Bahl&Gaynor
Investment Counsel

2Q2022 Review and Outlook

In this issue:

More of the Same

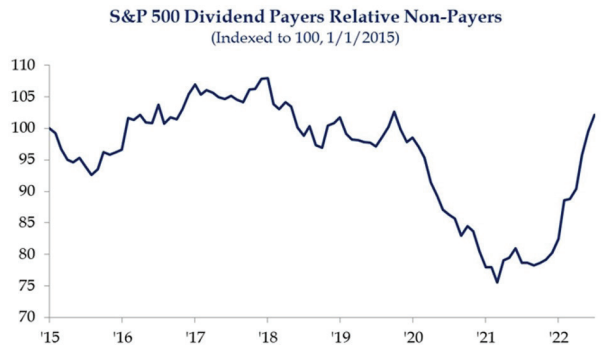
Inflation, the Fed's actions, and ensuing market responses continue to be top of mind for investors as we enter the back half of 2022. Any uncertainty about the Fed's path forward was left behind when the May Consumer Price Index surprised to the upside at +8.6%, causing the central bank to raise the Federal Funds rate by 0.75% and "strongly commit" itself to lower inflation at its June meeting. Higher rates and inflation continue to pressure both equity and fixed income markets, with the S&P 500 and U.S. Bloomberg Barclay's Aggregate indices posting their worst 1H2022 performances in over 50 years. The biggest losers within equities continue to be long duration and non-dividend equities *(Exhibit 1)* which underperformed for a second quarter in a row; an opportunity for high-quality and dividend-focused active managers *(Exhibit 2)*.

Exhibit 1:

S&P 500 Dividend Yield Tranches	2Q 2022 Total Return
S&P 500	-16.1%
Non-Dividend Companies	-26.1%
S&P 500 0-2% Yield	-16.3%
S&P 500 > 2% Yield	-10.8%
S&P 500 > 3% Yield	-5.1%
S&P 500 > 4% Yield	-0.5%
S&P 500 > 5% Yield	-0.1%
S&P 500 > 6% Yield	-13.8%

Source: Bahl & Gaynor. FactSet, 2022.

Exhibit 2:



Source: Strategas, 2022

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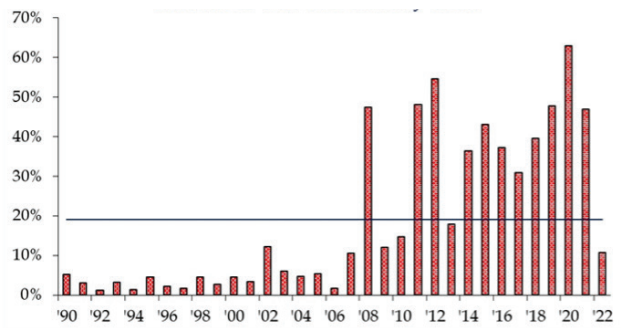
A Record Negative Year for Fixed Income

With U.S. fixed income yields higher, the percentage of S&P 500 companies with a dividend yield greater than the 10-Year U.S. Treasury yield has declined to levels not seen in 15 years *(Exhibit 3)*. These higher yields combined with the year-to-date volatility in equities have the market questioning whether the TINA (**t**here **i**s **n**o **a**lternative to equities) playbook has been replaced with TARA (**t**here **a**re **r**easonable **a**lternatives to equities). While Bahl & Gaynor recognizes the defensive properties fixed income assets can provide to a client's portfolio amid market volatility, the asset class has not been the ballast it has been in prior S&P 500 down years since 1977 *(Exhibit 4)*. This underperformance is likely due to the negative effects of inflation and higher interest rates, headwinds not often seen in the now expired four-decades-long bond bull market.

Exhibit 3

% of S&P 500 Stocks with Dividend Yields Greater than the 10-Year U.S. Treasury Yield



Source: Strategas, 2022.

