

# Dividend Growth ESG

Third Quarter 2023

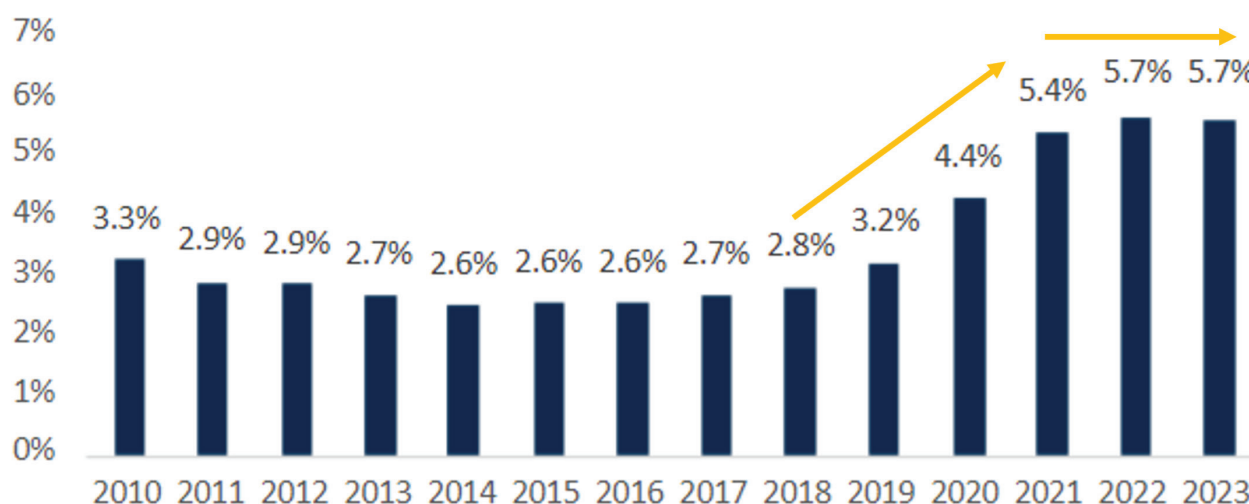
Bahl & Gaynor

## ESG Life Cycle

Over the last 18-24 months, ESG investors and market participants have been reminded that ESG funds are not immune to Harvard Professor Raymond Vernon's "product life cycle" theory. This theory states that every industry or product has three distinct stages: (1) Introduction and Growth, (2) Maturation, and (3) Standardization. While often difficult to observe these specific stages while amidst them, the ESG investing lifecycle has been less disguised.

Since 2018, sustainable funds have witnessed renewed growth often associated with a new product or innovation. Over the last two years, global AUM invested in sustainable funds has reached a plateau, a sign of industry evolution and digestion. With the maturation phase comes increased sophistication and application along with criticism and new entrants (e.g., anti-ESG funds). A stagnant product, for which there is no innovation, has historically shown decline following the maturation phase. However, for industries or products that can innovate (like the investment industry) the product life cycle is typically extended or a new product life cycle begins. While it is unclear how sustainable fund AUM will trend in the future, we at Bahl & Gaynor look forward to continued innovation in the ESG space and the ongoing opportunity to refine our investment process.

Sustainable Fund AUM As % Of Total AUM  
Active & Passive Combined (\$ mn)



Source: RBC ESG Strategy, Morningstar. As of July 2023.

Since 1990, our purpose has been centered around helping clients unlock the power of financial freedom to live life on their terms and shape a better tomorrow. Our mission of growing income through dividends centers upon many elements of responsible investing and sustainable capital allocation. We remain enthusiastic about the potential to further evolve our ESG capabilities rooted in our long-standing governance focused investment philosophy.

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**Strategy Objectives**

1. ESG integration: Superior ESG rankings versus the benchmark<sup>1</sup>
2. High current and growing income: 2.4% yield; +7.4% growth in trailing-twelve-month income as of 3Q2023
3. Downside protection: Competitive daily downside capture<sup>2</sup>
4. Price appreciation: Compelling risk-adjusted returns through a full-market cycle

**3Q2023 Results Relative to Strategy Objectives:**

**Income Growth**

- The Dividend Growth ESG strategy grew trailing-twelve-month income by +7.4%, demonstrating strong cash flow growth at enhanced yield.
- 14 strategy holdings announced dividend hikes; average TTM increase was +10.9%, signaling continue financial health of the portfolio.

**Downside Protection**

- Daily downside capture of 75.0%<sup>2</sup> across all S&P 500 down days in the quarter-to-date period ended 9/30/2023.

**Price Appreciation**

- During the third quarter of 2023, the strategy’s dividend growth focused mandate outperformed versus the S&P 500 amidst a market backdrop still buoyed by the largest market weights. During the quarter, the S&P 500’s top 10 constituents expanded to over 30.5% of the Index, the highest concentration in more than four decades.
- Despite the continued overall outperformance of the largest market-cap names, there was a subtle leadership change in the quarter. Dispersion of returns among the top ten holdings grew in the third quarter, relative to the first half of the year. Traditionally value corners of the market, like Energy, started to outperform traditionally growth parts of the market like Consumer Discretionary and Technology. Both the Energy and Health Care sectors posted third quarter returns above the S&P 500’s -3.27% total return.
- The strategy’s stock selection supported outperformance versus the equal weighted S&P 500, a proxy for the average stock.
- The market continues to work through numerous crosscurrents including higher (and possibly still rising) interest rates, a falling Consumer Price Index, and the possibility of revolutionary growth drivers through the continued advancement of Generative AI. Amidst these conflicting signals, we believe the outlook for risk-aware active managers with a focus on sustainable dividends and stable fundamentals remains positive.

3Q2023 Dividend Increases		
Company	% TTM Increase	Current Yield
Accenture (ACN)	15.2%	1.7%
Broadridge Financial (BR)	10.3%	1.8%
Cintas (CTAS)	17.4%	1.1%
Hershey (HSY)	15.0%	2.4%
Illinois Tool Works (ITW)	6.9%	2.4%
Keurig Dr Pepper (KDP)	7.5%	2.8%
Marsh & McLennan (MMC)	20.3%	1.5%
Microsoft (MSFT)	10.3%	0.9%
Mondelez (MDLZ)	10.4%	2.5%
PNC Financial Services (PNC)	3.3%	5.1%
Realty Income (O)	3.2%	6.2%
Regions Financial (RF)	20.0%	5.7%
Starbucks (SBUX)	7.5%	2.5%
Texas Instruments (TXN)	4.8%	3.3%

Source: Bahl & Gaynor and Factset, 2023.

3Q2023 Dividend Growth ESG Trades Executed	
Initiations	Eliminations
	Crown Castle Inc (CCI)
	Nike Inc (NKE)
	Truist Financial (TFC)
Increases	Reductions
Eli Lilly & Co (LLY)	Abbott Laboratories (ABT)
Hartford Financial Services (HIG)	Motorola Solutions (MSI)
Keurig Dr Pepper (KDP)	Qualcomm (QCOM)
KLA Corporation (KLAC)	UnitedHealth Group (UNH)
Marsh & McLennan (MMC)	
Realty Income (O)	
Regions Financial (RF)	
Starbucks (SBUX)	
TJX Cos (TJX)	
UnitedHealth (UNH)	
Williams Companies (WMB)	
Zoetis (ZTS)	

<sup>1</sup>Measured against the S&P 500 index. Please refer to Disclosures for additional information.

<sup>2</sup>Bahl & Gaynor and FactSet; historical downside capture is the sum of strategy returns on all S&P 500 down days divided by the sum of index returns on all respective down days. Down days are defined as any trading day the index posts a negative total return. Strategy performance is derived from the internal rate of return (IRR) of a single non-fee paying representative/model account.

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## Portfolio Review:

The Dividend Growth ESG portfolio outperformed versus the S&P 500 Index in the third quarter. Stock selection in Industrials and Healthcare and an underweight in Information Technology contributed positively to performance. An overweight in Utilities and underweight in Energy and Communication Services detracted from performance.

### The largest positive drivers of current quarter performance included:

- An above average position of diversified industrials company Eaton (ETN) contributed positively to strategy performance. Ownership of Broadridge Financial (BR) and Old Dominion Freight Lines (ODFL) also buoyed strategy performance following strong quarter-to-date returns.
- Within Information Technology, an active underweight to the two largest technology names, Apple (AAPL) and Microsoft (MSFT), supported performance. Ownership of networking services company Cisco (CSCO) and high-quality IT Consulting company Accenture (ACN) were also beneficial.
- Strong stock selection within Health Care, and specifically the ownership of Eli Lilly (LLY) within pharmaceuticals and AbbVie (ABBV) within biotechnology, was most beneficial to the strategy's performance in the third quarter. An overweight to pharmaceuticals and biotechnology also positively contributed to performance, due to the encouraging intra-quarter readout of anti-obesity medications.

### The largest negative drivers of current performance included:

- An active overweight to Utilities proved challenging as it posted the worst 3Q2023 S&P 500 sector performance amid sensitivity to rising interest rates. In particular, electric utility holdings NextEra Energy (NEE) and Eversource Energy (ES) negatively contributed to strategy performance.
- No ownership of Communication Services and Mega Technology, non-dividend paying companies Meta (META) and Alphabet (GOOG/L) hurt strategy performance this quarter. The strategy has no exposure to Communication Services given the dearth of high-quality dividend growth opportunities.
- Within Energy, not owning a material position in oil & gas refiners detracted from performance following continued strength in oil prices. However, the positions in storage and transportation companies, Williams Companies (WMB) and Kinder Morgan (KMI), partially offset no ownership of refiners and integrated oil & gas companies.

## Largest Portfolio Contributors

**1. Eaton (ETN)** ETN outperformed in the third quarter due to strength and diversity of end markets across commercial electrical, utility and aerospace which are exhibiting structurally higher growth than other end markets. ETN also continues to take higher market share within those segments, winning a structurally higher percentage of new business. Continued strength in core sales and orders should lead to sustained, near-term free cash flow, along with strong earnings and return of capital to shareholders.

**2. Broadridge Financial (BR)** BR continued to outperform in the third quarter following the company's dominant share in the proxy management segment. BR has passed peak investment in its burgeoning Wealth Management platform segment which has supported favorable free cash flow momentum, funding continued dividend growth.

**3. AbbVie (ABBV)** After previously underperforming, ABBV was a safe-haven in the third quarter as the company continues to achieve strong results in its core portfolio, led by Skyrizi and Rinvoq. ABBV's pipeline and positive outlook in its immunology franchise continues to give us confidence in the company's ability to manage through the patent roll-off of Humira and provide steady dividend growth for the portfolio.

## Largest Portfolio Detractors

**1. NexEra Energy (NEE)** NEE's clean energy subsidiary, NEP, faced headwinds during the quarter due to an unfavorable cost of capital and rate sensitivity. While the current environment poses challenges for the subsidiary to acquire new renewable assets, NEE's balance sheet remains strong with its core regulated utility exposure. Management has reaffirmed guidance and dividend growth through 2026 due to the ability of its core business to retain funding flexibility and organic growth.

**2. Waste Management (WM)** WM underperformed in the quarter and reduced second half 2023 guidance due to higher-than-anticipated inflation and challenging commodity pricing within recycling commodities and renewable energy. Despite these headwinds, core results continue to deliver due to effective pricing actions and an improved cost structure.

**3. Merck (MRK)** Despite possessing a robust pipeline and active M&A strategy, MRK underperformed during the quarter on fears of increased competition from generic drugs against their diabetes franchise. Recent acquisitions continue to diversify the company's revenue stream ahead of the patent roll-off of Keytruda later this decade and provide a solid foundation for continued earnings and dividend growth.

Strategy Characteristics			
Qualified Dividend Income (% of Total)	94.4%	Number of Holdings	47
Median ESG Percentile Rank (Universe   Sub-Industry) <sup>3</sup>	22.7   14.3	Weighted/Median Market Capitalization	\$167.7 B / \$85.1 B
QTD / YTD Turnover	4.2% / 11.3%	A-or better S&P Ranking	40.6%

<sup>3</sup>Source: Sustainalytics. Please refer to Disclosures for additional information on third-party data.

## 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

ESG Integration at Bahl & Gaynor is centered upon a materiality-based ESG assessment in combination with bottom-up fundamental research. The ESG assessment is conducted utilizing a sector-specific materiality approach which aims to incorporate data obtained directly from company-issued reports and third-party research providers. Information and data sourced from third-party ESG research providers may be inconsistent with other research providers and may be based on inconsistent and/or unaudited information. Bahl & Gaynor does not represent the information is accurate or complete and it should not be relied on as such. Bahl & Gaynor assumes no liability for the interpretation or use of this report. Due to the sector-specific materiality approach, certain ESG factors may be integrated into a company's ESG assessment in varying degrees or not at all; material ESG issues are subject to change over time.

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