

# 1Q2026 Investor Letter

## Narrative Shift

Much of our discussions with investors in recent months and quarters have centered upon the artificial intelligence revolution. This has included its impact on fundamental company narratives as well as reviewing market-level risks such as market cap concentration and equity return composition. The events of the last month regarding armed military conflict in Iran demonstrate how quickly narratives can shift, and the need to be prepared for them.

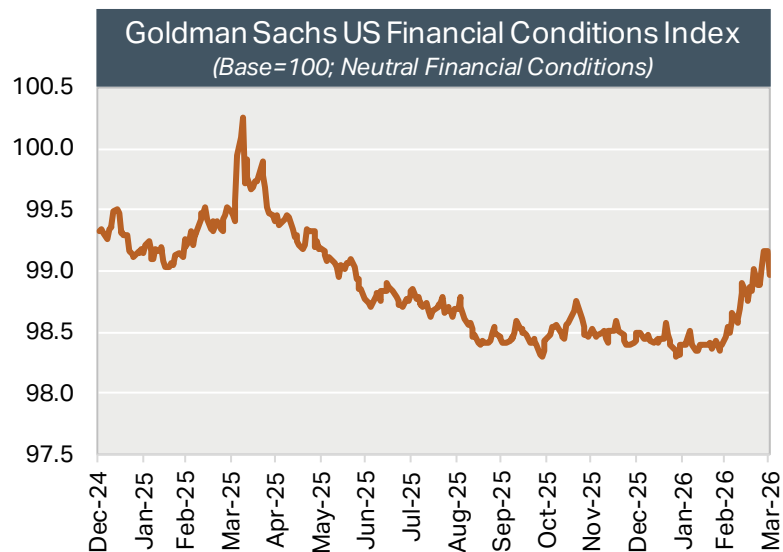
Acknowledging the humanitarian toll of armed conflict, we will spend much of this note outlining the impact from an investment perspective. This includes our view of the range of responses investors can have to sudden events like this, how our dividend growth approach is designed to address the downstream risks geopolitical events can present, and how we are continuing to manage our positioning.

## Tightening Financial Conditions

Put succinctly, military conflict tends to impact financial markets through its potential to tighten financial conditions. Broadly, financial conditions refer to the flow and availability of credit in an economy. The free flow and ample availability of credit permits businesses to operate and grow, supporting individual incomes and economy-wide income (GDP). Disruptions to the availability of credit can disrupt the day-to-day routines of businesses, individuals, and the economy overall.

The chart to the right shows the Goldman Sachs US Financial Conditions Index, a high-frequency composite measure of how easy or restrictive financial markets are for the U.S. economy. A higher index level indicates tighter financial conditions. Note the spike in early 2025 coinciding with "Liberation Day"-related volatility and the recent uptick concurrent with military conflict in Iran.

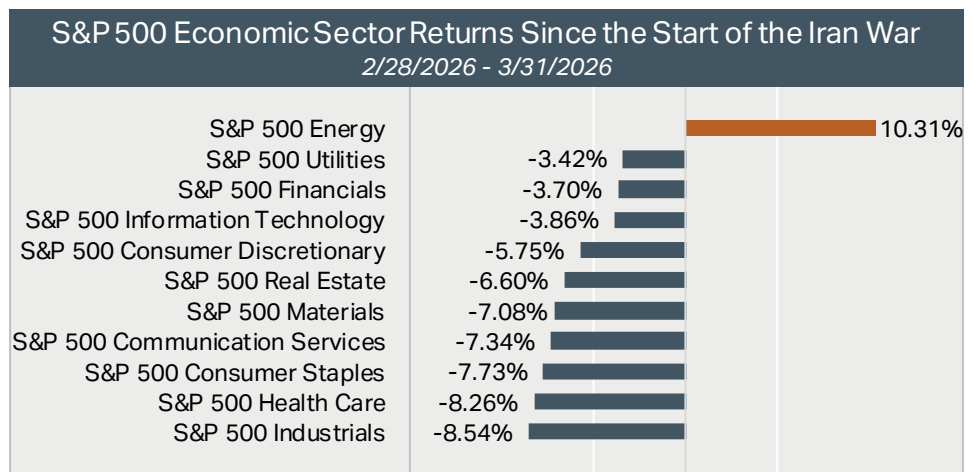
The current military conflict is impacting the supply of oil and gas to many regions of the world. Sudden and sustained disruption that drives up key commodity prices can have significant downstream effects on businesses and individuals. For example, sharp and severe increases in oil prices are another form of inflationary shock. This pressure tends to have a chilling effect on economic activity, which in turn can also impact markets because they discount future activity.



Source: Bloomberg. Data as of 3/31/2026.

## Investor Response to Shocks

Investors can sometimes react emotionally during periods of market stress. Sudden shocks can trigger this behavior, and the result can be volatility across financial markets that is difficult to interpret. For example, as shown to the right, some of the strongest-returning economic sectors since the outbreak of conflict on February 28 through the end of 1Q2026 have been Energy, Utilities, and Financials. Energy is understandable given the sudden price increase of common underlying commodities, same for Utilities given their traditional business model defensiveness. Financial sector performance is encouraging as it implies minimal disruption, so far, to the flow of credit throughout the economy.



Source: Bloomberg. Data as of 3/31/2026.

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At an individual level, volatility-inducing events can cause investors to make knee-jerk reactions that may not suit their long-term interests. Recently, investors have fled other traditionally defensive sectors like Consumer Staples and Health Care. This also holds true for the more cyclical Industrials sector. Both defensive and cyclical sectors have been painted with the same brush, which may imply a lack of fulsome fundamental underwriting among investors. Of course, we reserve the right to change our positioning when the facts change, but this is best done as an unemotional exercise, not an emotional response to panic. We adhere to our process and aim to manage portfolios with a focus on consistency over time. We believe this has a greater chance of creating durable value than a quick reaction time to unclear inbound data.

## Assessing Fundamental Impacts

Military conflict can be fluid, and the uncertain scale and duration of the current conflict makes it difficult for investors to assess the fundamental impact of such a fast-changing fact pattern. As such, this fluidity appears to be the primary source of market volatility as investors are trying to process change to myriad inputs and project this onto a global economy—perhaps an impossible task.

When we evaluate companies at Bahl & Gaynor, we focus intensely on company-level fundamentals and a cone of business outcomes that can result from different combinations of fundamental inputs. This approach can involve macroeconomic inputs, but part of our investment selection process involves identifying companies with a few (ideally controllable) variables that drive long-term value creation potential. We demonstrate this with an excerpt from our strategy slide presentation below:



In contrast, some investors focus on businesses with high sensitivity to macroeconomic inputs and invest to gain leveraged exposure to the directional movements of underlying variables (like the price of oil, for example). This can be a profitable approach, but it is not our approach. Our focus on company-level fundamentals and developing a cone of business outcomes allows us to fit different companies together in a portfolio aimed at achieving targeted client outcomes. These outcomes are not limited to an absolute rate of return, but a strategically managed risk profile and targeted level of income generation and growth from which returns also result.

## Financial Conditions Independence

In our communications with investors, we consistently tie discussions back to our exclusive focus on dividend growth investing. Currently, as investors navigate volatility due to tightening financial conditions and uncertainty, we see a growing dividend as an indicator of a company’s capacity to generate internal capital.

A dividend can be viewed as the sustainable ability of a business to generate excess capital from operations. If investors become more concerned about tightening financial conditions, we believe businesses with demonstrated ability to generate capital internally may be viewed favorably by investors. This contrasts with many notable fast-growing companies today whose growth cadence depends on ample access to *external* sources of capital whose availability can change suddenly and without advance warning.

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As a second layer of potential protection, much of our fundamental underwriting concerns a company's balance sheet strength. If cash generation can signal business model viability, balance sheet strength can provide stability through different phases of an economic cycle. Internally generated capital can be thought of as the first line of defense in an environment where capital is scarce. A conservatively financed balance sheet can be a second line of defense.

## Managing Our Positioning

We are frequently asked what portfolio changes we are making within our strategies to address risk-inducing events, like the military conflict in Iran, after they occur. Benjamin Franklin captures our thinking well: "An ounce of prevention is worth a pound of cure." Because our strategies are designed with well-defined outcomes in mind—growing income, downside protection potential, alpha generation—it is our responsibility to continuously manage portfolios toward these outcomes.

Our thinking about portfolio positioning does not materially change in a benign environment versus a hostile one because we think less about the environment as it may be and more about how different return and cash flow streams are priced (or mis-priced) currently. The power of compounding is in the avoidance of its interruption, so our investment process attempts to maximize the chance of uninterrupted compounding throughout various phases of the business and market cycle.

We have spent a great deal of time evaluating how the current environment has shifted the valuation of different businesses amid the rapid re-pricing exercise in which many investors are engaging. We believe there may be opportunities created by recent market movements, and our focus is to identify the favorable mis-pricings and shepherd them into our strategies while avoiding and removing the unfavorable instances of mis-pricing.

## Broadening and Volatility of a Different Variety

In our recent mid-quarter update, we posited "broadening and volatility" might be the themes investors settle on for the year. This thought came to us in the context of the evolving artificial intelligence narrative, but the end of the first quarter has proven how quickly narratives can shift.

We do think this is an important opportunity for investors to consider their experience through this narrative shift and resurgence of volatility. If too much volatility has been experienced, a change in positioning is likely warranted.

Our focus remains on maximizing what we believe are the durable drivers of value creation within our discipline: a growing income stream and downside risk protection supporting alpha generation potential over time. We welcome the opportunity to engage with new investors seeking a reset of their risk posture, and we thank our clients who have been committed to our approach through multiple phases of the business and market cycle.

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**Alpha** is a measure of risk-adjusted return expected from a portfolio above the benchmark return at any point in time. **Business Cycle** refers to the recurring pattern of expansion and contraction in overall economic activity over time, typically characterized by periods of economic growth, peak activity, slowdown or recession, and recovery. **Downside Protection** refers to investment characteristics or strategies intended to help limit losses or reduce the magnitude of declines during periods of market stress or negative returns. **Gross Domestic Product (GDP)** is a measure of the total market value of all final goods and services produced within a country's borders over a specific period of time and is commonly used as a broad indicator of overall economic activity and growth. **Inflationary Shock** refers to a sudden and unexpected increase in inflation driven by external factors such as supply disruptions, policy changes, commodity price spikes, or geopolitical events, which can lead to higher prices across the economy over a short period of time. **Market Cycle** refers to the recurring phases of financial market behavior over time, typically characterized by periods of rising and falling asset prices, changes in investor sentiment, and varying levels of market risk. **Volatility** refers to the degree of variation in the price of a security or portfolio over time. It is often used as a measure of risk and is typically expressed as the standard deviation of returns.

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