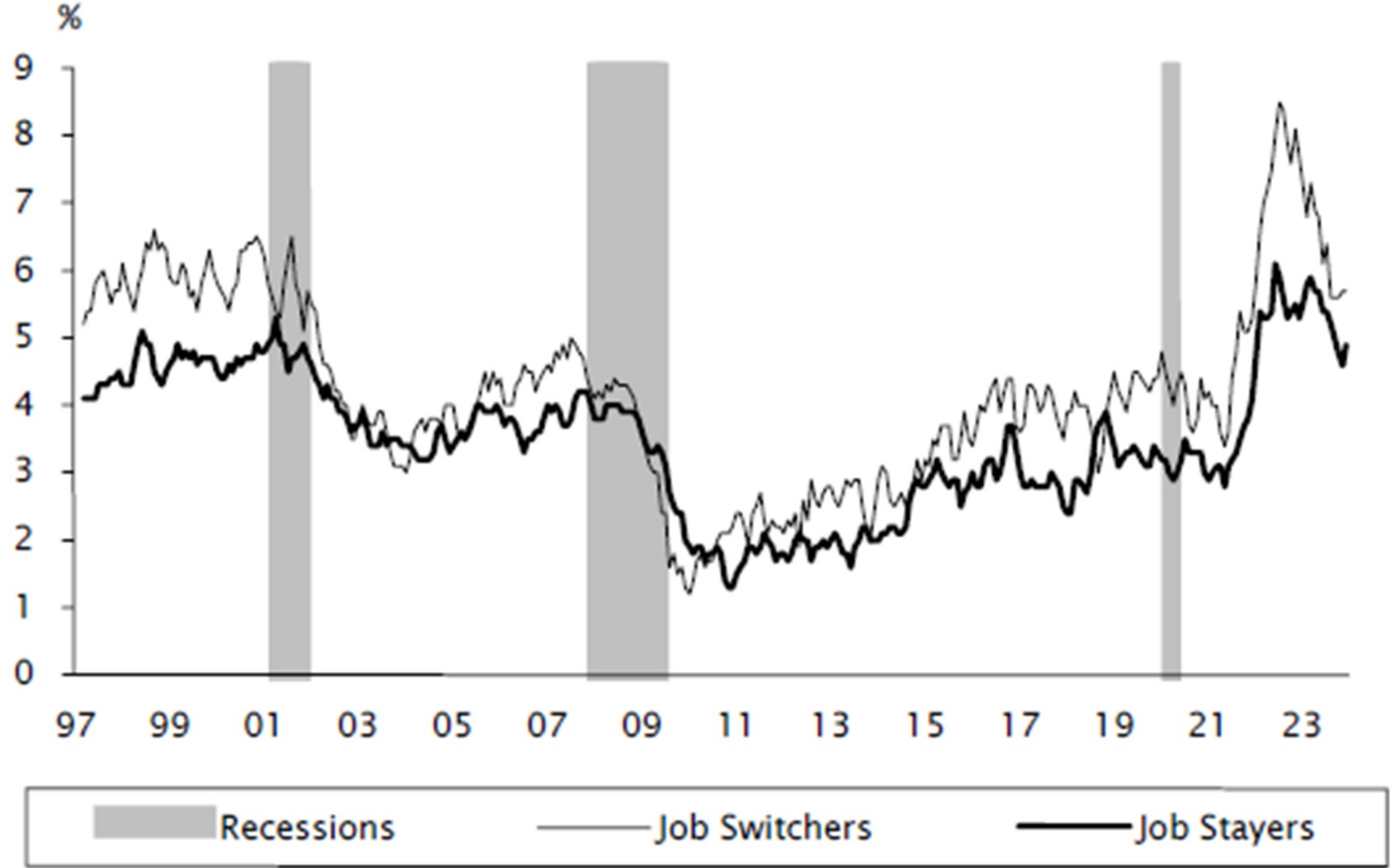
U.S. Unemployment Rate in Sideways Periods



Source: Strategas Research, BLS, Macrobond. November 21, 2023
 Note: Start Date is 12 months prior to sideways period.

Wage growth for job switchers has slowed down significantly

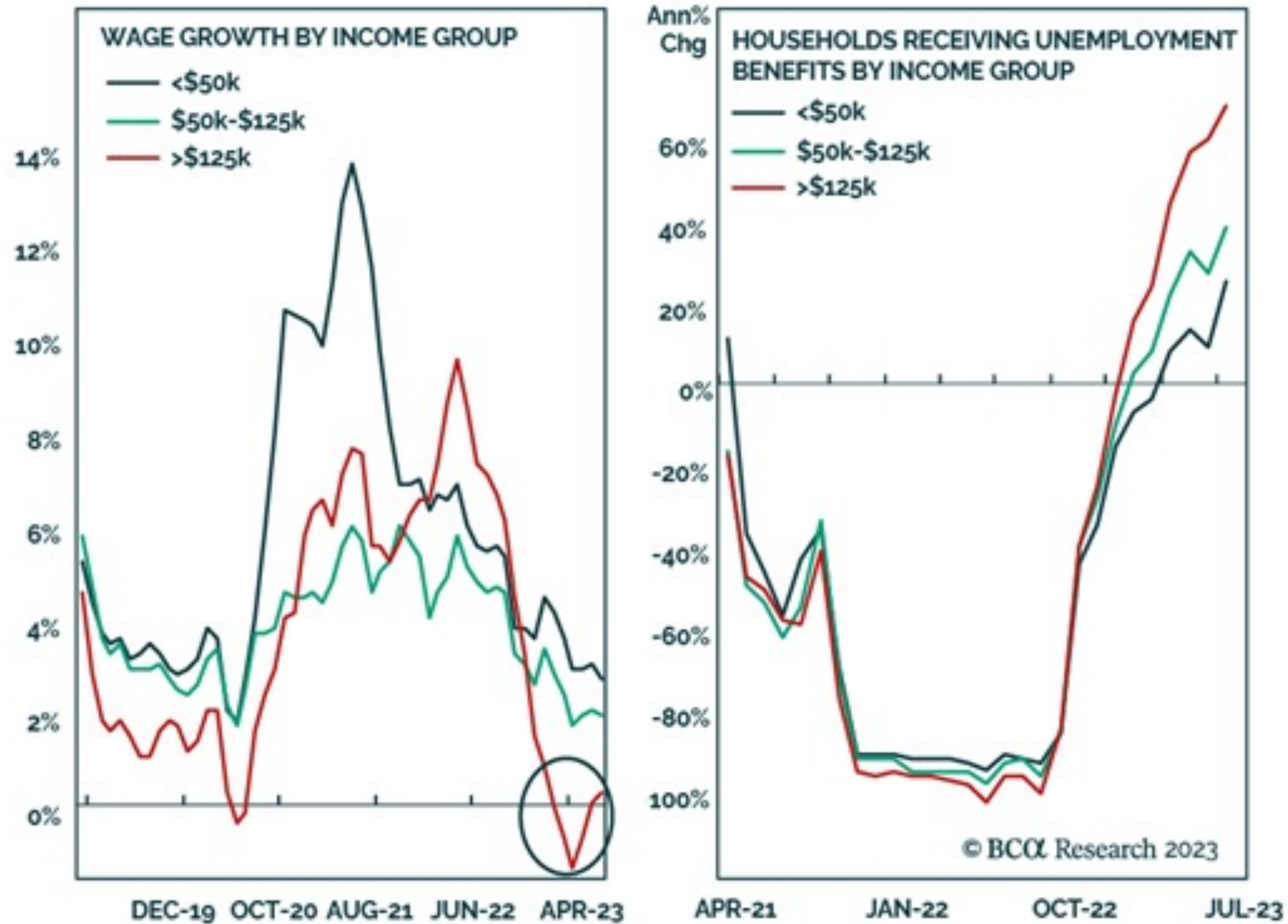
Wage Growth for Job Stayers and Switchers*
1997 Through December 2023



Source: Federal Reserve Bank of Atlanta, National Bureau of Economic Research. Empirical Research Partners. January 29, 2024. Data as of December 31, 2023
*Medians, expressed as 3-month moving averages

Higher-income households affected most by recent layoffs

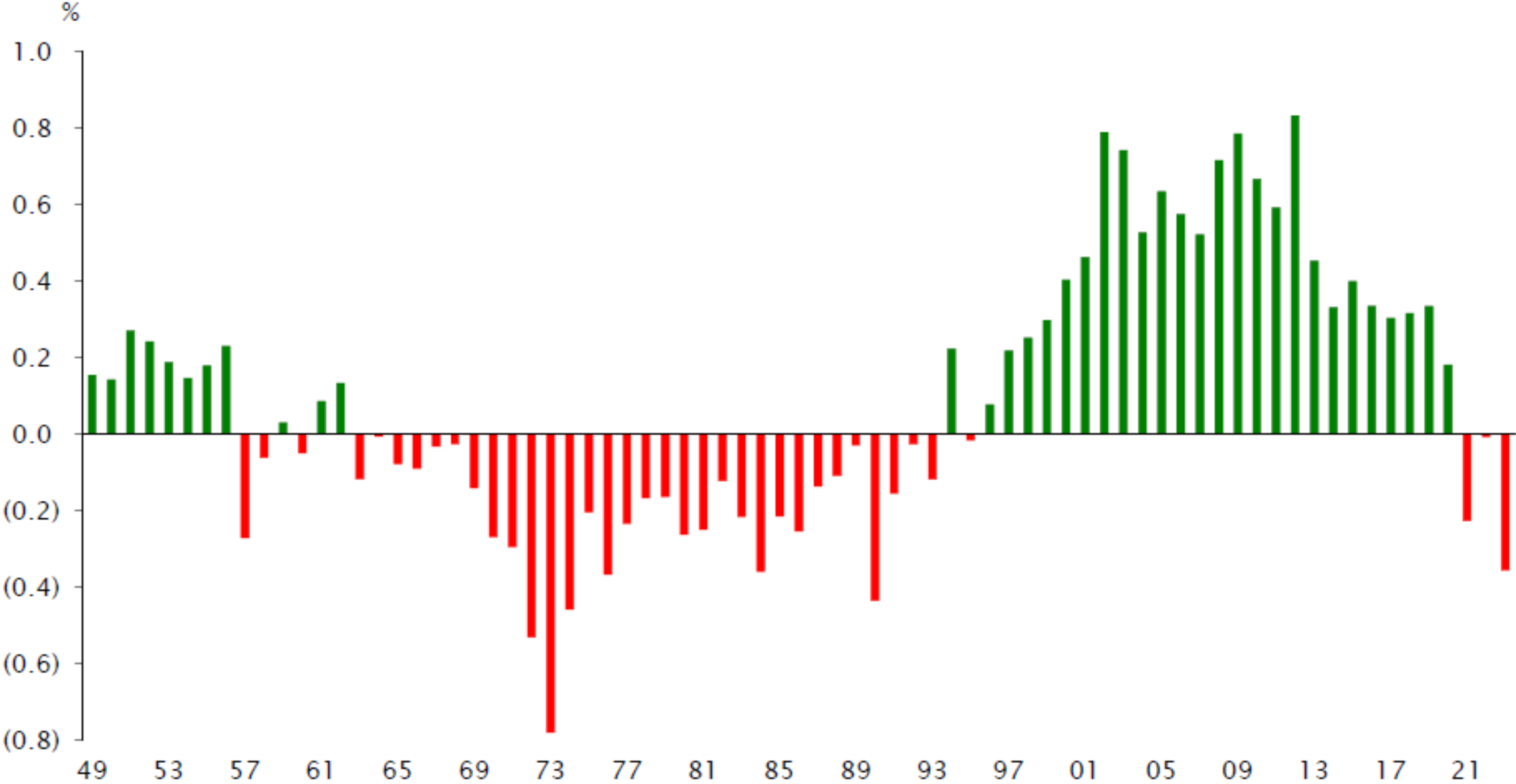
"Richcession" Will Be a Drag On Spending



Source: Bank of America, BCA Research, September 13, 2023
Note: Shown as 3-month moving average

Where are all the workers?

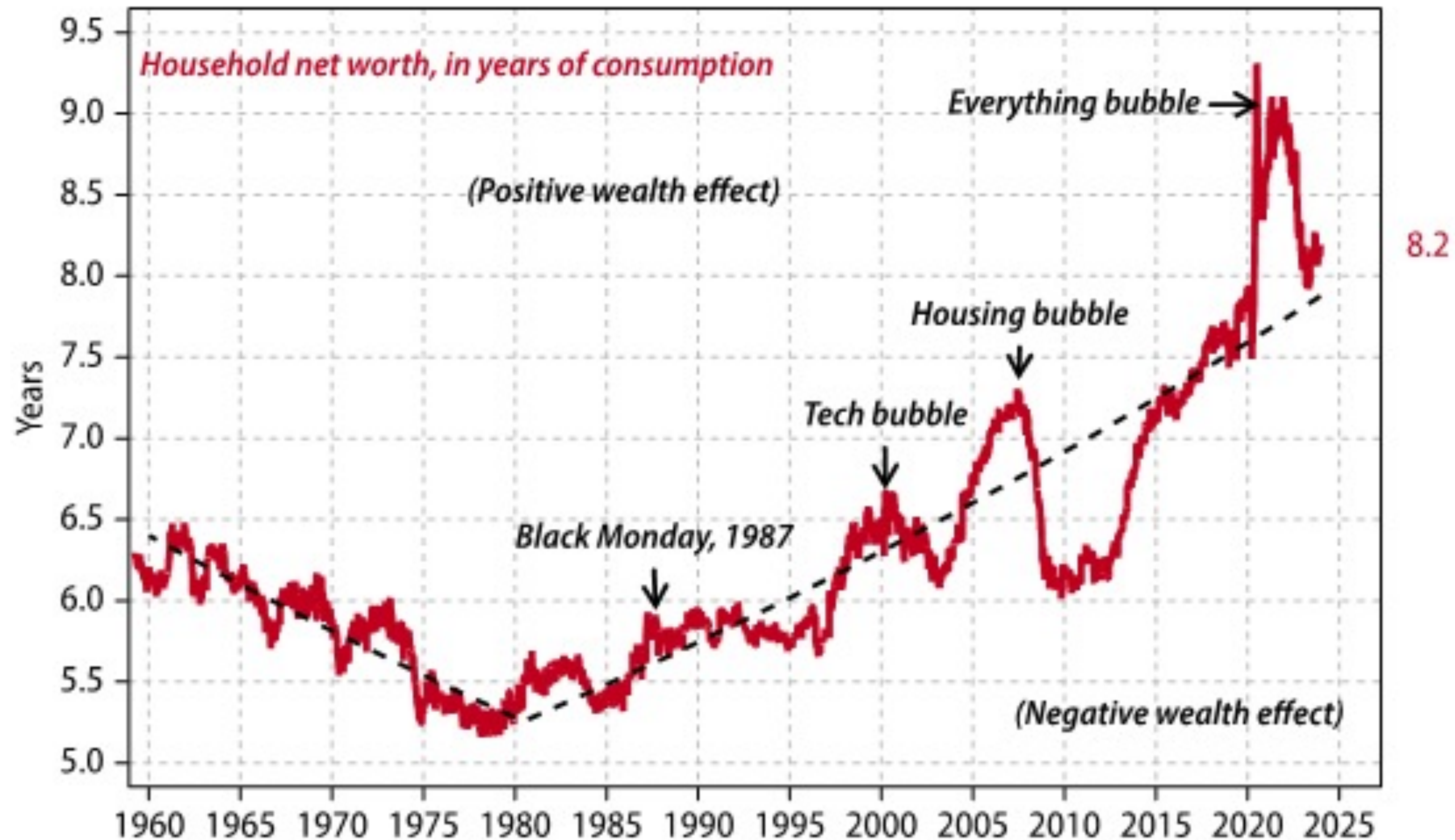
Those Aged 55 and Over
Annual Changes In The Share of The Workforce 1949 Through October 2023



Source: Empirical Research Partners. November 30, 2023

Consumers in great shape—particularly those ages 55+

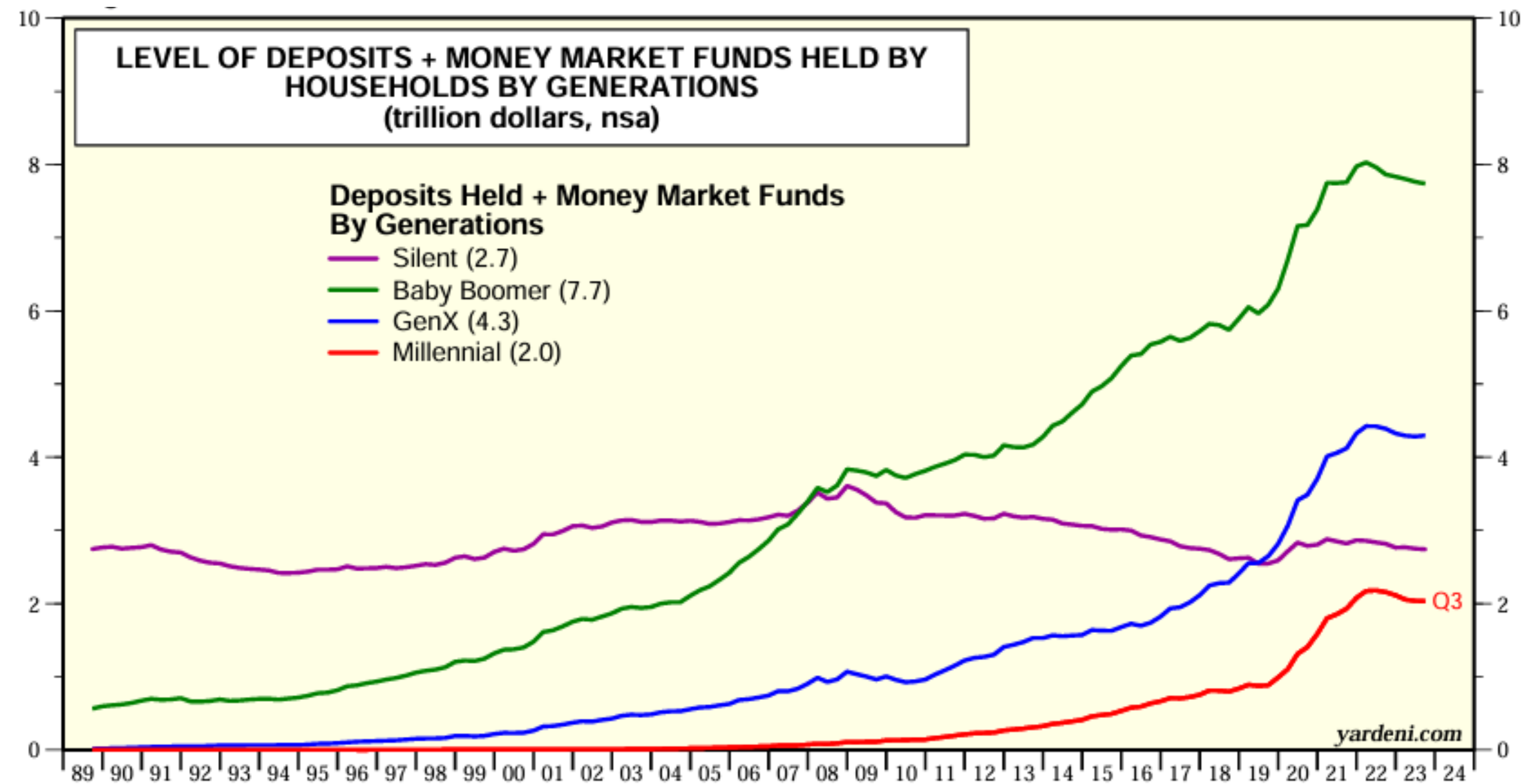
U.S. Household Net Worth, in Years of Consumption*



Source: Gavekal Research, Macrobond. December 21, 2023

*Net Worth based on flow of funds data, adjusted for recent equity and house price changes

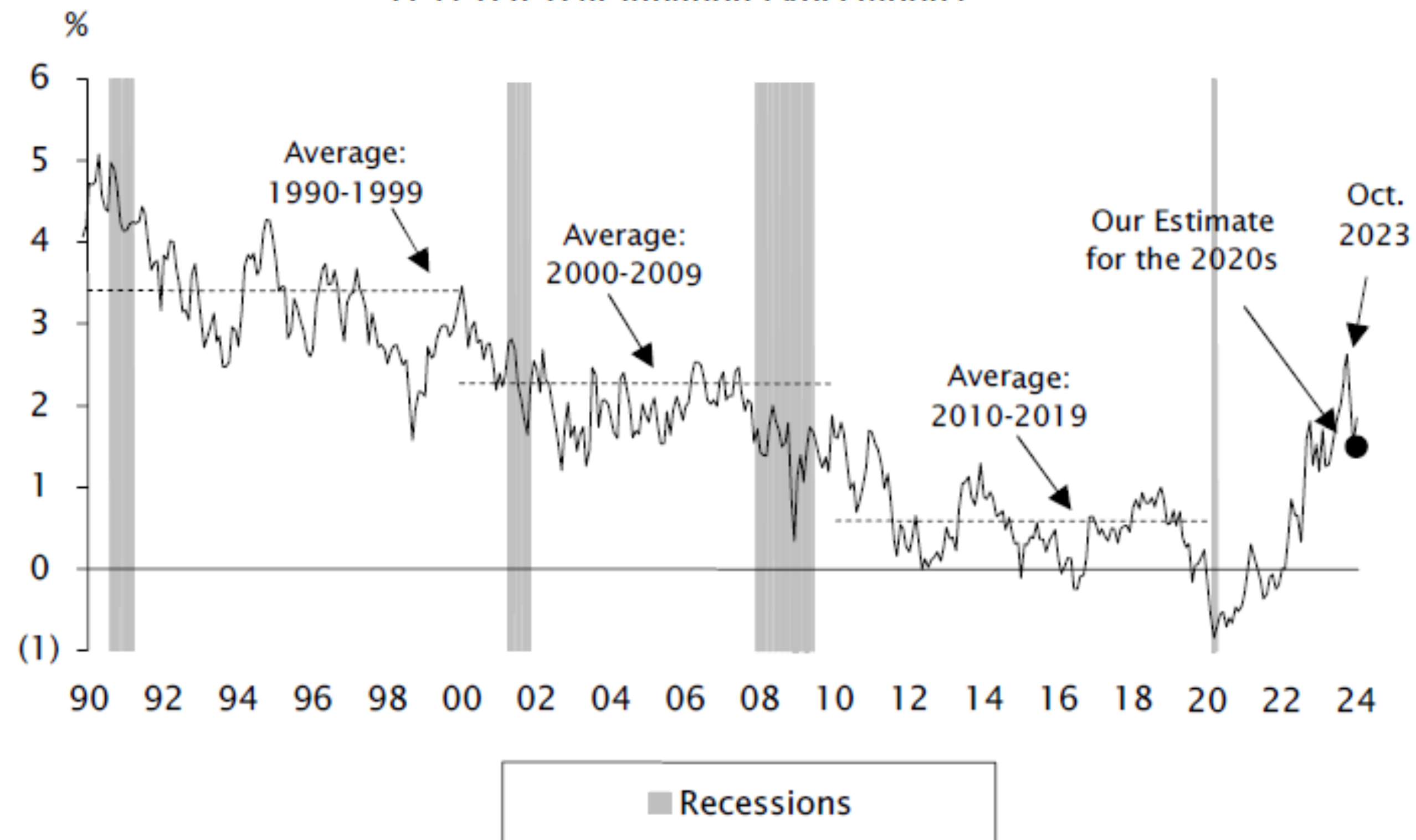
Baby Boomers have lots of liquidity



Source: Federal Reserve Board Financial Accounts of the United States, Distributional Financial Accounts (DFA). Yardeni Research. December 22, 2023

Fallout from the inflation fight - Real interest rates up dramatically

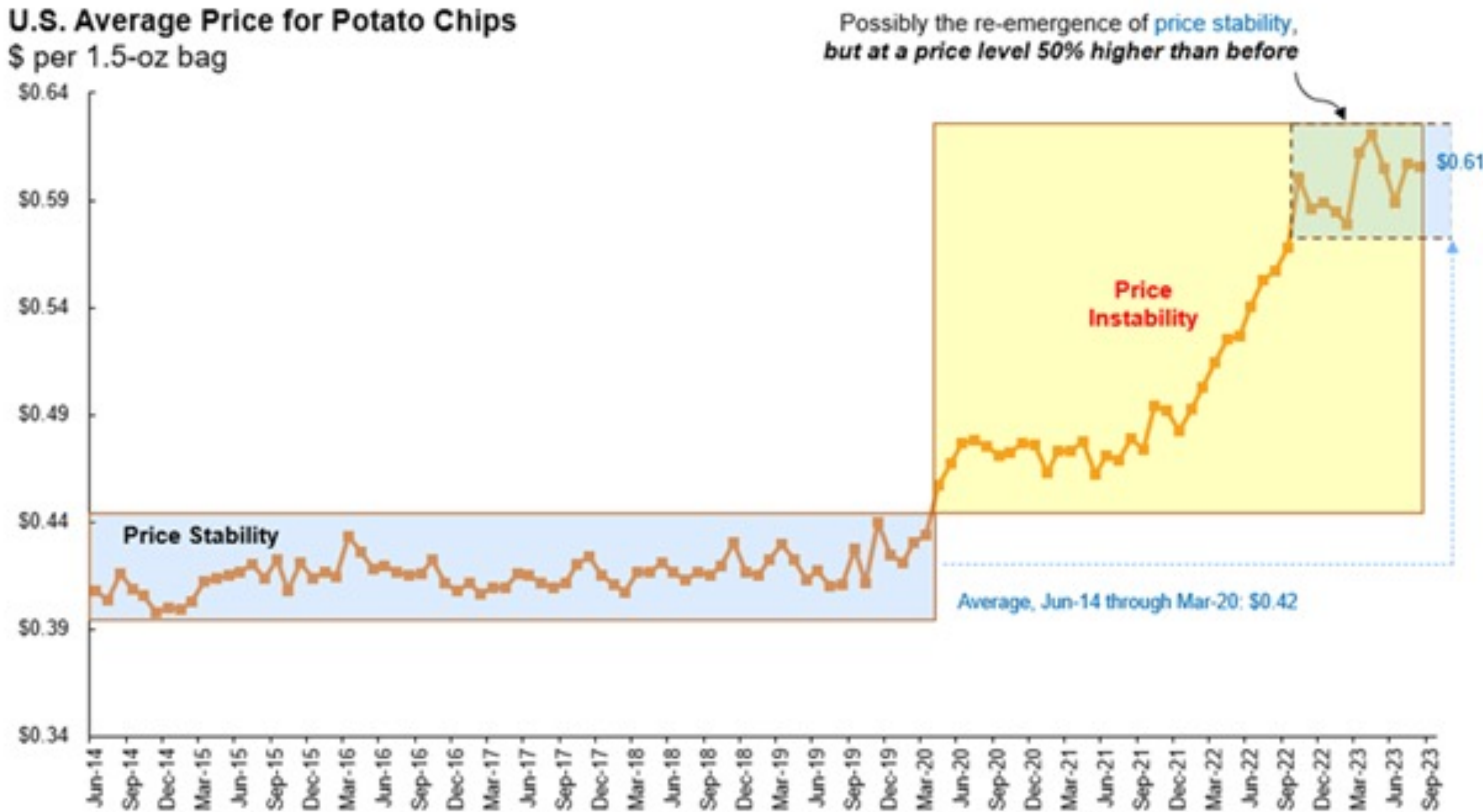
10-Year U.S. Treasury Bond Yields Less 10-Year Inflation Expectations*
1990 Through Late-January 2024



Source: Federal Reserve Bank of Cleveland, Federal Reserve Board, National Bureau of Economic Research, Empirical Research Partners Analysis. January 29, 2024.
* Less the trailing three-month average of 10-year inflation expectations as estimated by the Cleveland Fed model.

The cost of inflation: “instability,” then “new price level”

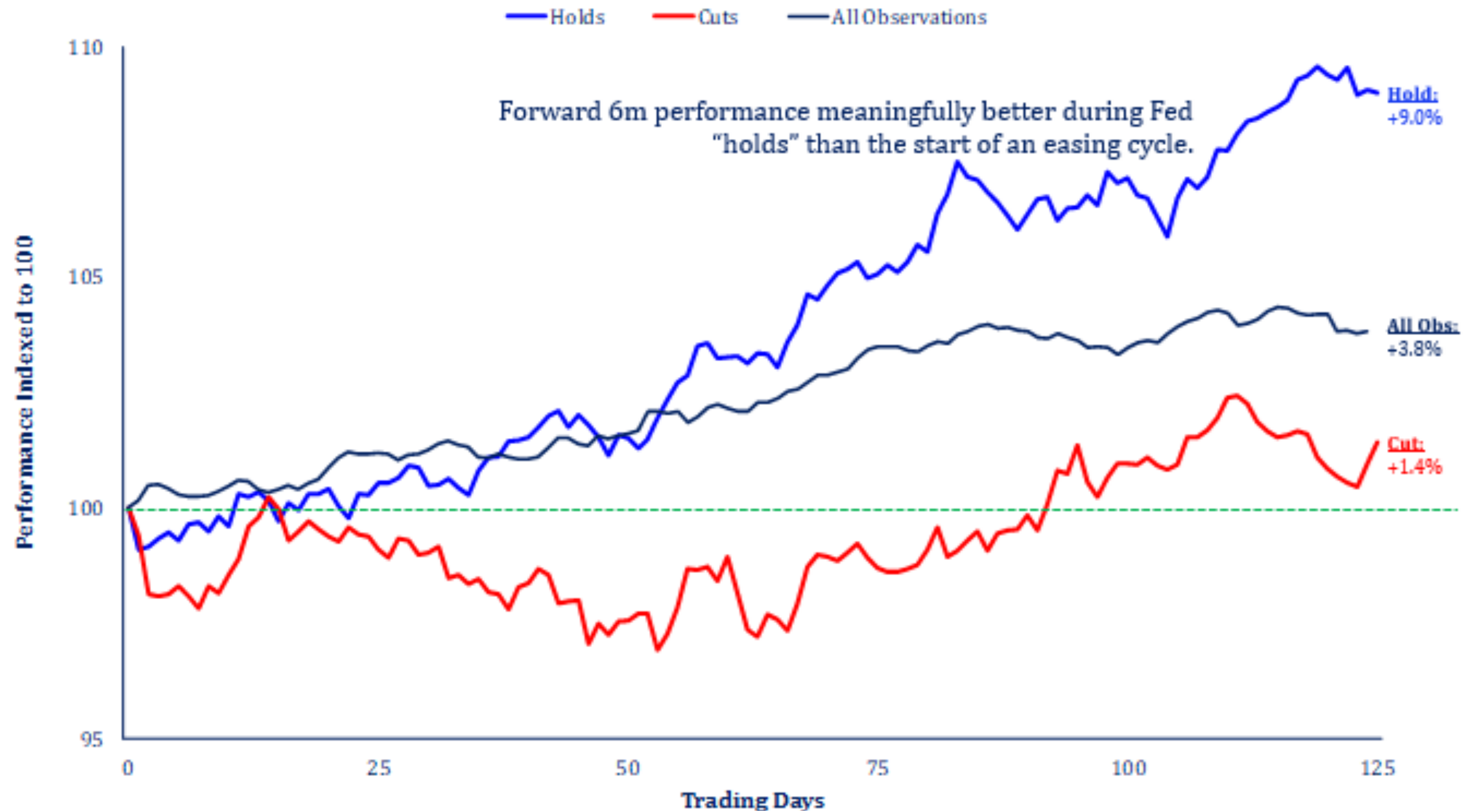
A Consumer of Potato Chips Now Pays, On Average, 50% More Than Before COVID



Source: BLS, 22V Research. Note: updated on 13-Sep-2023 with data through August 2023 (latest available from source). Fun fact: the first recorded recipe for potato chips appears in an 1817 cookbook (*The Cook's Oracle*) authored by the aptly-named chef William Kitchiner. Frito-Lay Inc. (formed in a 1961 merger of two predecessor firms, each founded in 1932) merged with Pepsi-Cola to form PepsiCo. in 1965. Production costs for a bag of potato chips include expenses for biaxially oriented polypropylene (inside lining of the bag), low-density polyethylene (a middle layer), Surflyn® (a branded thermoplastic resin for the bag's outer layer), nitrogen, potatoes, salt, spices, sunflower oil, water, natural gas, and diesel fuel.

It would be better for stocks if The Fed can keep holding

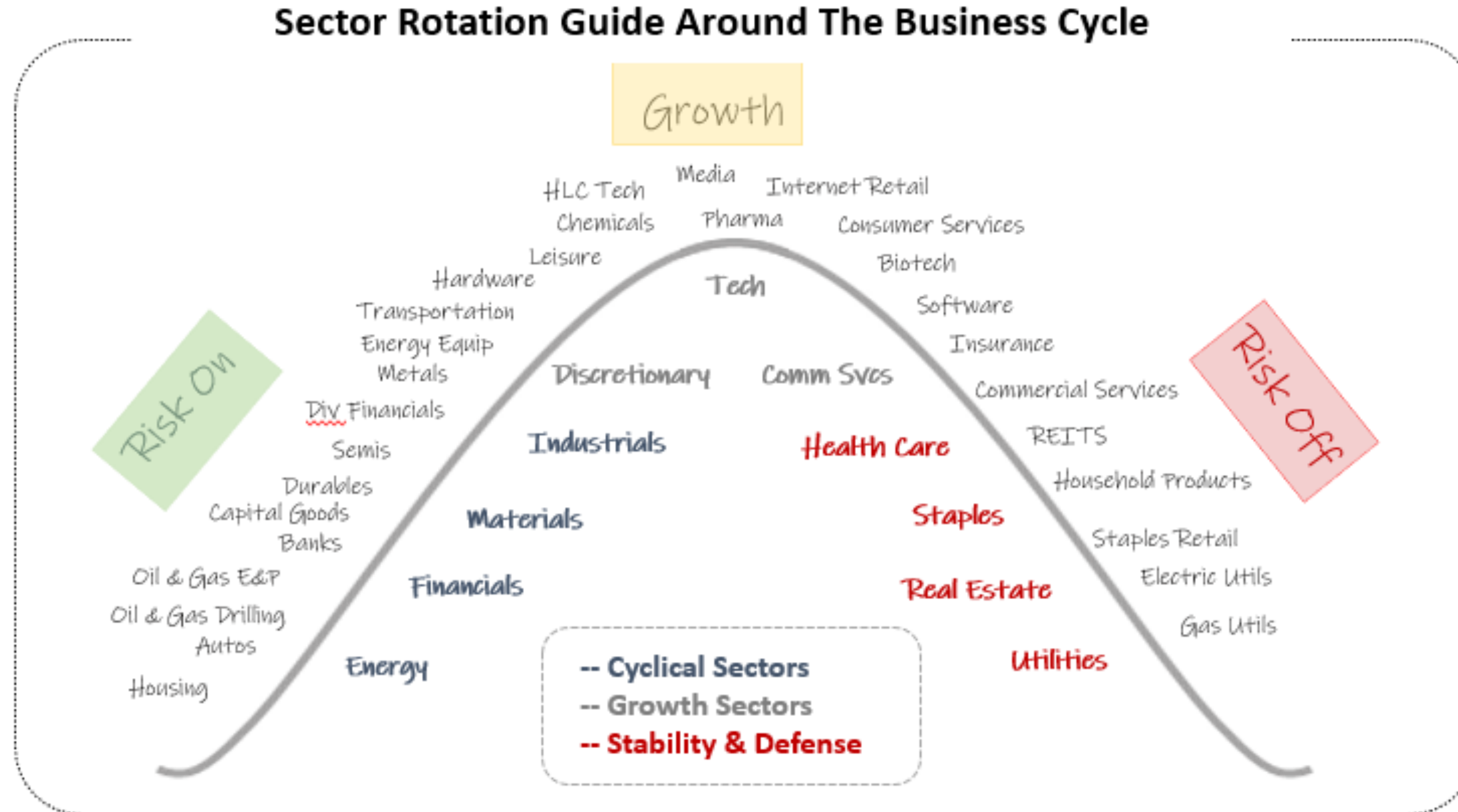
+6 Month Forward S&P 500 Performance Following Fed Rate Hold vs. Cut



Source: Strategas Research. December 6, 2023

Note: Includes 8 Cut observations since 1980 and 9 Hold observations since 1980

Where are we in the economic cycle?



A historically top-heavy market

Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

<u>Year</u>	<u>Top 10 as % of Total</u>	<u>S&P 500 % Perf.</u>
2007	78.7%	3.5%
2023	68.4%	24.2%
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1991	28.6%	26.3%
2006	27.6%	13.6%
2016	26.6%	9.5%
2003	23.6%	26.4%
1995	22.3%	34.1%
2014	22.2%	11.4%
2004	21.1%	9.0%
2005	20.5%	3.0%
2010	19.6%	12.8%
2012	19.2%	13.4%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%
1993	12.2%	7.1%

This is not the late '90s

Magnificent Seven Cash Balances

	CASH ON HAND	LONG-TERM INVESTMENTS	COMBINED	TOTAL ASSETS	COMBINED % OF TOTAL ASSETS
APPLE	\$62,482	\$104,061	\$166,543	\$335,038	49.7
ALPHABET	\$118,332	\$31,224	\$149,556	\$383,044	39.0
MICROSOFT	\$111,262	\$9,879	\$121,141	\$411,976	29.4
AMAZON	\$63,970	\$0	\$63,970	\$477,607	13.4
META	\$53,446	\$6,208	\$59,654	\$206,688	28.9
TESLA	\$23,075	\$0	\$23,075	\$90,591	25.5
NVIDIA	\$16,023	\$0	\$16,023	\$49,555	32.3

Source: Investing.com. BCA Research. November 6, 2023.
 Note: Figures as of Q2 2023 balance sheets, denoted in Million USD.

Defensive stocks are valued at a historically-large discount to early cyclicals

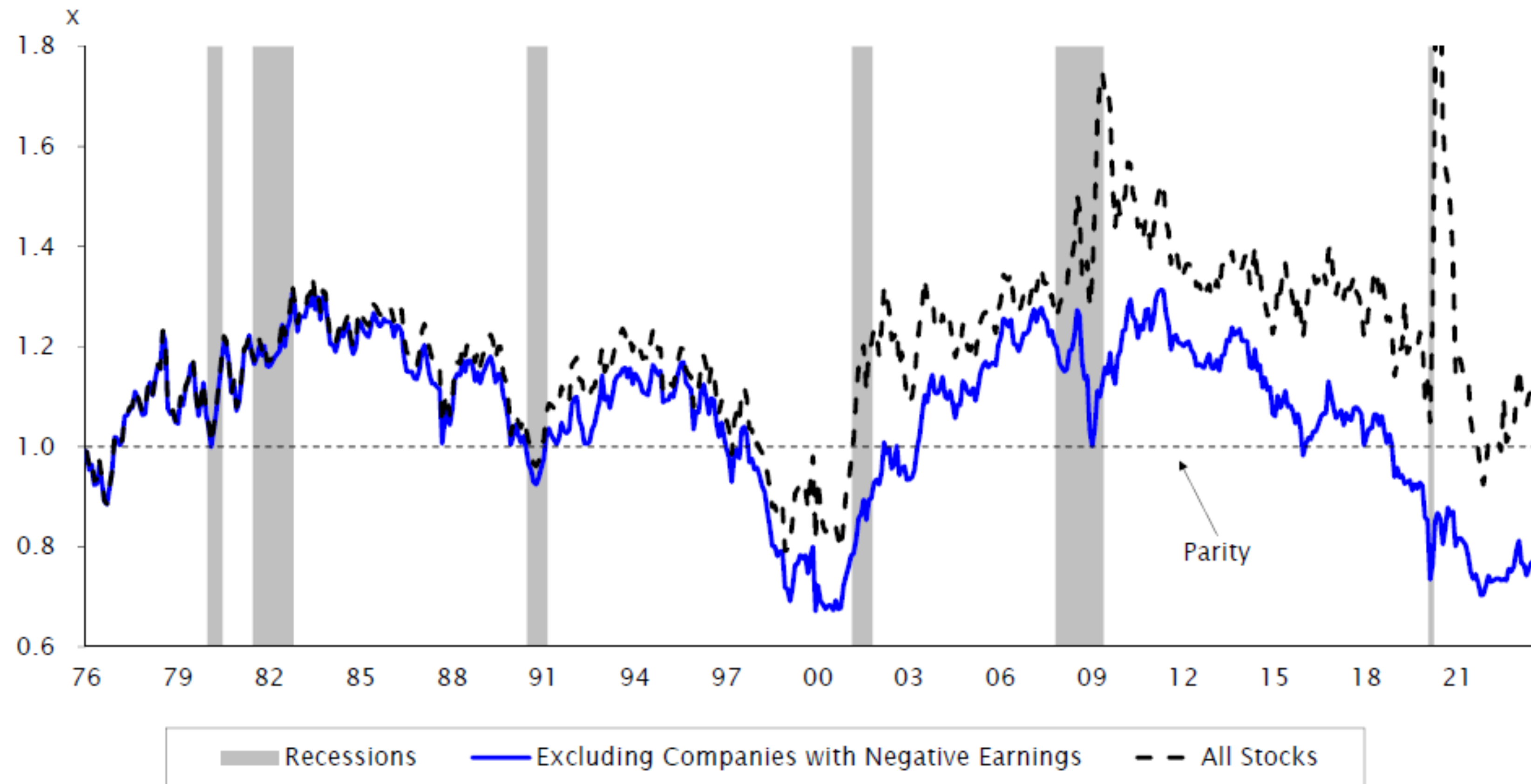
Early Cyclicals Relative Defensives vs. Leading Index



Source: Wolfe Research, Bloomberg Finance, Conference Strategy, and Standard & Poor's. December 8, 2023.

Profitable small-caps are valued at a historically-large discount to large-caps

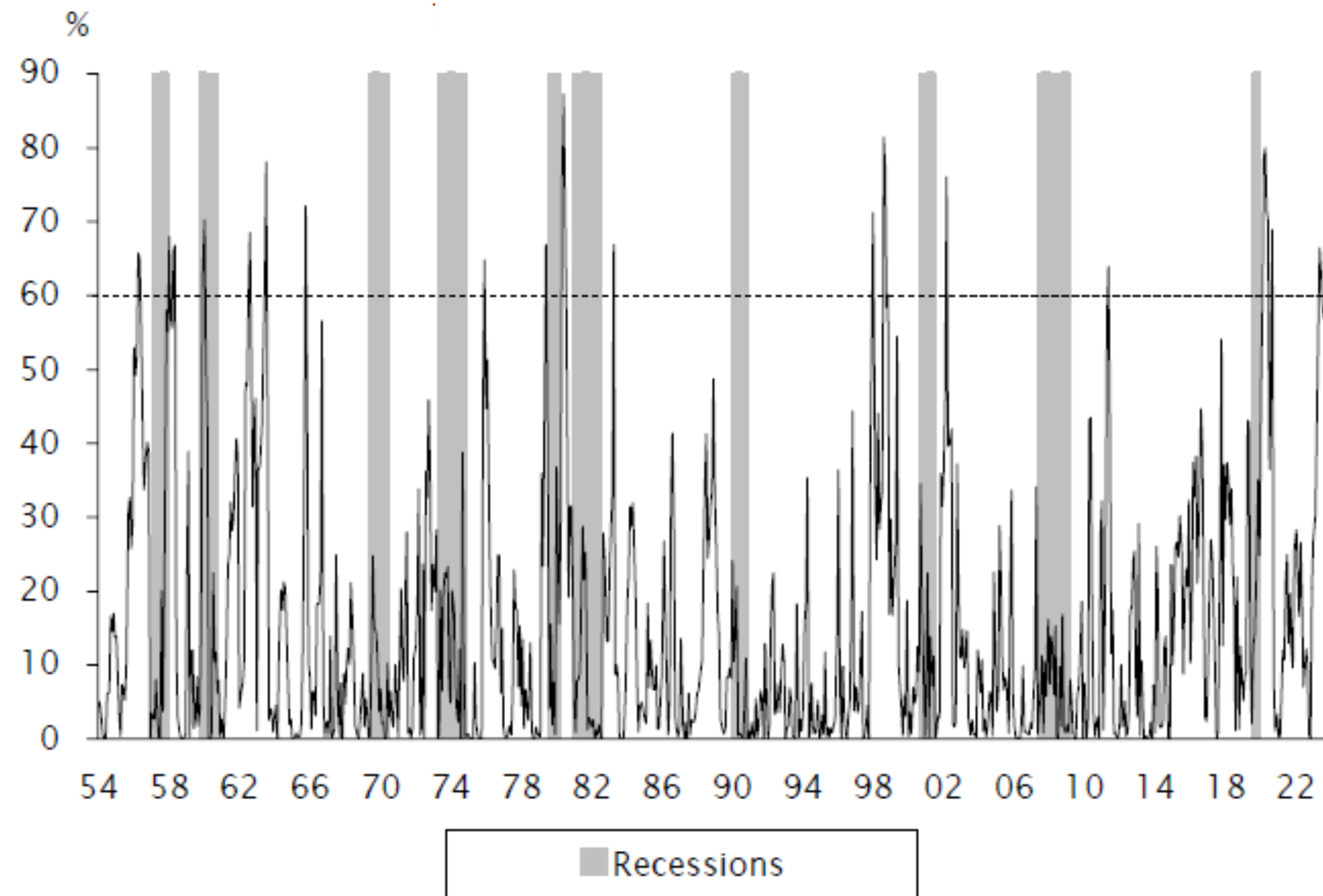
Small-Capitalization Stocks
Forward P/E Ratios Relative To That of Large-Cap Stocks* 1976 Through Late-November 2023



Source: Empirical Research Partners. November 30, 2023
*Capitalization-weighted data

The bond market explained 2/3 of stock returns in 2023

Large-Capitalization Stocks, Share of the Return Dispersion Explained by Changes in the Ten-Year Treasury Bond Yields*
1954 Through Mid-January 2024

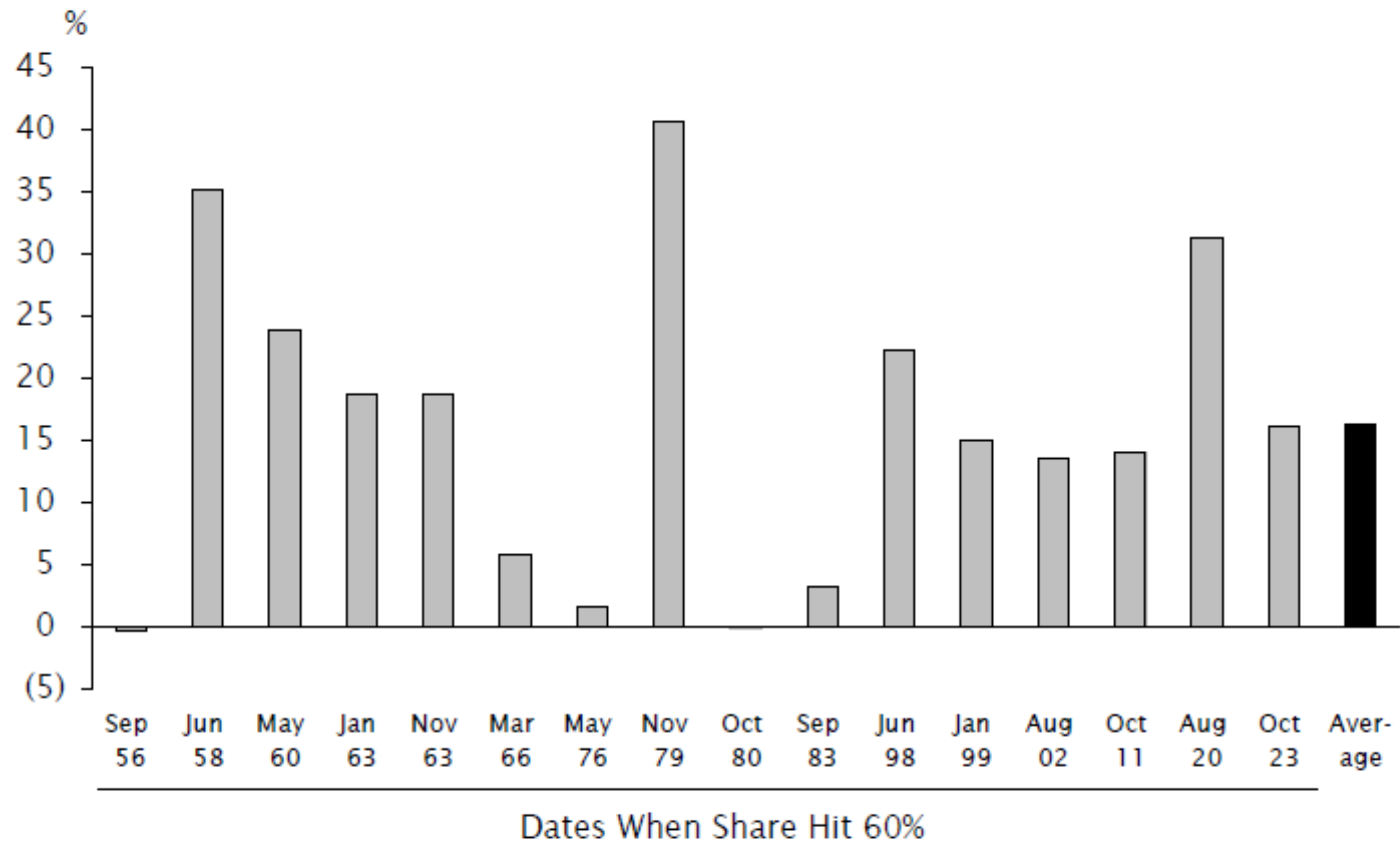


Source: Bloomberg, LP, National Bureau of Economic Research, Empirical Research Partners Analysis. January 29, 2024.

* Produced by the sum of squares explained by regressions over trailing nine-month periods.

Stocks historically produced positive returns the following year

Large-Capitalization Stocks 1954 Through Late-January 2024
 One-Year Returns Following Points at Which the Returns Explained by Changes in Ten-Year Treasury Bond Yields Hit 60%*

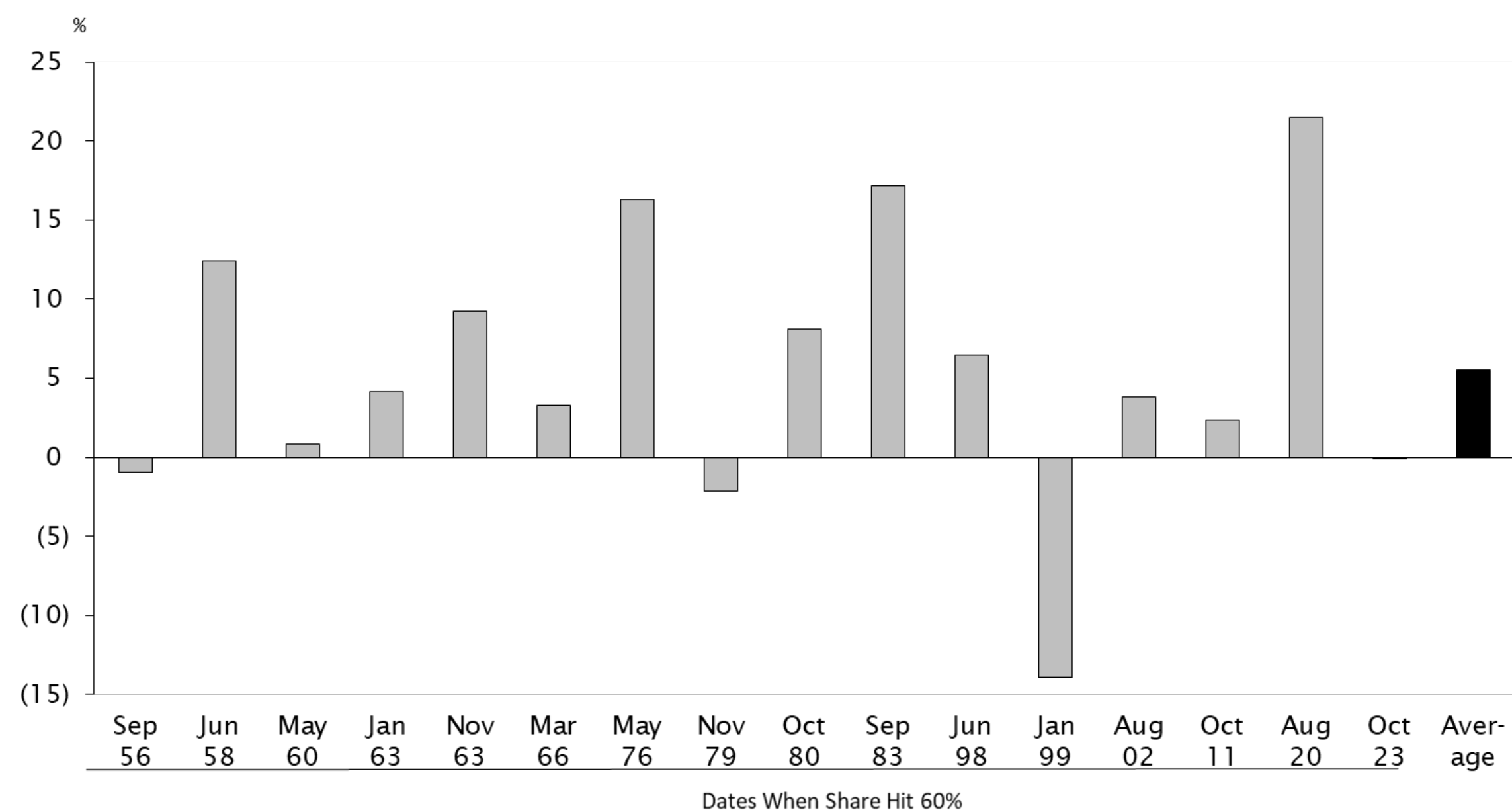


Source: Bloomberg L.P., Empirical Research Partners Analysis. January 29, 2024

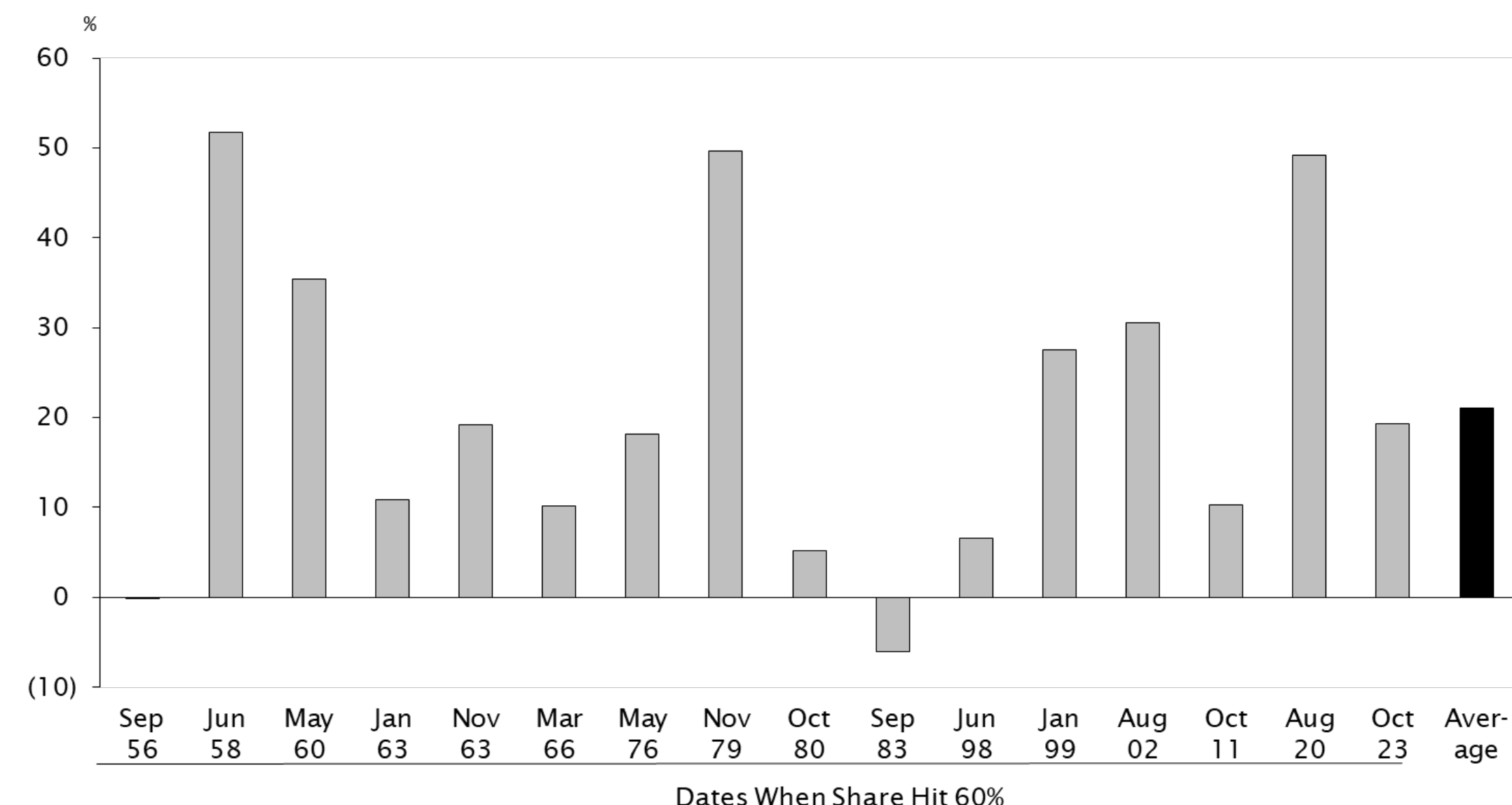
*Capitalization-weighted data; produced by the sum of squares explained by regressions over trailing nine-month periods.

Mostly benefiting value and small cap stocks

Large-Capitalization Stocks, Lowest Quintile of Valuation
1954 Through Late-January 2024
One-Year Returns Following Points at Which the Returns
Explained By Changes in 10-Year Treasury Bond Yields Hit
60%*



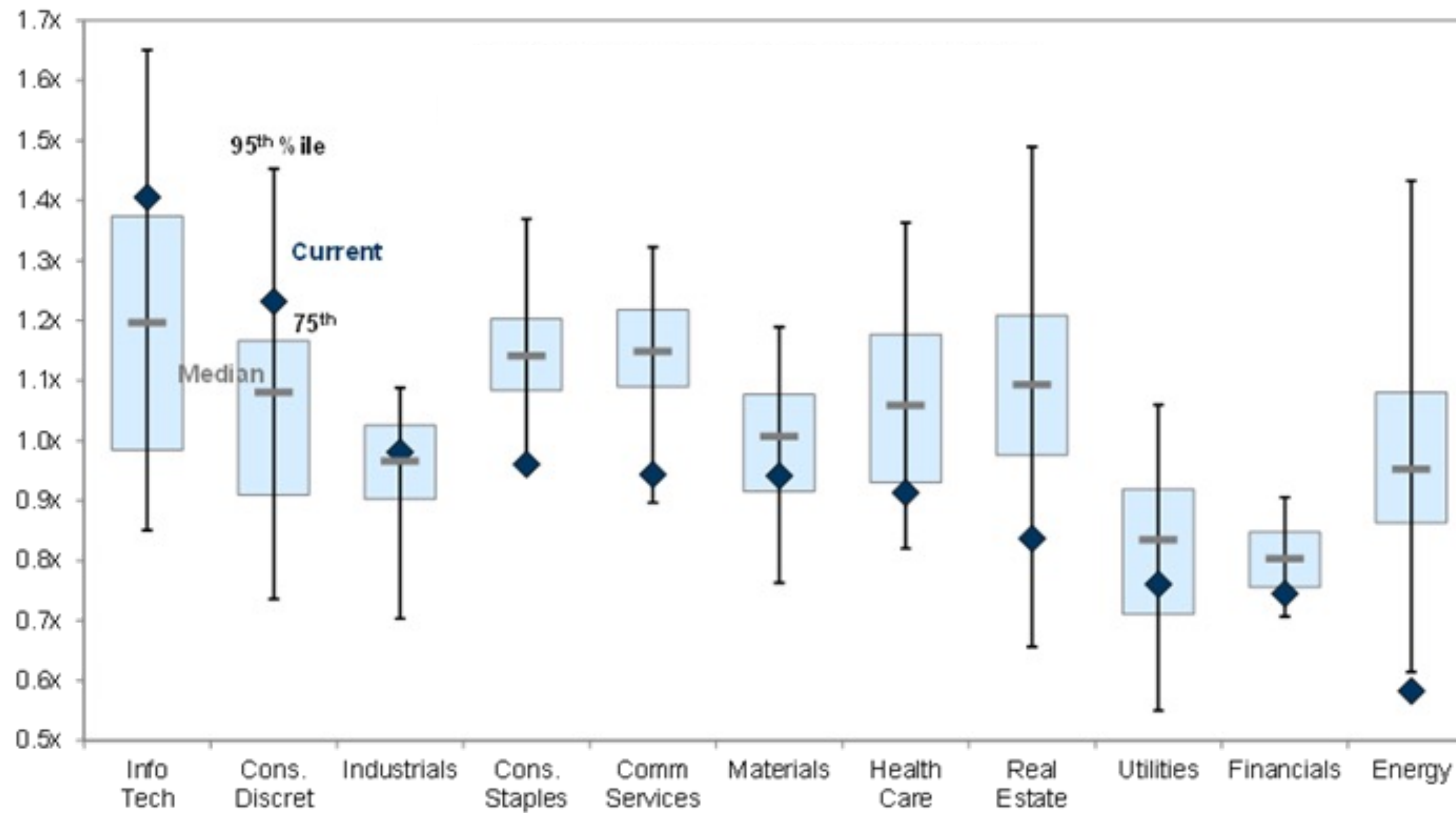
Small-Capitalization Stocks, 1954 Through Late-January 2024
One-Year Returns Following Points at Which the Returns
Explained By Changes in 10-Year Treasury Bond Yields Hit
60%*



Source: Bloomberg, LP. Empirical Research Partners Analysis. January 30, 2024
*Capitalization-weighted data; produced by the sum of squares explained by regressions over trailing nine-month periods

Sector valuations

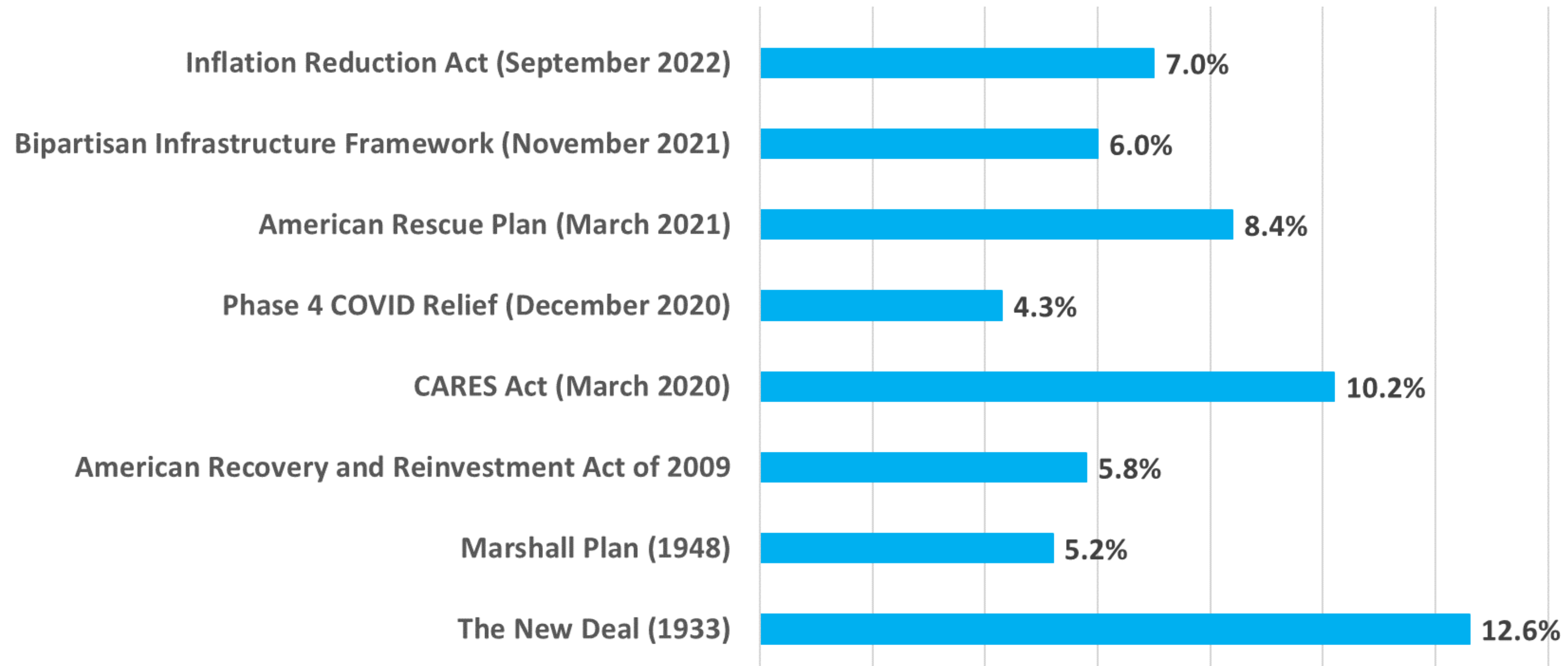
Distribution Of Sector FY2 P/E Ratios Relative To S&P 500 During Last 30 Years



Source: Goldman Sachs Research. January 29, 2024
Blue bars show P/E Ratios relative to the S&P 500 over the last 30 years. The Diamonds show the current relative P/E of the sector.

Historic fiscal policy

Select Stimulus as a Percentage of U.S. GDP



And the debt champion is...

Debt Levels and Increases in Major Economies

	2022 Gross Government Debt <i>US\$ tr</i>	Increase in Gross Government Debt between 2019 and 2022 <i>US\$ tr</i>	2022 population <i>millions</i>	2022 Govt Debt per Capita <i>US\$</i>	Increase in Govt Debt per capita between 2019 and 2022 <i>US\$</i>
USA	30.57	7.32	333.01	91,795	21,022
Canada	2.12	0.58	38.74	54,663	13,653
UK	2.66	0.19	67.60	39,417	2,351
Japan	10.94	-1.13	125.17	87,409	-8,215
Germany	2.89	0.60	83.29	34,677	7,190
France	3.13	0.48	65.63	47,695	6,965
Italy	2.96	0.27	59.19	50,046	5,065
China	13.61	5.49	1412.50	9,634	3,879

Source: Gavekal Research as of February 2023.

Somebody's got to pay for the largesse!

Dividend Contribution to Total Return

Decade	Price Pct. Change	Dividend Contribution	Total Return	Dividends Pct of TR	Avg Payout Ratio
1930s	-41.9%	56.0%	14.1%	100.0	90.1
1940s	34.5%	100.1%	134.6%	74.4	59.4
1950s	257.3%	180.3%	437.7%	41.2	54.6
1960s	53.7%	54.2%	107.9%	50.2	56.0
1970s	17.2%	59.1%	76.4%	77.4	45.5
1980s	227.4%	143.1%	370.5%	38.6	48.6
1990s	315.7%	115.7%	431.5%	26.8	47.6
2000s	-24.1%	15.0%	-9.1%	100.0	35.3
2010s	189.7%	66.9%	256.7%	26.1	35.2
2020s	47.6%	10.0%	57.6%	17.3	36.0
Average	114.4%	87.8%	202.2%	59.4	52.5

Source: Strategas Research. January 11, 2024
Past Performance is no guarantee of future results

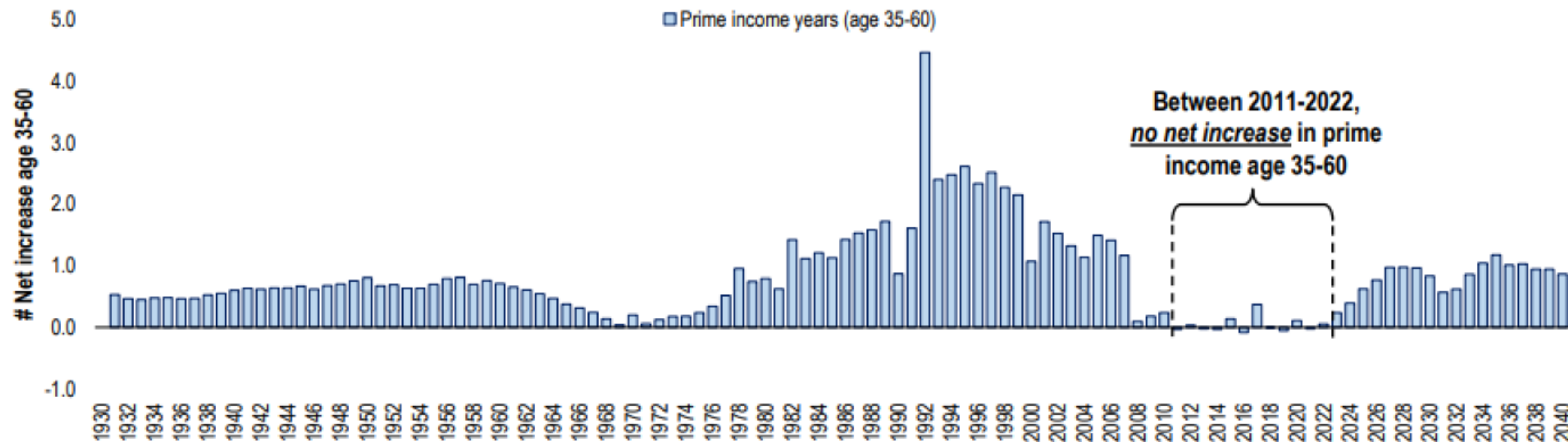
It all depends on your time horizon: In the long term, prime skilled adults age 35-60 are growing

No growth in workforce: 2011-2022: Millennials *replacing* boomers

The potential workforce is actually not growing between 2011-2022 as there is a large offset between Boomers retiring and the replacement of those by millennials.

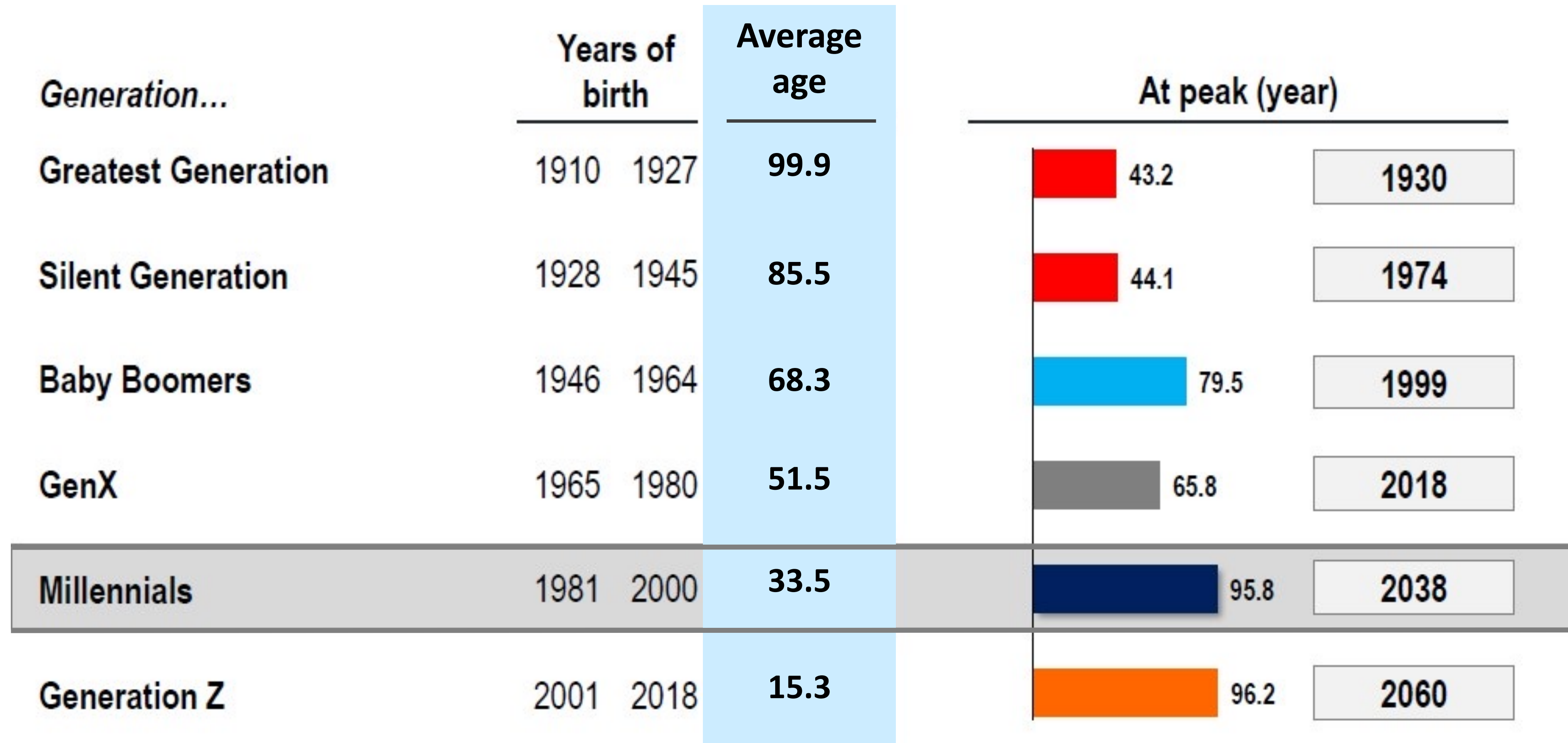
Figure: Number of adults entering prime earning age (35-60)

Number in millions



The largest generation ever, Millennials are just entering their prime income years

Total U.S. Population Divided by Age Groups



Peak population figures above include immigration. Reduced immigration will lead to a smaller overall size of Gen Z.
Source: DESA UN Data sets, Fundstrat; Federated Hermes. Updated January 2, 2024

All will be well

Country	1990 Mln	2005 Mln	90-05 % Δ	2020 Mln	05-20 % Δ	2035 Mln	20-35 % Δ	2050 Mln	35-50 % Δ
China	649.0	829.4	28%	929.8	12%	859.9	-8%	770.1	-10%
United States	147.7	175.5	19%	193.9	10%	199.8	3%	210.0	5%
Europe	430	447.6	4%	446.8	0%	409.5	-8%	372.4	-9%
Japan	76.6	78.6	3%	69.1	-12%	61.4	-11%	49.4	-20%
India	420.4	601.3	43%	802.2	33%	949.0	18%	1001.2	5%
Southeast Asia	215.3	309.0	44%	397.8	29%	445.2	12%	460.9	4%

Source: Evercore ISI Research, September 27, 2022

Federated Hermes Forecast

Views are as of January 26, 2024

	2019A	2020A	2021A	2022A	2023A	2024E
Real GDP	2.50%	(2.20)%	5.80%	1.90%	2.50%	1.90%
Core CPI	2.30%	1.60%	5.50%	5.70%	3.90%	2.90%
Core PCE	1.60%	1.50%	4.90%	4.40%	2.90%	2.50%
Benchmark 10yr Treasury Yield	1.92%	0.92%	1.51%	3.88%	3.88%	3.75%
Fed Funds Rate (upper band)	1.75%	0.25%	0.25%	4.50%	5.50%	4.75%
S&P 500 EPS	\$167	\$137	\$208	\$219	\$225E	\$250
Target Forward P/E	23.6x	18.1x	21.8x	17.1x	19.1x	18.9x
S&P 500 Target Price	3,231	3,756	4,766	3,840	4,770	5,200

PCE = Personal Consumption Expenditures. 2016, 2017, 2018, 2019, 2020, 2021 and 2022 are actual. 2023 is still estimates unless otherwise noted. Views are as of the date indicated 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. Source: Federated Hermes and the Commerce Department.

Interested in hearing more?

Visit federatedinvestors.com/LindaDuessel to sign up for email updates, watch YouTube videos, connect on LinkedIn and more.

LINDA DUESSEL



Mind on the Market

With more than 30 years of experience, Linda Duessel is nationally recognized for her expertise in analyzing equity market conditions. Linda discusses personal finance with investor groups across the country on topics of interest ranging from the impact of the alternative minimum tax to investing for retirement. Additionally, Linda has been extensively quoted by Associated Press, The Wall Street Journal and Barron's, as well as featured in the annual roundtable for USA Today.

As senior equity market strategist, Linda is part of the equity income team, which is responsible for formulating Federated's views about the market and the firm's positioning strategies within the equity income team. As senior client portfolio manager, she is responsible for articulating the strategy, process, positioning and performance of Federated's equity income products.

Interested in hearing more from Linda? Here are two ways:

1. **Read her weekly market views**
Look for them on our site and in our weekly email.
2. **Connect with her on LinkedIn**