July 2019

Bahl&Gaynor
Investment Counsel

A letter from
Bahl & Gaynor's Chairman

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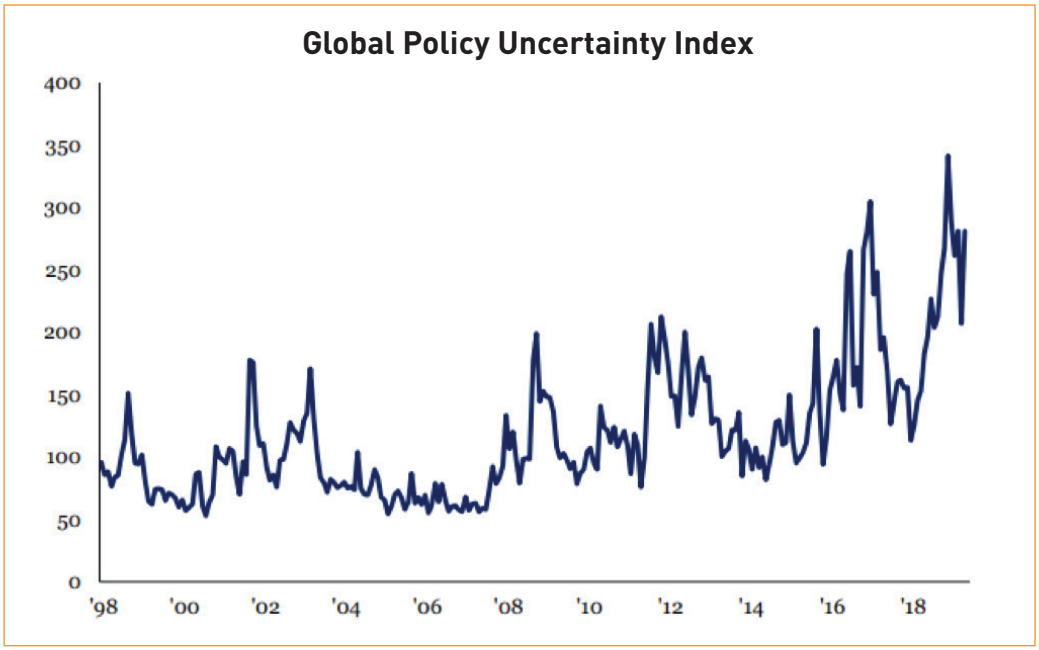
In this issue:

Tariffs are Front and Center

Capital markets during the quarter remained laser-focused on the developments, headlines and growth implications associated with Washington-driven policy. Trade disputes coupled with national security concerns pertaining to Canada, Mexico, China, India and Iran provided investors no shortage of issues to consider. This is reflected in the composite Global Policy Uncertainty Index pictured below, which has been elevated through much of the year. In addition, the G-20 meeting in late June will likely influence capital market volatility and could ultimately come to bear on the trend lines of consumer confidence, capital spending and earnings growth. Although there never seems to be a dearth of concerns for the market and investors to digest, the wall of worry looms tall at quarter end!



Source: Economic Policy Uncertainty, Strategas, 2019.

Observationally, elevated levels of geopolitical tension ahead of the G-20 meeting have driven many companies to repurchase their own shares more aggressively. This can be seen in the chart on the next page which suggests 37% of cash available for corporations to spend could be earmarked for such repurchases in 2019. With an uncertain policy backdrop, it is often easier for management teams and boards to take financial risk as opposed to economic risk. Said differently, investing in one's

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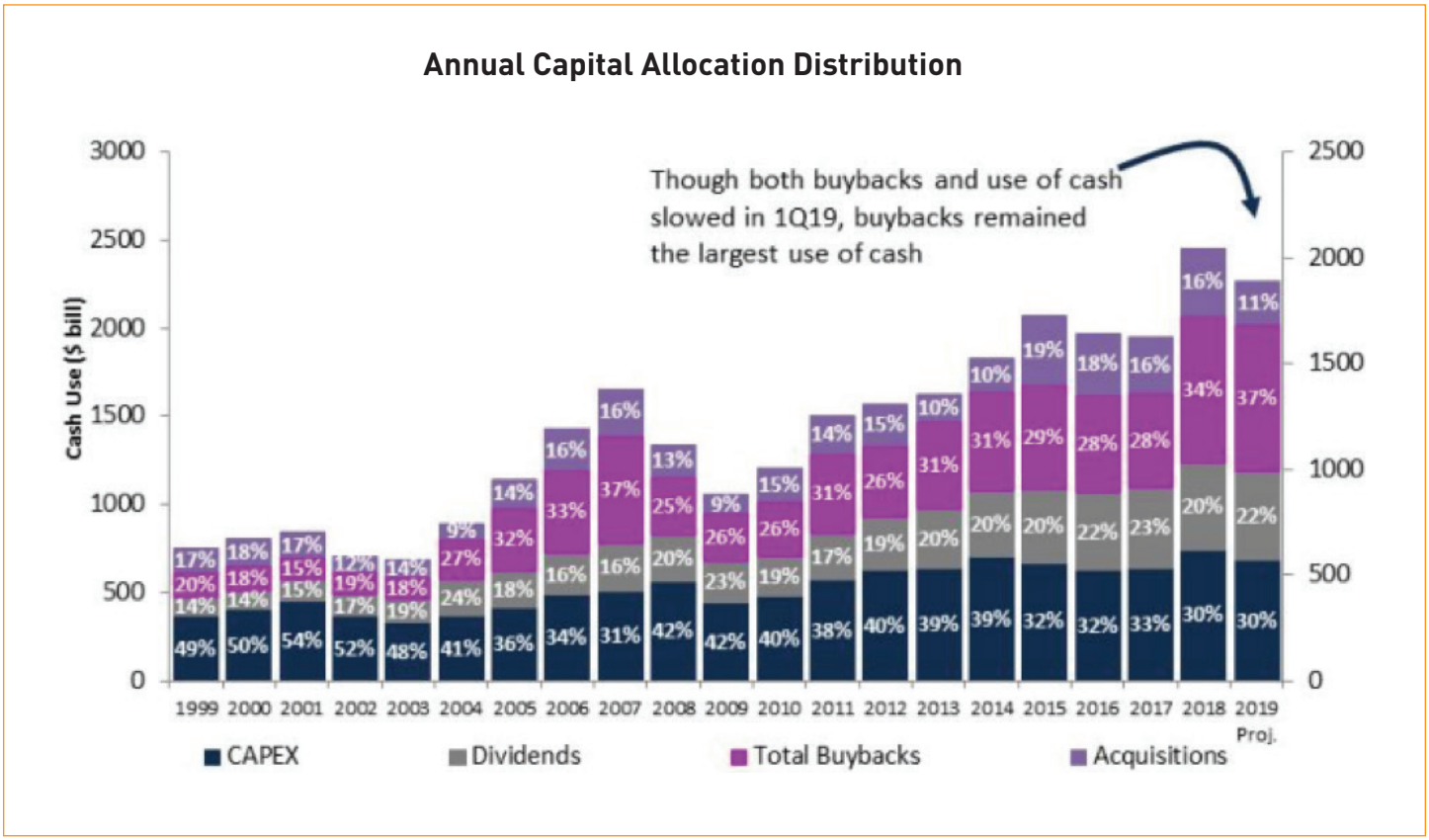
own shares through share repurchases carries fewer potential negative consequences than writing checks for capital equipment (capex) or acquiring other businesses (M&A) that may or may not produce sufficient returns depending on how the policy environment shifts. This share repurchase emphasis will likely remain a place-holder while management teams and boards await an updated global trade roadmap before reigniting other forms of investment.

Although this emphasis on less-risky capital allocation methods is discouraging at the margin from a business confidence standpoint, it should not be overlooked that corporations have near-record amounts of cash available to them. This reflects an enduring benefit following a reduction in the corporate tax rate in 2017. Healthy cash flows usually indicate healthy businesses, and this bodes well for one of Bahl & Gaynor's chief investment concerns, future dividend growth.



Source: Evercore ISI, 2019.

Recall the Global Policy Uncertainty Index earlier in this note, illustrating rising levels of uncertainty since the beginning of 2018. This rising uncertainty nearly perfectly aligns with a slowdown in capex pictured on the next page and the trend would suggest continued restraint in spending until an environmental change materializes.

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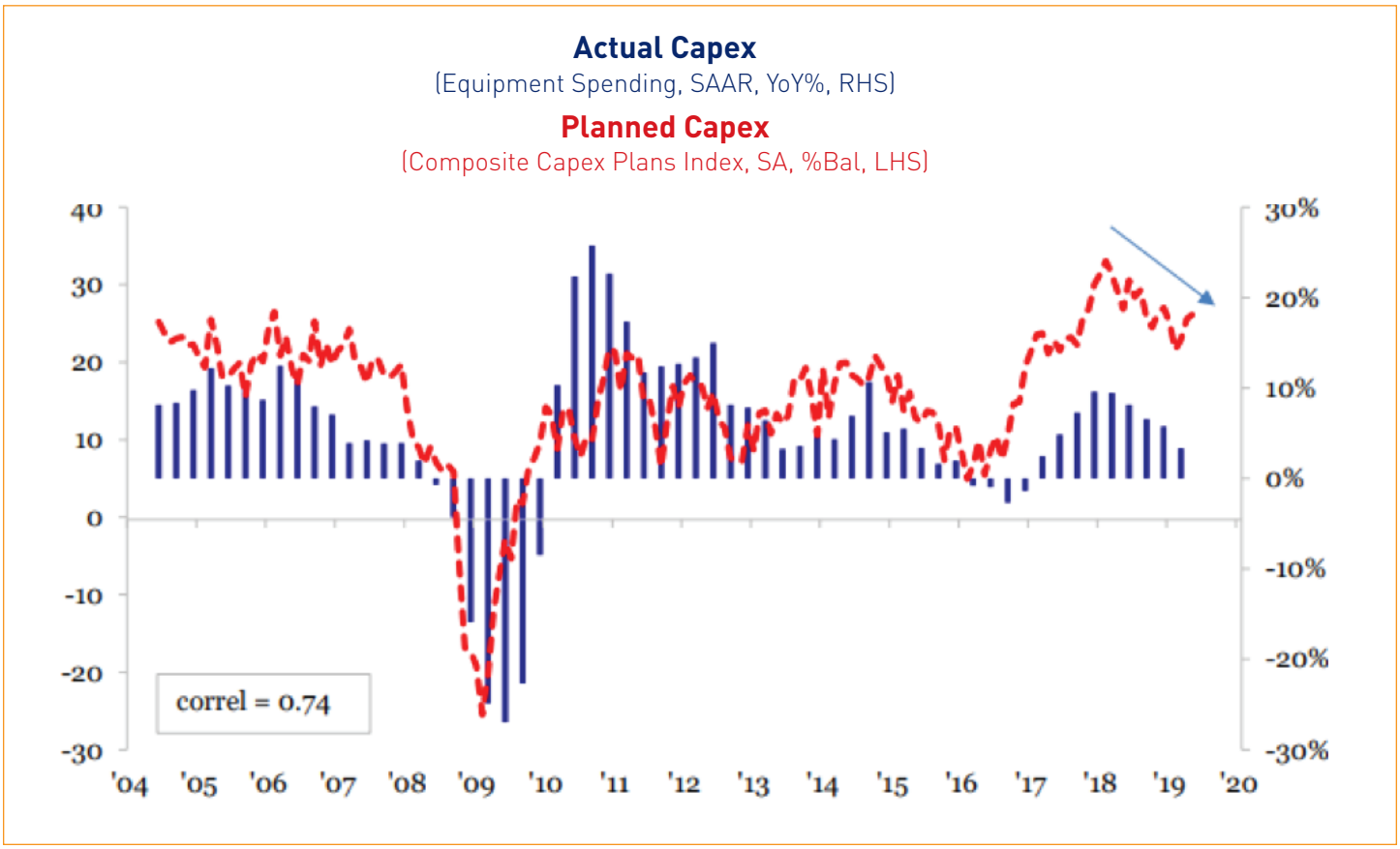
Tariffs are Front and Center *Continued*



Source: Strategas, 2019.

Bahl & Gaynor expects management teams to address environmental uncertainty during the upcoming 2Q2019 earnings season. Part of the expectation-setting exercise that adjoins any earnings season likely dictates companies provide a cautious operating outlook for the balance of 2019. Interestingly, a cautious outlook issued from Corporate America, coupled with a growing list of global consumer and business-based economic indicators flashing yellow, could add political urgency to removing some bricks from the wall of worry – namely a trade resolution.

Accordingly, estimates for S&P 500 earnings are now under review with recent revisions modestly lower driven by slowing revenue growth and margin pressure. Bahl & Gaynor is hopeful that trade talks will soon produce a "win-win" resolution for both the US and China, reducing investor uncertainty and providing a credible pathway for resolution, benefitting the global macro outlook.

Does the Federal Reserve Have a Role to Play?

Recent Federal Reserve Board comments have indicated a clear appreciation of what risks slowing European and Chinese economic outlooks present to the US economy. Capital markets are increasingly convinced the Fed will soon act preemptively to counter lower growth, and consequently, lower inflation trends that are underway domestically. The domestic bond market appears to be foreshadowing this Fed action as the graph on the following page outlines how long rates have moved dramatically lower during the quarter, undercutting the short-term Fed Funds rate.

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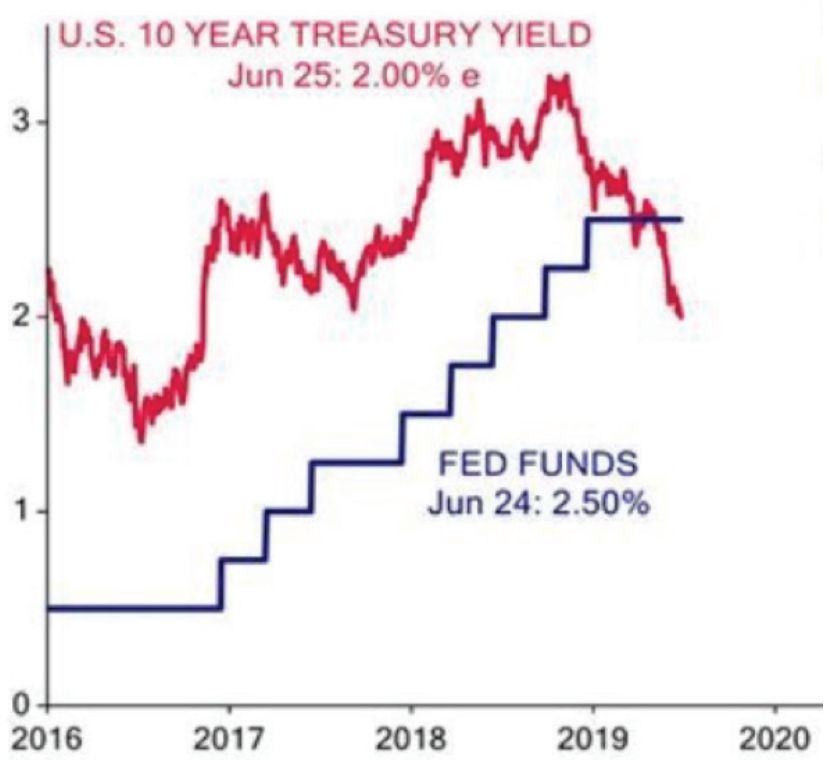

Source: Evercore ISI, 2019.

With the current Fed Funds rate residing at 2.5%, the Federal Reserve Governors have less room relative to prior history to accommodate an economic slowdown through policy rate cuts alone. Therefore, the Fed could also move to slow or stop the run-off of its balance sheet, the effects of which would likely be tantamount to an additional policy rate cut. The anticipatory nature of both actions could also enhance the efficacy of otherwise limited monetary policy tools. In recent weeks, capital markets have responded constructively to verbal indications of accommodative action on the part of the Fed. This suggests confidence among investors that policymakers will take the necessary steps to extend what is now the longest economic expansion in US history.

Why A High-Quality Investment Approach Matters

The second quarter's sudden and unanticipated political and economic developments are a stark reminder of the risks persistently attendant to capital market exposure. Unforecastable military, economic and political shifts will always contribute to market volatility. These dynamics were on full display during the month of May, which represented a -6.35% drawdown for the S&P 500. This also proved to be a month where ownership of high-quality securities was rewarded. Bahl & Gaynor believes that if macro conditions continue to deteriorate, investors will increasingly favor companies with strong balance sheets, consistent cash flows and secular growth opportunities. It is in drawdown events that a persistent commitment to this investment profile is rewarded through continued growth of dividend income, downside protection and risk-adjusted returns.

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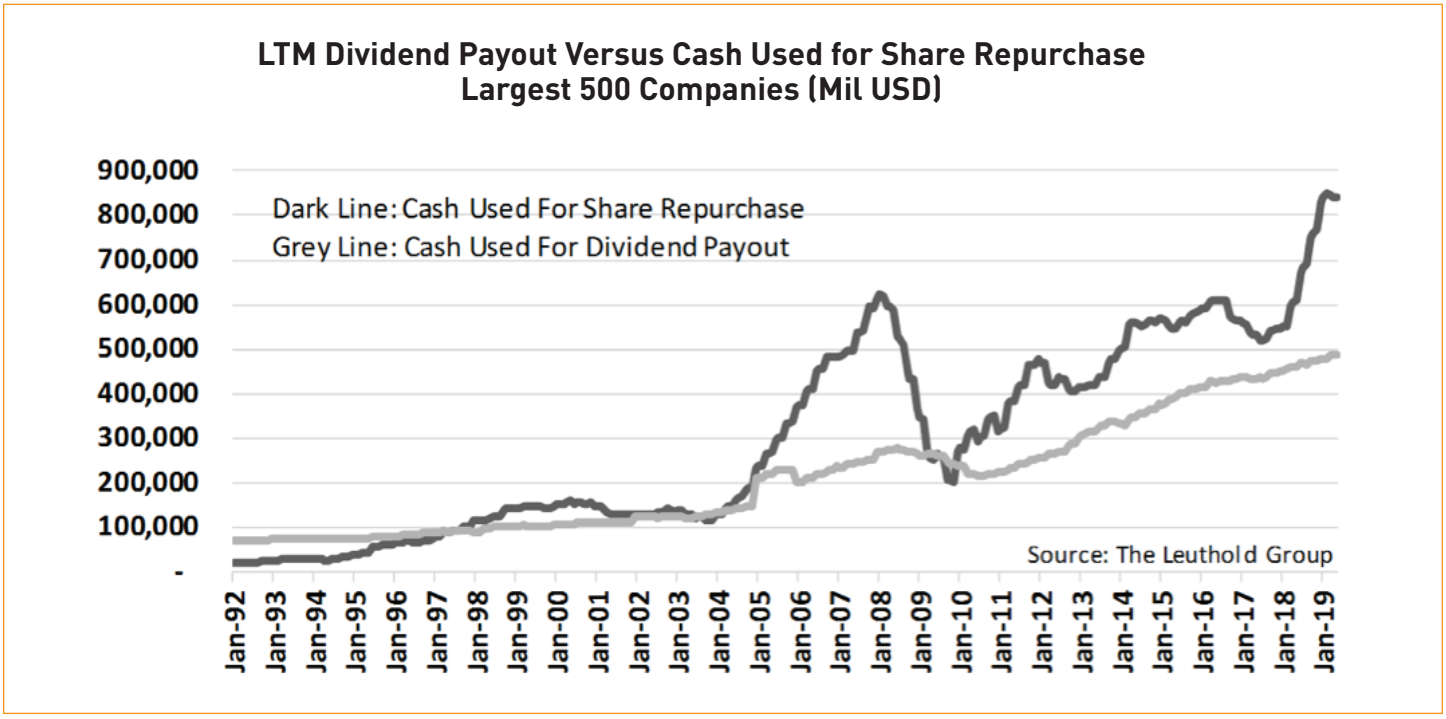
High-Quality *Continued*

The graph below illustrates the relative stability dividend income (smooth light grey line) offers compared to the more cyclically sensitive share repurchase method of capital return (jagged dark grey line). Regarding downside protection, markets provide little to no warning for a change in preference regarding quality investments, therefore a permanent exposure to high-quality attributes is warranted. And if the combination of growing income and protection in difficult markets is achieved, favorable risk-adjusted returns will likely follow.



Source: The Leuthold Group, 2019.

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Financial Planning Update:

Planning for Healthcare Costs in Retirement

While it may or may not be the case that "an apple a day keeps the doctor away", it is unfortunately more certain that an apple a day won't solve the challenge of funding your healthcare expenses in retirement. Many people know that US healthcare costs have been increasing significantly faster than the overall inflation rate. However, many people don't realize that this sustained growth in spending has ramped healthcare into the third largest projected expense in retirement behind housing and transportation. A recent Fidelity Benefits Consulting estimate predicts that an average couple will need $285,000 in today's dollars for healthcare costs in retirement, and that excludes any long-term care expense!

While these large numbers can be daunting, peoples' individual experience with healthcare costs vary dramatically based on some key factors:

Family Health History

Age of Retirement If retiring before Medicare eligibility at age 65, you may need to buy health insurance on the exchange, which is highly likely to be more expensive than employer subsidized insurance or Medicare.

Location There are dramatic differences in healthcare costs across the US between high-cost and low-cost locations for Medicare Part D, Medicare Advantage, and Medigap policies.

Supplemental Coverage Options When enrolling in Medicare, you will choose between Traditional Medicare and Medicare Advantage and have decisions to make about prescription coverage and supplemental Medigap policies. It is highly recommended to meet with an expert on Medicare five to six months before you turn 65 to determine the appropriate coverages for your situation.

Income in Retirement Premiums for Medicare Part B (doctor visits and outpatient care) and Part D (drug coverage) increase dramatically for participants with higher incomes. Medicare Part D Premiums average about $40/month but can vary from $15 to $130 per month based on income and location. See table below for Part B premiums for 2019 tiered by income.

2019 Premiums for Medicare Part B

If your yearly income in 2017 (for what you pay in 2019) was			
File individual tax return	File joint tax return	File married & separate tax return	You pay each month (in 2019)
$85,000 or less	$170,000 or less	$85,000 or less	$135.50
above $85,000 up to $107,000	above $170,000 up to $214,000	Not applicable	$189.60
above $107,000 up to $133,500	above $214,000 up to $267,000	Not applicable	$270.90
above $133,500 up to $160,000	above $267,000 up to $320,000	Not applicable	$352.20
above $160,000 and less than $500,000	above $320,000 and less than $750,000	above $85,000 and less than $415,000	$433.40
$500,000 or above	$750,000 and above	$415,000 and above	$460.50

Source: www.Medicare.gov, 2019

Educating yourself about the possible healthcare costs you will face in retirement and acting early to implement an appropriate savings plan are the keys to meeting this challenge. Utilizing Health Savings Accounts (HSAs) and IRAs/401ks are a tax efficient way to save for these expenses.

Contact your Bahl & Gaynor Portfolio Manager if you would like to work with our planning team that has extensive Medicare expertise or if you have other questions related to healthcare costs or in general for your retirement.

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Bahl & Gaynor Celebrates 29 Years

On July 2, 1990, Bahl & Gaynor first opened its doors and aspired to conduct its business according to two foundational principles:

1 A commitment to investing client capital according to a philosophy of long-term ownership of high-quality, dividend-growth equities, and;

2 Always placing the interests of our clients at the center of everything we do.

Although the path to our 29th anniversary could not have been predicted in advance, we believe an enduring dedication to these founding principles will help to ensure we continue to provide value to the investing public for many decades to come.

This journey would not have been possible or satisfying without the trust and support of our clients – for these things we are grateful and look forward to continuing to serve you.

Sincerely,

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Disclosure: