

Mid-Quarter Thoughts

OVERVIEW

As we pass the fourth quarter's midpoint, trends highlighted in our 3Q2025 Investor Letter have remained largely unchanged. Investor optimism remains strong, fueled by robust AI-driven capital investment, the resumption of policy rate cuts, steady trade policy, and anticipated fiscal policy tailwinds. These conditions have led to notable outperformance by momentum, growth, and unprofitable companies, relative to quality, low volatility, and profitability. We view this as a sign that investors have become even more confident in current trends and see little risk of disruption.

At Bahl & Gaynor, economic strength and investor confidence are most clearly reflected in the dividend outcomes we deliver to our clients. We continue to see dividend increases in line with expectations across our portfolio holdings and hope to close 2025 by delivering strategy level income growth well ahead of inflation and our typical guidance. Our strategies present a distinct risk profile compared to the broader market, as demonstrated by downside capture ratios, underscoring the role of diversification and robust risk management in navigating recent market trends.

INVESTOR BEHAVIOR

The recent market environment has featured some uncommon trends, such as consecutive years of double-digit returns for large cap indexes and unprofitable small and mid-cap (smid) companies outperforming their profitable counterparts. We believe these occurrences are causing investors to re-evaluate their positioning in both constructive and potentially less constructive ways.

Less constructive behavior includes investors:

- ✦ Abandoning long-term asset allocations.
- ✦ Chasing recent winners or adjusting portfolios to "look more like the market."
- ✦ Measuring success by peer comparison rather than long-term objectives.

More constructive behavior emphasizes:

- ✦ Reassessing expectations and preparing for potential change.
- ✦ Seeking overlooked and mispriced opportunities outside narrow market leadership.
- ✦ Diversifying to protect gains and align with future goals.

LARGE-CAP MARKET OBSERVATIONS

The S&P 500 Index and other large cap indexes are poised for a third straight year of double-digit returns—a rare occurrence in market history. Within this sphere, areas connected to the AI infrastructure build out continue to deliver exceptional results. While our strategies participate in these trends with prudent risk management (as discussed in our podcast, [The Dividend Corner: The Artificial Intelligence Buildout](#)), the intense focus on AI has left other large cap opportunities overlooked, potentially offering value for discerning investors.

Current market concentration and high valuations in large cap markets aren't necessarily signals of imminent reversal, but they do highlight opportunities outside the mainstream focus. Where expectations are lower and capital flows have been scarce, truly differentiated business models may have an opportunity to outperform expectations. This can prove to be a unique risk exposure and potential return opportunity, and it is in the realm of our active process to identify, underwrite, and position portfolios to capture these opportunities. By maintaining high active share, a focus on quality, and valuation discipline, our large cap strategies offer valuable diversification and potential protection against future market shifts.

SMALL/MID-CAP MARKET OBSERVATIONS

In 2025, unprofitable smid companies are on track to outperform their profitable peers—a trend observed only twice since 2005: in 2009 and 2020. Similar to those periods, today's environment is shaped by unique macro events including the expectations for policy rate cuts, cooling inflation expectations, and other favorable influences in the smid market. Of note, the proportion of unprofitable companies in the Russell 2500 Index remains historically high, suggesting that recent strong performance is driven more by sentiment than fundamentals—usually fleeting based on history.

We view this dislocation as an opportunity for investors to consider quality smid exposure as an effective tool for incremental diversification of large cap exposure, and a compelling alternative to index exposure in the smid space. Near term, if the market conditions should change, profitable and dividend-paying companies are well-positioned to benefit, supported by solid fundamentals and ongoing dividend growth. Longer term, as we have highlighted in white papers like [Big Reasons to Think Small Vol. II](#), the earnings growth profile, demanding valuations, and anomalous low trailing performance of the smid space could support attractive future returns. Adding quality as an overlay may offer an even more differentiated risk posture from the otherwise mixed quality of index-level exposure.

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FINAL THOUGHTS

- Dividend growth and downside capture remain differentiating strengths of Bahl & Gaynor's approach.
- Rather than asking "Am I missing out?", investors are encouraged to ask:
 - ✦ What could change?
 - ✦ Where are underappreciated opportunities?
 - ✦ Am I positioned to meet my goals?
- While markets evolve, human nature does not—success depends on managing expectations, emotions, and discipline throughout market cycles.

We are grateful to our investors who continue to entrust us with their capital, and we look forward to serving investors who see a fit for the outcomes we seek to deliver and the goals they hope to achieve.

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Active Share measures the percentage of a portfolio's holdings that differ from its benchmark index. It ranges from 0% (identical to the benchmark) to 100% (no overlap with the benchmark). A higher Active Share indicates that the portfolio is managed with greater divergence from the benchmark's composition.

Concentration Risk is defined as the potential for financial loss due to an overexposure to a single counterparty, group of securities, sector, or geographic location.

Downside Capture ratio measures a portfolio's performance in down markets relative to the benchmark. A value of less than 100% indicates that an investment has lost less than its benchmark during periods of negative returns for the benchmark. **Growth Factor** refers to the investment characteristic associated with companies that demonstrate above-average revenue or earnings growth compared to the overall market or their peers. Growth-oriented stocks typically reinvest earnings to expand their business rather than paying high dividends. **Fundamental Analysis** evaluates a security's intrinsic value by analyzing financial statements, industry trends, and economic factors to determine whether it is overvalued or undervalued. **Low Volatility Factor** refers to the investment characteristic associated with stocks or securities that historically exhibit smaller price fluctuations compared to the broader market. **Momentum Factor** refers to the tendency of securities that have performed well in the recent past to continue performing well in the near future, and those that have underperformed to continue underperforming. It captures the market's short- to medium-term persistence in price trends. **Profitability** refers to a company's ability to generate earnings or income relative to its revenue, assets, or equity. It indicates how effectively the company converts sales or investments into net income. **Quality Factor** refers to the investment characteristic associated with companies that demonstrate strong and stable financial performance, such as consistent profitability, low debt levels, and efficient use of capital.