Exhibit 4

S&P 500 Down Years (1977 - 2022)

Year	S&P 500 Total Return ("Stocks")	Bloomberg Barclays U.S. Agg Index TR ("Bonds")	60/40 Portfolio (Stocks/Bonds)
1977	-7.2%	+3.0%	-3.1%
1981	-4.9%	+6.2%	-0.5%
1990	-3.2%	+9.0%	+1.7%
2000	-9.1%	+11.6%	-0.8%
2001	-11.9%	+8.4%	-3.7%
2002	-22.1%	+10.3%	-9.2%
2008	-37.0%	+5.2%	-20.1%
2018	-4.4%	+0.0%	-2.6%
2022 YTD	-20.0%	-10.4%	-16.1%

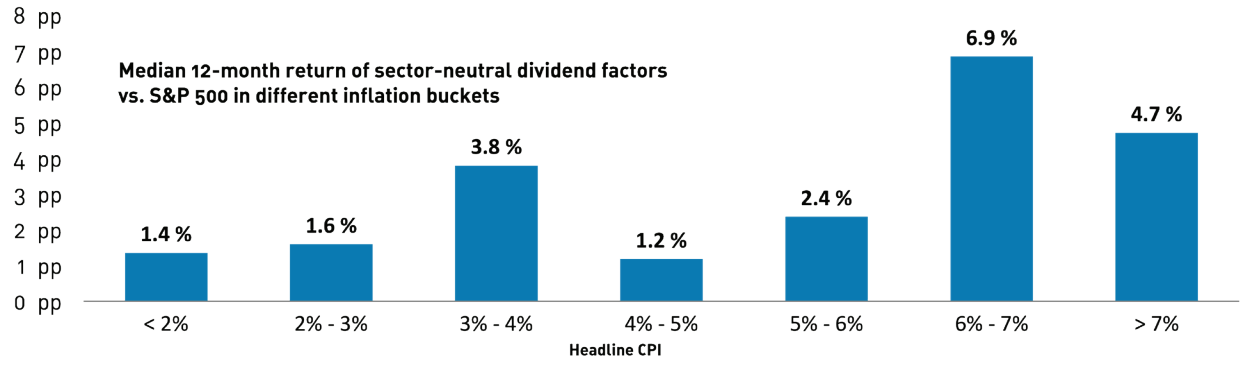
Source: COMPOUND; Charlie Bilello; Y-Charts, 2022.

Dividends and Dividend Growth to Combat Inflation

Bahl & Gaynor's dividend growth equity strategies seek to own companies with clear competitive advantages capable of growing revenues in excess of cost, even amid inflationary periods, to support higher dividend payouts. We believe dividend growth is a clear sign of quality and conviction from our holdings, and note that dividend growth companies have outperformed broader index returns across all inflationary timeframes going back since 1970, particularly during runaway inflationary periods *(Exhibit 5)*.

Exhibit 5

Stocks with high dividend growth outperform the market during periods of high inflation (since 1970)



Source: Goldman Sachs Investment Research, 2022.

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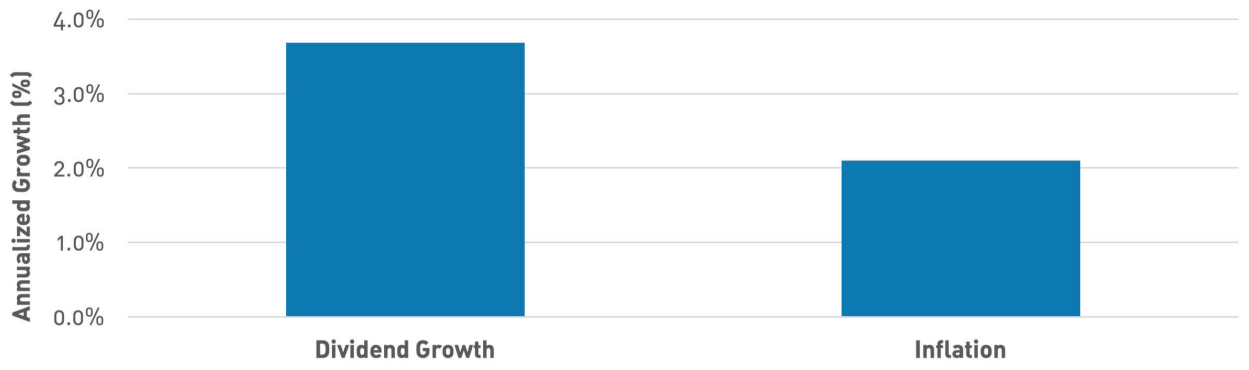
In addition, growing dividends offer a key advantage that many fixed income products cannot – inflation protection. Over the last 150 years, dividends paid by U.S. companies have grown 3.7% per year compared to inflation's growth at 2.1% per year *(Exhibit 6)*, demonstrating the enhanced long-term purchasing power dividends provide.

Exhibit 6
Annualized dividend growth of U.S. stocks vs. inflation, 1871–2022

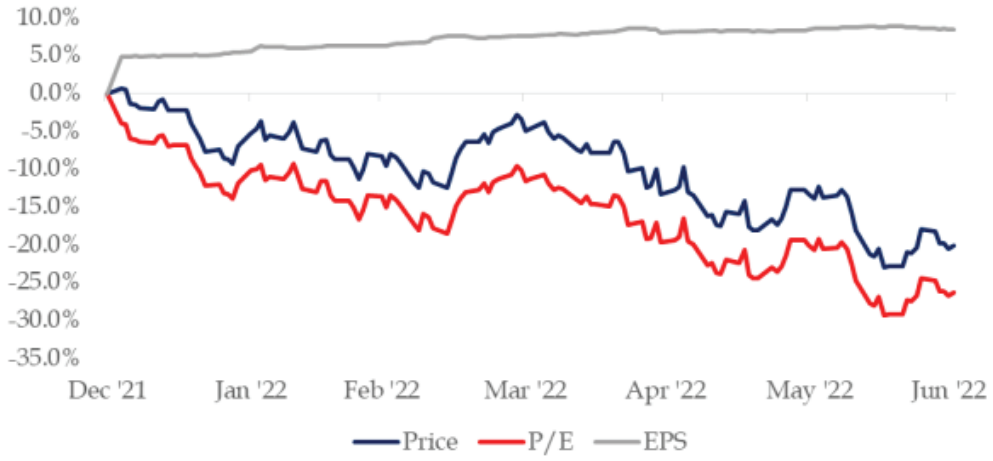


Source: Shiller Data Library, http://www.econ.yale.edu/~shiller/data.htm.

Multiples and Earnings Drive Market Returns

The expected return of any stock is a function of earnings growth per share, dividend yield and a price-to-earnings (P/E) multiple expansion or contraction. Negative year-to-date equity market returns have entirely been driven by P/E multiple compression *(Exhibit 7)*. P/E ratios are typically affected by inflation, which has remained elevated, and liquidity, which is decreasing due to the Fed's announced quantitative tightening (QT) stance. QT is an effort to normalize monetary policy, decrease the money supply in the economy and ultimately normalize (i.e., raise) interest rates to reduce inflation. This posture is a stark contrast to the last decade of intermittent quantitative easing (QE) and easy monetary policy.

Exhibit 7
Year to Date Percent Change in S&P 500
Price, P/E Ratio, & EPS



Source: Strategas, 2022

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Earnings growth is another significant component of equity market returns. The market in 2Q seemed to be grappling with earnings visibility as a result of the potential slowdown in consumer spending and decline in corporate profit margins. Consumer discretionary spending seems likely to slow due to higher energy prices, rising interest rates (and thus a less attractive borrowing outlook) and decreased fiscal stimulus, deflating consumer pocketbooks. These factors, combined with the reality that inflation has crept into sticky corners of the economy such as rent, contributed to the lowest all-time reading of the University of Michigan's U.S. Consumer Sentiment indicator in June. Given the abundant inflationary headwinds for corporate America (wages, transport costs, etc.), one must believe that optimistic earnings estimates will continue to drift lower *(Exhibit 8)*, presenting further risk to the outlook for equity markets.

Exhibit 8
2023 S&P 500 EPS Progression

Source: Strategas, 2022

In sum, markets seem to be battling with the duality of two components of equity returns: (1) What valuation multiple is right for the market? and (2) How will earnings trend given the multitude of economic headwinds? Bahl & Gaynor's approach has the two-fold advantage of generally lower starting valuations coming into 2022 and likely greater earnings stability as proven out by the quality of Bahl & Gaynor's equity portfolios and the strong trailing-twelve-months portfolio dividend growth.

Closing Thoughts

As an active manager, it is Bahl & Gaynor's responsibility to imagine a variety of potential market outcomes. If the market increasingly responds to pressures more definitive of a secular bear market, we believe our high-quality, dividend strategies are positioned to provide positive dividend growth alpha for investors. Our strategies remain fully invested and will participate when equity markets ultimately recover.

As always, we at Bahl & Gaynor remain committed to our mission to deliver exceptional service to our clients. We seek to provide a high-quality investment strategy characterized by a growing stream of income, something that remains especially relevant in today's environment.

Disclosure: