Annual Cash Income Received from $5M Invested						
		5 Years Ago		3 Years Ago		9/30/2023
Bahl & Gaynor [1]	$	154,849	$	184,536	$	229,971
Cumulative Increase		–	*$*	*29,687*	*$*	*75,122*
US Stocks[2]	$	99,385	$	115,990	$	141,315
Cumulative Increase		–	*$*	*16,605*	*$*	*41,930*

Cognitive Dissonance

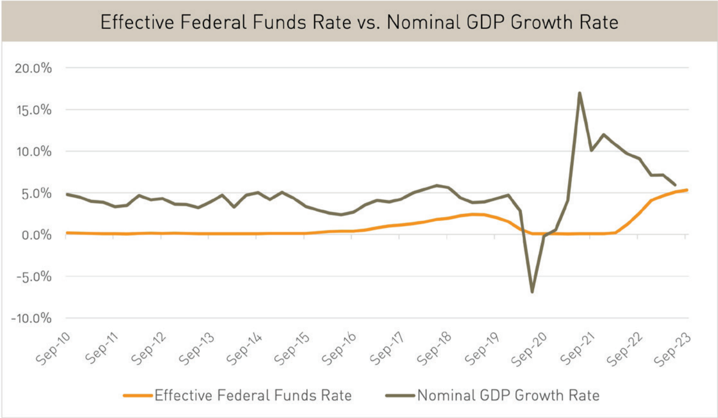
Dear Fellow Investors,

In her 1571 Statute of Usury, Queen Elizabeth abolished the prohibition of interest. A maximum rate of 10% was established at the same time by central decree. Elsewhere in late-Renaissance England, the flowers of invention, global commerce, and exploration were in full bloom. Sir Francis Drake set sail six years later, the tobacco trade arrived in 1586, and Galileo invented the water thermometer shortly thereafter. These advancements inevitably required capital and the benefits of freer pricing of that capital, crystallized in a rate of interest, were immediately evident. However, the central mechanism created for setting the interest rate brought with it an almost immediate, irresistible temptation to reduce it.

The history of the Western World following the Queen's decree is littered with recurring episodes of centrally-directed rate suppression followed by speculative manias of various types, inflation, and, finally, broader economic malady. Fast forward to today, and we find ourselves more than a decade into yet another such episode, with interest rates held to levels significantly below the underlying nominal growth rate or basic return on assets of the economy. While this turn of events is not new, the more novel market feature at present is a pervasive cognitive dissonance with respect to rates and what they might be in the future. There exists an irrepressible belief that (with a high degree of certainty) the government can and will return interest rates to miniscule levels in relatively short order, recession or not. Setting aside the fundamentally unsustainable nature of such a policy for a moment, this belief has become the fulcrum of markets. To preview, we judge this current state of play to be deserving of an even greater than usual attention to risk.

That both equity and fixed income markets are expecting, and indeed relying upon rate cuts (and relatively soon) illuminates the rather unique psychology that has evolved to define the current market regime. Fixed income markets imply rate cuts beginning in 2024. This pseudo-paradox vis-à-vis equity market expectations for higher earnings in 2024 and 2025 is partly demystified when considering that it is rates and not earnings driving the present levitation in indices. Indeed, Austrian economist Fredrick Hayek taught us that low rates lengthen the "structure of production" making investments with distant payouts appear more valuable. Over much of the last decade, low rates *have* increased the value of assets with distant and uncertain payoffs (the more distant and uncertain, the better). Taking together the current price of higher-risk corners of the equity market, particularly those with little or no earnings, and pricing in bonds that implies interest rates will be cut significantly beginning in 2024, the market appears to believe it can have its cake and eat it too. And so we are left with markets today that are perhaps more reliant on a return to very low interest rates than any we have observed in U.S. history.

Inflation tends to be a "sticky" phenomenon, as experienced around WWII and again in the 1970s, in which accelerating price pressures seem to subside before exploding upward yet again. Evidence of a "wage-price spiral" is again forming today, with labor strikes and bargaining power surging just as the supposed decline in consumer price pressures is arriving. Commodities provide another inconvenient and uncontrollable factor, with oil prices pushing structurally higher. While we of course have no way of knowing whether sticky inflation will again buoy prices and rates, it is interesting to observe that the market has consistently underestimated both the level of inflation and the Fed's ability to "pivot" back to lower interest rates since hikes began. More interesting still, even a maintenance of current economic conditions (i.e. current inflation and growth), much less a possible reacceleration, suggests higher interest rates may be warranted, particularly in the middle of the duration curve against which most consumer and industrial loans are made. Despite all the hand-wringing over the pace and scale of rate hikes since March 2022, the Federal Funds rate at 5.5% still stands below nominal GDP growth, tracking north of 6%. If anything, rates are neutral, and perhaps accommodative, a reality which is easily confirmed by the strength of a variety of assets prices, wages, houses, commodities, and the like.



Source: FRED, September 2023.

Fixed income markets have begun to awaken to this reality in recent weeks. Equity indices, concentrated in glamour issues with limited tangible return streams (i.e., dividends), not so much. Using a simple discounted cash flow model of the market, I estimate an increase in the discount rate used to price equities (via interest rates and/or equity market risk premia) of 2 percentage points would result in a 25-30% decline in the fair value of the S&P 500 *without any change in earnings growth expectations.* The P/E multiple on the stock market in such a scenario would compress from the present level of about 19x to 14x, again purely due to the pricing in of rates closer to what is implied by today's economic backdrop. This simple math illustrates the significant "duration risk" that has accumulated in equity markets due to the self-fulfilling combination of unnaturally low interest rate expectations and equity market index concentration in companies with a relatively long "structure of production."

Back in the world of fundamental dividend growth investing, skies are clearer. Equity market dividends in the last twelve months are up 7.1% over a year ago[3] and expected to grow again in 2024. In our universe – a subset of companies with the intrinsic quality, cash earnings, and fortitude to declare growing dividends – the opportunity set has scarcely been this ripe. This is due in equal part to the underlying fundamental business resilience of our companies and the market's current propensity to overlook what we do. While our year-to-date turnover remains quite low (as usual), we continue to seek out opportunities to upgrade quality and thus reduce risk in our portfolios. Recent additions to companies like Phillips 66, Procter & Gamble, Williams Companies, and Booz Allen Hamilton are illustrative of our efforts to "top-grade" quality and reduce portfolio risk at attractive prices. We are not in the business of forecasting the direction of the market, though simply taking what the market gives at present enhances both our ability to grow portfolio dividend income – our primary objective – and protect capital if a repricing of equity markets does come to pass.

As always, I encourage you to reach out with questions, feedback, and comments. Thank you for the trust you place in us and your partnership with Bahl & Gaynor.

Sincerely,

Robert S. Groenke
Chief Executive Officer

[1]Bahl & Gaynor annual cash income received is calculated on a gross of fee basis and does not incorporate the impact of advisory and other fees which will be experienced by investors. The Bahl & Gaynor value is calculated each quarter, beginning 9/30/2017 with hypothetical $5,000,000 starting capital split 50%/50% between the Bahl & Gaynor Income Growth SMA strategy (Income Growth) and the Bahl & Gaynor smig® SMA strategy (smig). Quarterly income earned is calculated using each SMA strategy's historical model income, adjusted by a multiplier factor to reflect the starting capital. Income includes the reinvestment of income. Four quarters of income are summed to calculate annual income received in each period shown. The initial 50%/50% allocation occurs at the beginning of the five-year period and is not rebalanced thereafter.

[2]US Stocks annual cash income received is calculated each quarter, beginning 9/30/2017, with a hypothetical $5,000,000 investment in the Vanguard® Total Stock Market Index Fund ETF (Ticker: VTI) which was chosen to represent an investable market cap-weighted index that invests across large-, mid-, and small-cap stocks and distributes income in the form of quarterly dividends. Quarterly income is calculated by multiplying the implied number of shares purchased with $5,000,000 at initial investment by the quarterly dividend rate and assuming income reinvestment to increase the number of implied shares each subsequent quarter.

[3]The Market income growth rate is calculated using the SPDR® S&P 500 ETF Trust (SPY), an investable proxy for the S&P 500 Index that pays out real distributions of dividend income paid by the index constituents. SPY income is calculated as of the most recent quarter-end using the trailing twelve months of income earned per the distribution rate paid by the ETF, with income reinvestment at the end of each quarter, compared to the income earned in the twelve-month period one, three and five years prior.

All figures are for illustrative purposes only. Individual Bahl & Gaynor clients may realize different income growth rates due to variable client investing needs. **Past performance does not guarantee future results.** Investing in the stock market always contains some level of risk. No strategy guarantees positive performance.

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