Dividend Growth ESG 2Q2022

ESG Proposals Make a Splash

As we enter the second half of 2022, there is an emerging sense that potential shifts in regulation could drive changes for asset managers and publicly traded companies. Focused on investment advisers and investment companies, the recent SEC proposals are aimed at promoting consistent, comparable and reliable information for investors in an effort to dispel "greenwashing." Specifically, the SEC proposal expands the current "Names Rule" as well as increased disclosure requirements for ESG funds in order to illuminate "what's under the hood" of these funds. Increasing disclosure to protect and aid investors by allowing them to make more informed decisions seems to be the primary goal of the SEC's propositions.

Although these proposals may not be legislated and promulgated in the current form, we are optimistic that broad agreement regarding the definition, and disclosure, of ESG standards will provide clarity to investors and allow best-in-class managers to excel.

Economic & Social Consideration at Odds with Climate Change... Emerging Rule or Short-Term Trend?

In response to Russian military efforts, many countries continue to implement sanctions and restrictions on Russian energy imports. These sanctions, combined with Russia's voluntary restrictions on the flow of energy, have exacerbated concerns regarding global energy availability and reliability. As a result, many global political leaders and global companies have – to varying degrees – de-prioritized climate change concerns. This global de-prioritization can be observed by the sudden reversal in the usage of coal-fired power plants which continue to be a highly carbon intensive source of energy.[1,2,3]

Though global energy trends suggest a bleak outlook for carbon emissions, a number of companies remain convicted in "Green CAPEX" projects that address climate change concerns without sacrificing its focus on increasing shareholder value. For example, **NextEra Energy (NEE)** recently elaborated on the attractive economics of the development of renewable energy which supports long-term investment opportunities. Similarly, **Waste Management (WM)** recently announced a two-pronged $1.6B Green CAPEX plan focused on expanding its "landfill-to-gas" capacity and recycling capabilities. The company's investments are expected to generate attractive levels of incremental cash flow while also significantly improving its overall emission-profile. **Air Products and Chemicals (APD)** also recently announced the expected construction and operation of an Arizona-based facility for green liquified hydrogen, an opportunity for ESG and traditional finance lenses to meet. Though global metrics seem to support a contrary viewpoint, these select companies uniquely demonstrate that decarbonization and economics are not mutually exclusive.

BlackRock Works to Democratize Shareholder Voting

Expanding choice and democratization define the evolution of investing over the last several decades, whether considering the breadth of publicly traded stocks or the rise of investment vehicle options. With expanded choice and increased complexity, oversight and monitoring of investor portfolios became the responsibility of professional asset managers. Historically, many of these larger managers were unable to provide pooled vehicle (i.e., commingled funds like mutual funds) options for proxy voting, the linchpin of public company corporate governance.

[1]Source: Kappeler, Inke and John, Tara. "Germany to fire up coal stations as Russia squeezes gas supply." CNN Business, 19 June 2022, https://www.cnn.com/2022/06/19/energy/germany-russia-gas-supplies-winter-intl/index.html. 30 June 2022.

[2]Source: Shepherd, Christian. "With coal surge, China puts energy security and growth before climate." The Washington Post, 22 April 2022, https://www.washingtonpost.com/world/2022/04/22/china-coal-climate-change-xi-energy. 30 June 2022.

[3]Source: "India relaxes environment rules for coal mines, citing heatwave." Phys Org, 11 May 2022, https://phys.org/news/2022-05-india-environment-coal-citing-heatwave.html. 30 June 2022.

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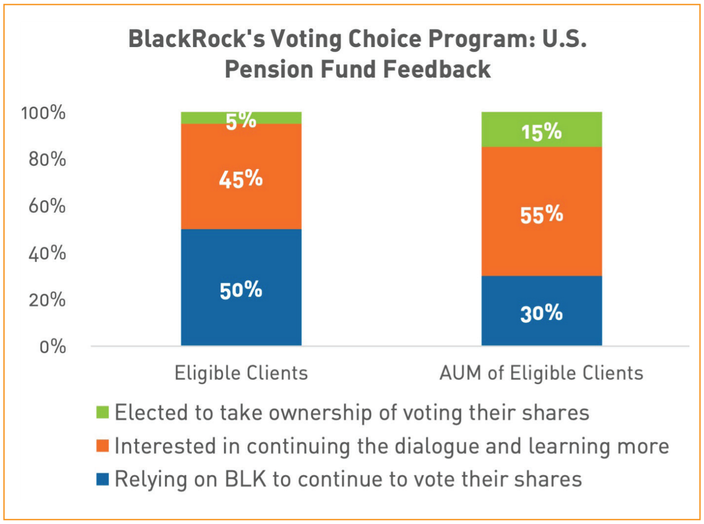
To address investor demands, in 2Q22 **Blackrock (BLK)** announced its Voting Choice program will allow for institutional investors in certain pooled vehicles the choice of how to vote their shares. Options include allowing investors to vote their own shares, select from a menu of third-party alternatives (e.g., Glass Lewis or ISS) or reaffirm BlackRock to vote on their behalf. Eligible investors include public and corporate pensions, insurance companies and other institutional investors. While client uptake is still uncertain **(Figure 1)**, nearly half of all clients' index equity assets are now eligible and the program supports the firm's strong track record of nimbly addressing changes in investor demand. The "real winners" may be the third-party voting lines if investors simply switch from BlackRock to another third party. In that instance, Blackrock and large third parties typically vote with management so in practice the change may have little impact in the near term, only increasing third-party providers' power at the margin. However, longer term this continues to put more power in investors hands – it is all in how they choose to use it!

Figure 1



Source: BlackRock, 2022.

Bahl & Gaynor follows a third-party approach, engaging Broadridge ProxyEdge® platform to vote and maintain all proxy records. The Dividend Growth ESG strategy uses Glass Lewis ESG Guidelines as the default voting guideline. Please reach out to your Bahl & Gaynor contact with any questions.

Closing Thoughts

Despite significant asset price volatility in 2Q 2022, both public companies and the investment management industry are pressing ahead in important ways. Both are in the process of formalizing and elevating ESG practices to help themselves and investors continue to "raise the bar" and evaluate key ESG issues. We are optimistic that the SEC's proposals, public companies' prioritization of green, positive net present value (NPV) projects, and asset managers' continued focus on the space will drive innovation and advancement for the ESG industry.

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Strategy Objectives

1. ESG Integration: Significant improvement in ESG rankings relative to benchmark[1]
2. High current and growing income: 2.4% yield; +12.3% growth in trailing-twelve-month income as of 2Q2022
3. Downside protection: Top quintile downside capture vs large core peers (S/I) [2, 3, 4]
4. Price appreciation: Competitive risk-adjusted returns through a full-market cycle

[1] Source: Sustainalytics [2] Measured against the S&P 500 index [3] Source: PSN, Bahl & Gaynor, 2022 [4] Inception: 12/31/2018

Current Quarter Strategy Thoughts Relative to Objectives:

- The Dividend Growth ESG strategy grew trailing-twelve-month income by +12.3%, providing real client purchasing power growth.
- 12 strategy holdings announced dividend hikes; average TTM increase was +12.0%, signaling fundamental strength amid a deteriorating economic and market environment.

- Daily downside capture of 76.4%* during 2Q2022 across all S&P 500 down days, notably better than the strategy's since inception average of 88%, indicative of investor preference for quality during periods of market volatility.
  - Daily upside capture of 81.4%* during 2Q2022 across all S&P 500 up days provided the strategy excellent risk-adjusted returns for the quarter.

- The strategy **outperformed**, returning -10.92% gross (-11.00% net) versus the S&P 500's -16.10% return.
- Investors favored sectors with defensive qualities, such as Consumer Staples, Health Care and Utilities, which supported robust strategy relative performance and downside protection.
- Non-profitable technology and long duration equities performed worst as investors repriced a more difficult macro environment (higher inflation for longer and weaker consumer spending).
- Strategy characteristics of sustainable dividends and stable fundamentals remain top of mind for investors in this environment, despite already-strong year-to-date relative performance.

2Q2022 Dividend Increases

Company	% Increase	Current Yield
American Tower (AMT)[1]	+12.6%	2.2%
Apple (AAPL)	+4.5%	0.7%
Alexandria Real Estate (ARE)[1]	+5.4%	3.3%
Avery Dennison (AVY)	+10.3%	1.9%
Cisco (CSCO)	+2.7%	3.6%
Medtronic (MDT)	+7.9%	3.0%
PepsiCo (PEP)	+7.0%	2.8%
PNC Financial Services (PNC)	+30.4%	3.8%
Procter & Gamble (PG)	+5.0%	2.5%
Qualcomm (QCOM)	+10.3%	2.3%
Union Pacific (UNP)	+34.0%	2.4%
UnitedHealth Group (UNH)	+13.8%	1.3%

[1]Increases dividend multiple periods per year.
Source: Bahl & Gaynor and Factset, 2022.

2Q2022 Dividend Growth ESG Trades Executed

Initiations	Eliminations
Fidelity National (FIS)	Baxter International (BAX)
Keurig Dr Pepper (KDP)	
Increases	**Reductions**
Avery Dennison (AVY)	JPMorgan Chase (JPM)
Fidelity National (FIS)	Microsoft (MSFT)
PNC Financial Services (PNC)	
TJX Companies (TJX)	
Truist Financial (TFC)	

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Positive drivers of current quarter performance

- No exposure to high-multiple, non-dividend paying internet and direct marketing companies or electric automotive player Tesla (TSLA) in the Consumer Discretionary sector. Exposure to home improvement retail was also a tailwind.
- Stock selection within semiconductors and other hardware companies while being underweight Apple (AAPL) within Information Technology sector benefited relative performance.
- Selection within pharmaceuticals, biotechnology, and health care equipment industries in addition to an underweight allocation to medical technology companies.
- Stock selection in sub-industries with reduced cyclicality within the highly fragmented Industrial sector was a tailwind during the quarter.
- Stock selection and over allocation to stable-consumer end markets such as soft drinks, snack foods and branded household products.

Negative drivers of current quarter performance

- No exposure to the Energy sector in a period that favored companies with leverage to oil & gas commodity prices.

Largest Portfolio Contributors

1. Merck (MRK) A bid for defensive assets in a market drawdown and strong execution from key oncology and vaccine franchises benefitted shares. MRK's strong cash flow generation is expected to support a growing dividend and M&A to bolster its pipeline. Supported by ongoing prioritization of ESG initiatives, MRK continues to stand out as a leader across pharmaceutical companies.

2. Air Products and Chemicals (APD) Better-than-feared quarterly results amid soaring energy prices benefitted shares. Longer-term, APD remains positioned to benefit from expanding gasification market opportunities, which include emerging clean-energy areas such as green hydrogen. These opportunities should drive attractive earnings and dividend growth.

3. PepsiCo (PEP) Despite persistent cost inflation, recent results demonstrate strong product demand and the company's ability to pass along costs to the consumer while minimizing demand destruction. This continues to support earnings and dividend growth as well as the company's multi-faceted sustainability efforts.

Largest Portfolio Detractors

1. Prologis (PLD) Despite a best-in-class development pipeline, record re-leasing spreads on its portfolio of industrial properties and industry-leading commitment to achieve carbon neutrality by 2040, fears of a slower investment pace from PLD's largest tenant, Amazon, pressured shares. Amazon only represents about 5% of PLD's leasing revenue.

2. Best Buy (BBY) Pressure to consumer spending driven by rising inflation prompted a lowered 2022 EPS guidance. Investment in BBY's Total Tech Platform, margins that remain above pre-COVID levels and investments in carbon initiatives and its workforce reinforce BBY's position to grow through-cycle earnings and dividend while maintaining its ESG leadership.

3. Broadcom (AVGO) Macro concerns and announced $61bn acquisition of VMware pressured shares. Despite this, demand for AVGO's high-performance semis and infrastructure components remain stable and the VMware deal gives exposure to steadier software revenue streams.

Strategy Characteristics			
Qualified Dividend Income (% of Total)	93.4%	Number of Holdings	56
Median ESG Percentile Rank (Universe / Sub-Industry)[1]	19.3 / 13.4	Weighted/Median Market Capitalization	$207.9 B / $86.8 B
QTD / YTD Turnover	4.8% / 6.9%	A-or better S&P Ranking	43.6%

Source: [1]Sustainalytics. Please refer to Disclosures for additional information on third-party data.

PERFORMANCE	2Q2022	YTD	1 Year	2 Years[1]	3 Years[1]	S/I[1,3]
Dividend Growth ESG (Gross)	-10.92%	-17.56%	-5.14%	+12.26%	+8.83%	+12.83%
Sharpe Ratio	-	-	*-0.33*	*0.79*	*0.49*	*0.73*
Dividend Growth ESG (Net)[2]	-11.00%	-17.71%	-5.48%	+11.93%	+8.61%	+12.64%
Sharpe Ratio	-	-	*-0.35*	*0.77*	*0.48*	*0.72*
S&P 500[†‡]	-16.10%	-19.96%	-10.62%	+12.18%	+10.60%	+14.47%
Sharpe Ratio	-	-	*-0.65*	*0.70*	*0.55*	*0.75*

Source: Bahl & Gaynor and PSN, 2022. [1]Annualized. [2]B&G net-of-fee figure is after management, trading and applicable bundled fees. [3]Inception: 12/31/2018

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Thanks

Your continued support and interest are much appreciated.

Everyone at Bahl & Gaynor would like to thank you for the opportunity to serve your investment needs.

Important Disclosures

Legal Stuff

*Bahl & Gaynor and FactSet; historical downside (upside) capture is the sum of strategy returns on all S&P 500 down (up) days divided by the sum of index returns on all respective down (up) days. Down (Up) days are defined as any trading day the index posts a negative (positive) total return. Strategy performance is derived from the internal rate of return (IRR) of a single non-fee paying representative/model account.

† Past performance does not guarantee future results. Historical performance results for investment indices and/or categories have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial fees, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your account holdings do or will correspond directly to any comparative indices. The index and other amounts shown above do not relate to the Bahl & Gaynor Income Growth strategy and are for illustrative purposes only.

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