January 2020

Bahl&Gaynor
Investment Counsel

A letter from

Bahl & Gaynor's Chairman

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Co-Founder & Chairman
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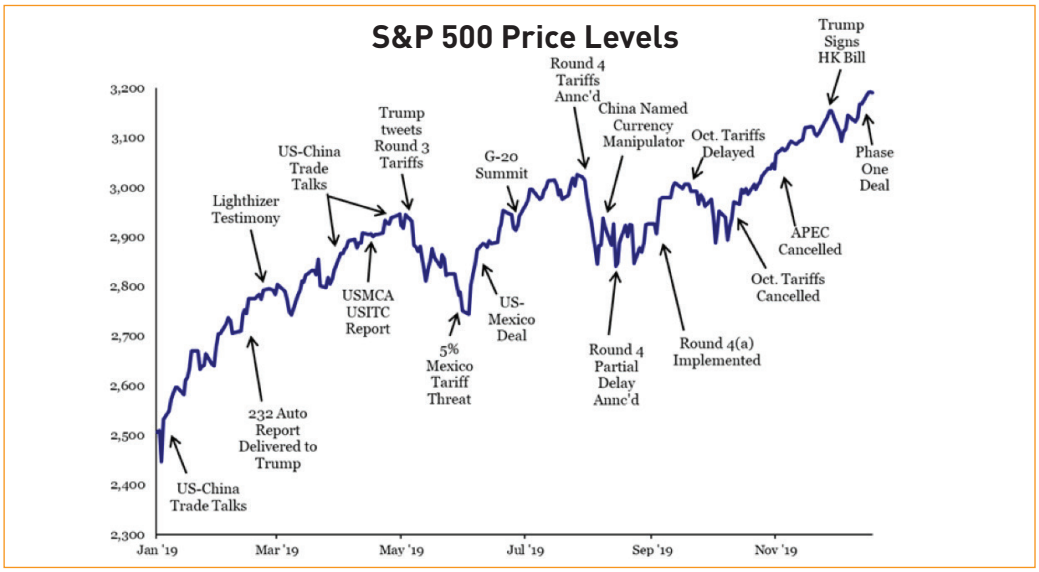
In this issue:

Turn the Page

The holidays are now behind us, early 2020 New Year's resolutions are already "flexible", the tree is on the curb and investors are quickly assessing opportunities for the year ahead. The capital markets produced impressive resilience and price strength throughout 2019 as displayed in the graph below. However, persistent and unsettling tariff, political and economic headlines drove higher levels of uncertainty and drove many individual investors to reduce equity market exposure and transition to the perceived safety of cash and fixed income assets. In 2019, more than $220 billion was withdrawn from equity-focused mutual funds and flows into equity-oriented ETFs were at an eight-year low. Many continue to seek an enhanced level of safety and reliability as important market-centric questions remain open. Add in the upcoming 2020 election with new geopolitical threats, and investors only have more



Source: Strategas Research Partners, 2019.

elements to consider. New questions and circumstances nobody can foretell will certainly greet us in 2020, as they do each year.

As we leave the decade of the 2010s in the rear-view mirror, the next ten years will present exciting new opportunities and challenges. From the Bahl & Gaynor Family to yours, a very Happy New Year and welcome to the 2020s... please buckle your seat belt and return your tray tables and seats to their upright position.

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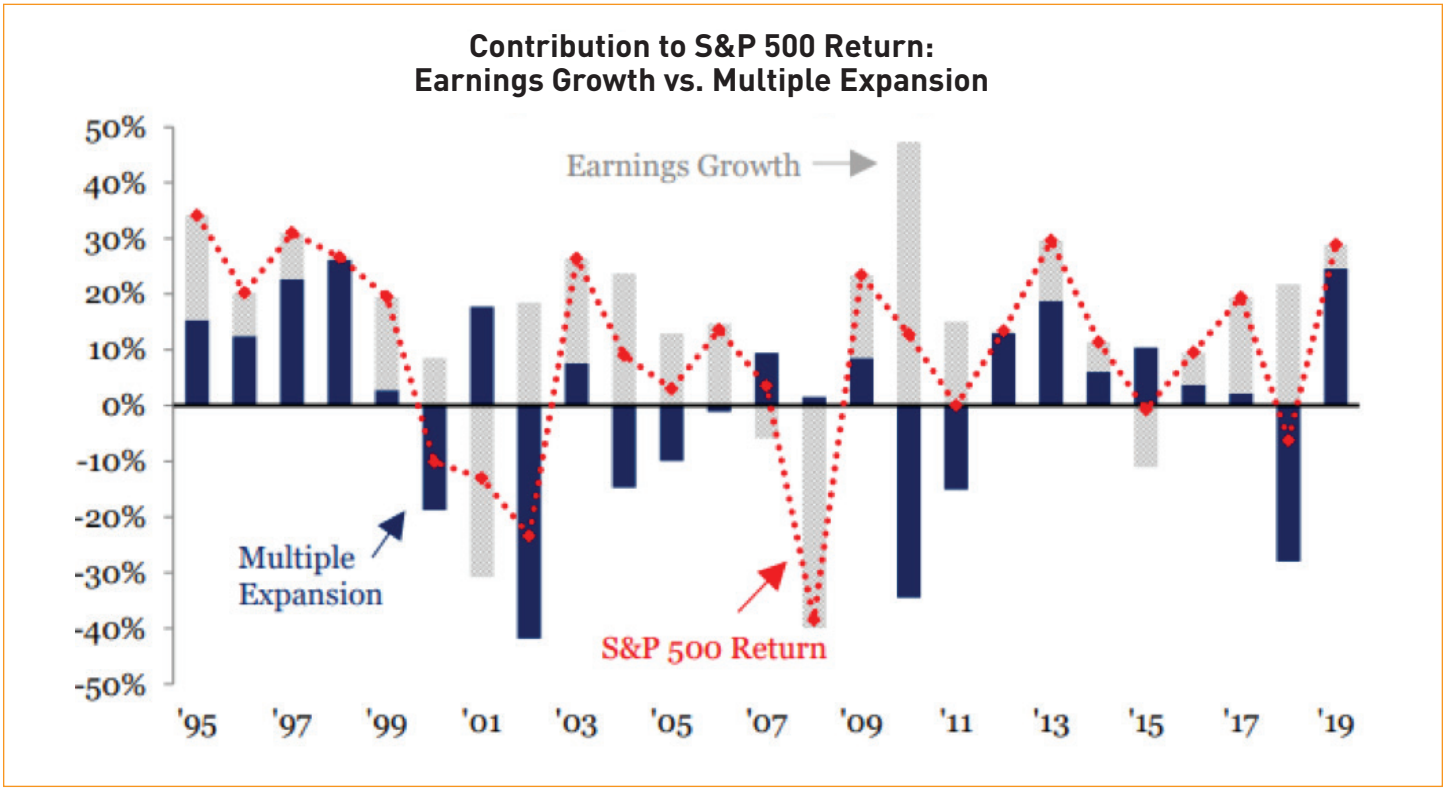
Long May You Run

2019 global economic growth stair-stepped lower as the year progressed. Trade tensions and ineffective monetary policy in the globally important Japan and European Union were central factors to this sluggish profile while softer US Fed policy served as a partial offset. US economic growth was a respectable +3.1% in 1Q2019 but decelerated to a more modest +2.1% run rate by the third quarter. In effect, S&P 500 profit growth estimates for the year were revised lower by mid-summer. Despite the revisions lower, equity market averages grinded solidly higher, supported by expanded valuations multiples (seen in the graph below) as a result of controlled inflation trends and a variety of economic metrics that served as a "no recession now" signal. As the equity markets are a forward-looking mechanism, the lift in the price-to-earnings multiple may also signal the expectation of stronger U.S growth in 2020. Consensus expectations for 2020 US GDP and S&P 500 earnings growth are +1.8% and +7.0%, respectively. Can these estimates hold or, perhaps, grind higher? We await the results.



Source: Strategas Research Partners, 2019.

More Than This

The financial press and, increasingly, politicians, have weighed in extensively on current cash balances among S&P 500 constituents. Apple (AAPL), Microsoft (MSFT), Berkshire Hathaway (BRK.B) and others are often cited with sizable liquidity that tends to move ever higher with each passing quarter. Strong cash flow generation and repatriated foreign domiciled earnings spurred by the Tax and Jobs Act of 2017 have kept S&P 500 cash at the high level displayed below.

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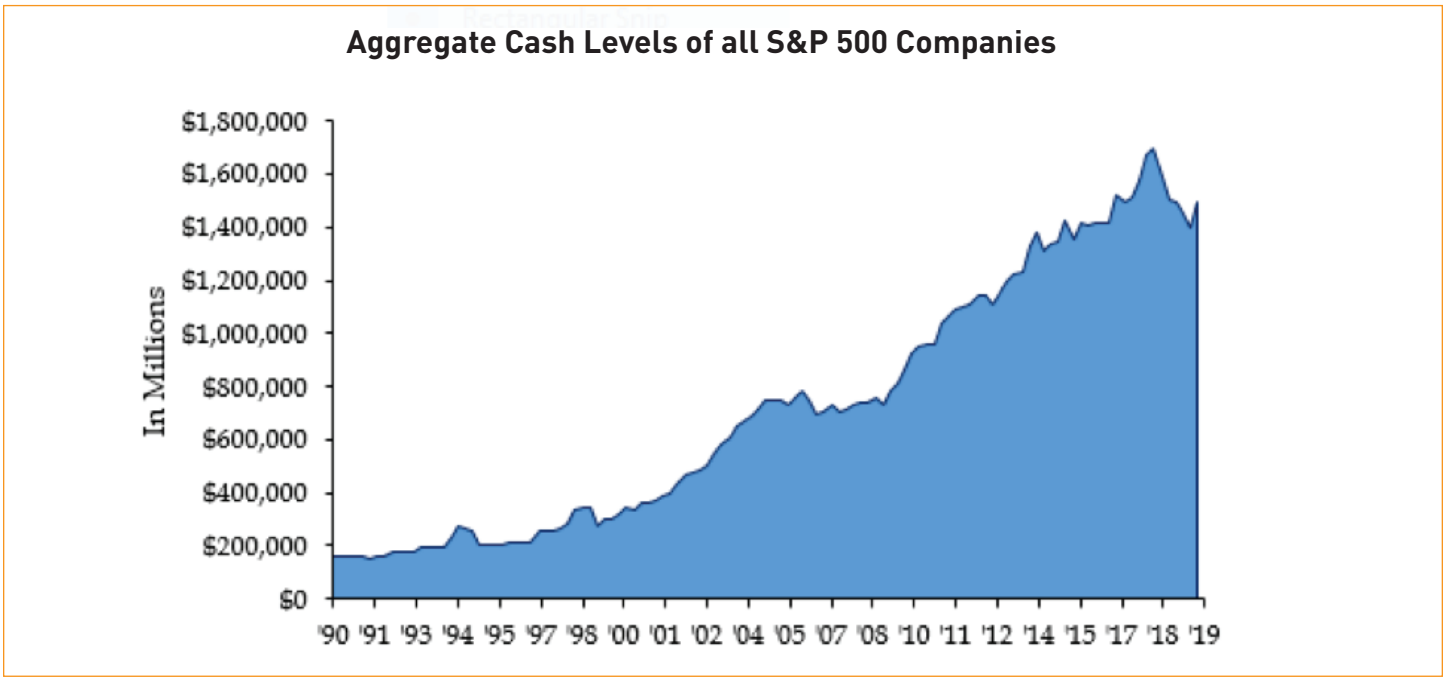
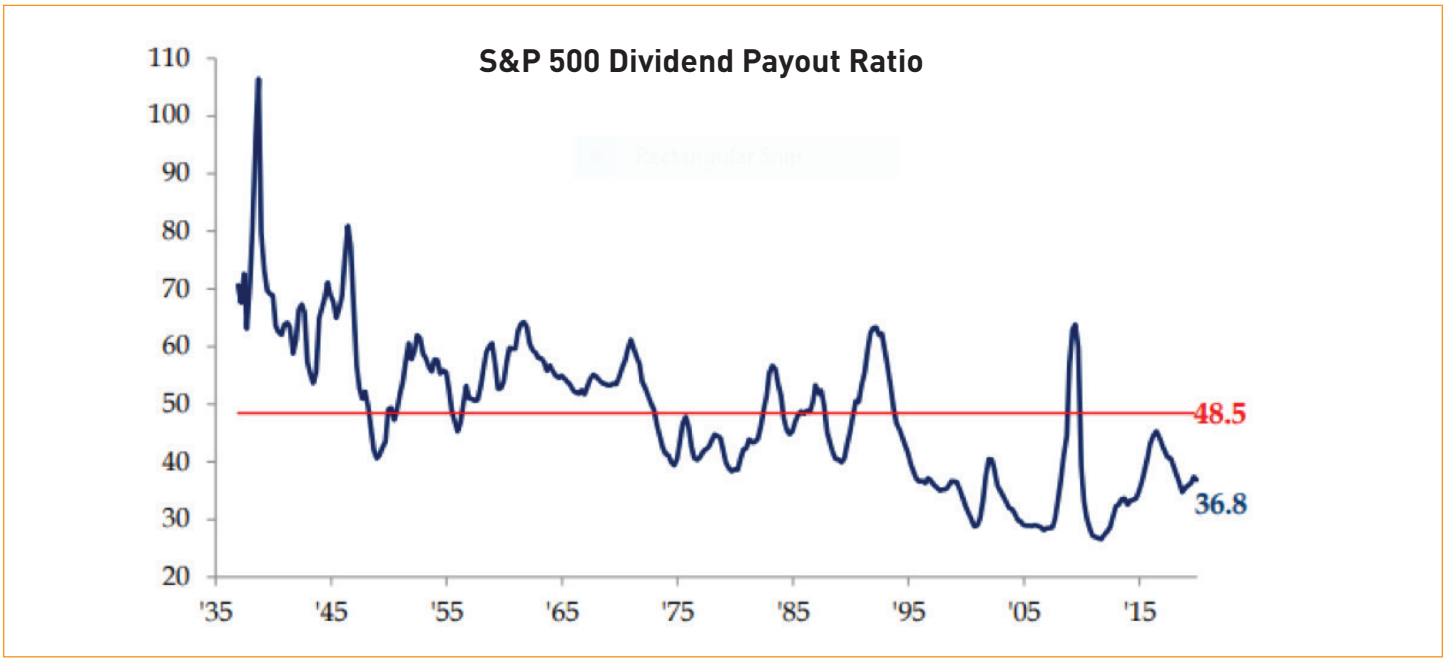


Source: Strategas Research Partners, 2019.

As both Phase One of the China/US trade deal and NAFTA 2.0 now appear to be resolved, we look for business clarity to improve and CEO confidence to move higher. Priorities for corporate liquidity often include a degree of debt reduction and merger activity. For many companies, share buyback programs also represent a meaningful commitment of cash balances, totaling an estimated $480 billion in 2019 alone. Of course, the direct return of capital to company owners in the form of a rising dividend stream is Bahl & Gaynor's preferred outlay of corporate cash to shareholders. It is our long-term observation that, directionally, the degree of the dividend increase a company announces is often closely correlated to the strength of that company's forward financial results. In addition to adding downside protection, a portfolio of high-quality companies with a rising dividend stream above inflation ensures stable lifestyle enhancements over time for investors. Bahl & Gaynor remains optimistic towards future dividend growth. While 2017's tax law drove large dividend increases during 2018, dividend payout ratios, on average, remain comfortably below long-term averages seen in the chart below.



Source: Strategas Research Partners, 2019.

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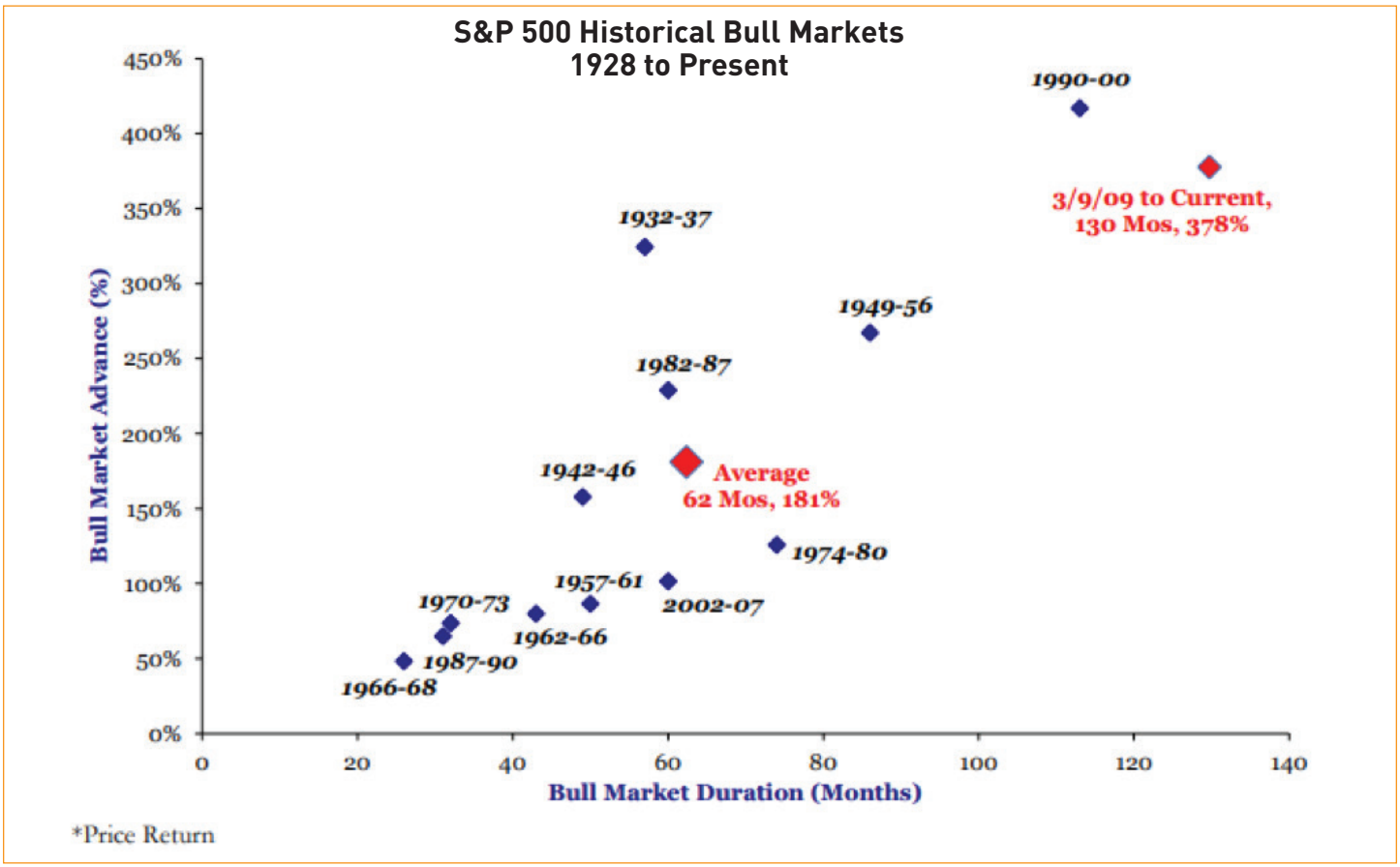
Roll with the Changes

The list of concerns as we exited 2018 was a long one, to say the least. On 1/1/19, issues facing investors included a government shutdown, China trade issues, a pending NAFTA 2.0, three indicated Fed rate hikes in 2019, a dramatic drawdown in US equity markets during 4Q2018, North Korean tensions, and recession fears… a truly "Grinch-like" holiday assortment.

We spoke with management teams in 2019 that elected to hold back on the immediate deployment of cash for large scale capital programs. As many of the very visible issues listed above are now behind, and CEO confidence is rising, business investment is likely to follow. Avoiding distractions by maintaining our focus on solid, yet slowing, market fundamentals again proved to be a winning investment strategy. One by one, the issues listed above defined the bricks composing the 2019 equity market's "Wall of Worry." Fortunately, many resolved themselves as the year progressed. Trade negotiation breakthroughs, an on-hold Fed, and firm capital market returns were all very welcomed holiday gifts. The bull market, though unloved, remains intact.



Source: Strategas Research Partners, 2019.

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Financial Planning Update:

"Stayin' Alive" with a Health Savings Account (HSA)

Millions of Americans either have or are eligible for health savings accounts, but many do not understand their full benefits. By not contributing to their HSA, employees are losing out on immediate tax benefits as well as other benefits of a health savings account. Below describes an HSA and its benefits provided by Bahl & Gaynor's financial planning team.

What is an HSA and how do I become eligible?

A Health Savings Account (HSA) is a government-regulated savings account that allows participants to contribute tax-free income to cover qualified healthcare-related expenses that are not covered by your insurance. To be eligible to open and contribute to an HSA, you must be covered by a qualifying high deductible health plan. If you are enrolled in Medicare, you cannot contribute to an HSA.

HSA are triple-tax free

One of the first things to understand about an HSA is that they provide a triple tax advantage. Your contributions are tax-deductible, assets in your HSA typically grow tax-free, and funds can be withdrawn tax-free for qualified medical expenses. Most states follow the same federal tax rules for health savings accounts, but some do not. Consult your tax advisor to find out your state's tax laws on health savings accounts.

HSA's funds do not need to be used every year

Unlike flexible spending account (FSA) contributions that are "use it or lose it" year to year, HSAs do not require you to spend your contributions. The purpose of an HSA is to encourage people to grow their accounts to fund a major medical expense or to help pay for medical expenses during retirement.

HSA contribution limits

The 2020 contribution limits for HSA accounts are $7,100 for families and $3,550 for a single participant. If you are age 55 older, you can contribute an extra $1,000 catch-up contribution annually. Both employees and employers can contribute to an HSA account, but the combined contributions cannot exceed the annual contribution limit. Another benefit of the HSA is that the contribution limits are not subject to income phaseouts like Individual Retirement Accounts (IRAs).

What Expenses does an HSA cover?

HSA funds are used to pay for qualified medical expenses. Generally, this includes expenses associated with doctor visits, prescribed medical treatments, prescribed medicine, and dental visits. HSA funds can also be used for other medical expenses including eyeglasses, medical devices, nursing care and lab fees. If you are on Medicare, you can use your HSA to pay for Medicare Part B, Part C (Medicare Advantage Plan), and Part D (Prescription Drug Coverage) in addition to qualified medical expenses. Premiums for Medicare supplemental policies, also known as Medigap policies, are not eligible to be paid from a health savings account.

HSA withdrawals

Health savings accounts were initially designed as a tax-efficient vehicle to save for medical expenses. Increasingly, people are using the tax advantages of the HSA to save for retirement. For those who have maxed out their 401(k) and IRA contributions, contributing to an HSA may be a good way to supplement retirement savings. At age 65, withdrawals from an HSA for non-medical expenses will still be taxed as ordinary income but no longer have the additional 20% tax penalty for non-medical expenses. Much like a traditional IRA or 401(k), you will have to pay ordinary income tax on non-medical expenses, but you will not have a Required Minimum Distribution (RMD) from the health savings account. Withdrawals for Qualified Medical Expenses are not subject to federal income tax or a penalty at any age.

The health savings account is a tax-advantaged account that can be used to pay for medical expenses throughout your life or can be used as an additional retirement savings vehicle. If you have questions regarding your health savings account, please contact your Bahl & Gaynor Portfolio Manager.

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Same as it Ever Was

At Bahl and Gaynor, we fully acknowledge that our organization has little control over the direction of the capital markets or the headlines that influence such movements. Instead, our focus remains directed towards our market-tested strategies that have reliably protected principal in a variety of unpredictable capital market environments, generated a consistent growth of dividend income, and delivered competitive risk-adjusted returns over full-market cycles. We believe time in the market remains a fundamental tenet to long-term wealth creation.

From the Bahl & Gaynor Family, we raise a glass and wish all our readers a very happy and healthy 2020!

Sincerely,

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Disclosure: