

2Q2026 Investor Letter

The Signal and the Noise

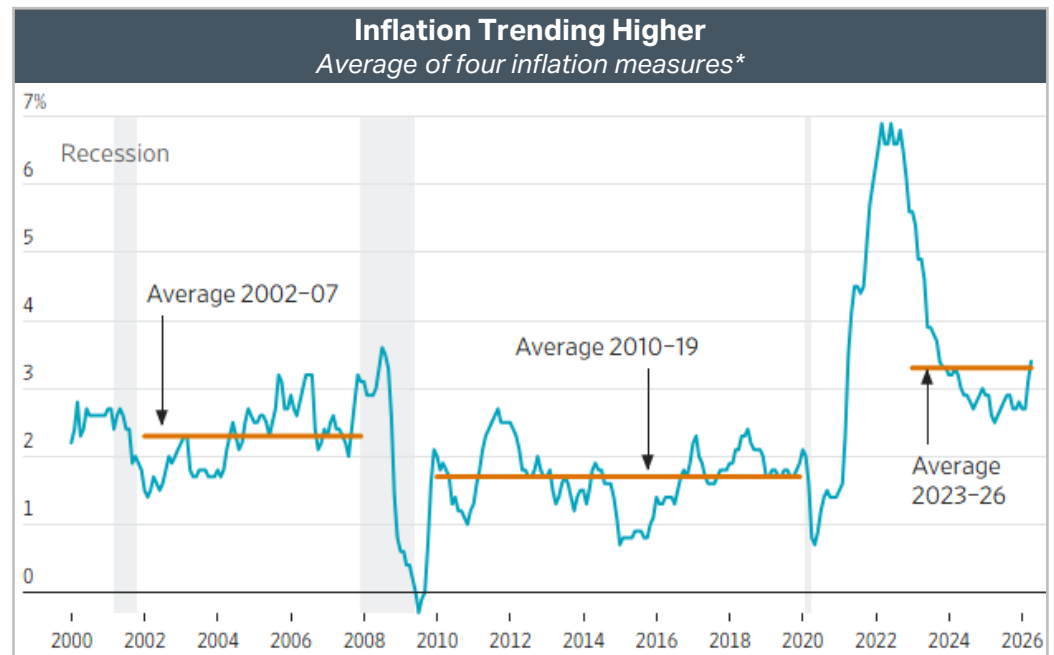
The market in 2Q2026 has been less defined by a single narrative than by the collision of several competing ones: new index highs alongside deteriorating internals, strong corporate earnings accompanied by an unsettled interest rate complex, genuine technological transformation alongside valuations that require that transformation to proceed on a very specific schedule. Near the quarter's close, a sharp drawdown in AI-related equities provided an unusually clear window into the tensions beneath the surface of a superficially buoyant market. We want to use that window—not to predict what comes next, but to think carefully about what it reveals: the market's framework for underwriting long-term opportunity, where fundamental reality and sentiment-driven pricing may be diverging, and what this all means for the discipline we bring to managing client capital.

Equities are expected to earn a risk premium over cash and bonds because holding them can be genuinely uncomfortable. Historically, investors have generally expected higher returns as compensation for accepting greater investment risk and uncertainty. This uncertainty arrives in the form of conflicting signals, unresolved questions, and sharp reminders that the market's willingness to underwrite a long-term opportunity at a given price can shift faster than the fundamentals of an underlying business. For investors with long-term goals, including retirement security, generational wealth creation, and sustainable income generation, navigating this discomfort with discipline is not a secondary feature of an investment strategy. It is a primary one.

With that framing in mind, we want to acknowledge the signals we believe a disciplined investor should be monitoring carefully, perhaps especially with many market indexes near all-time highs:

1. The Interest Rate Complex

The 2-year Treasury yield has crossed above the Federal Funds Rate. This condition is often viewed as the bond market's concern that the Fed may be behind the curve on containing inflation, potentially requiring more aggressive future action than current policy implies. The 30-year Treasury also appears to be embedding a structural inflation premium, suggesting the market is not fully convinced inflation will return durably to the Fed's 2% target (see graph to the right). Equities, meanwhile, are priced as if both concerns are resolved—confidence the bond market does not appear to share.



Source: *The Wall Street Journal*, 2026. *Consumer price index, total and core (excluding food and energy); Personal consumption expenditures price index, total and core. Commerce Dept. Labor Dept. via Federal Reserve Bank of St. Louis, *Inflation Insights* (estimated total and Core PCE inflation, April 2026).

2. Oil and Geopolitics

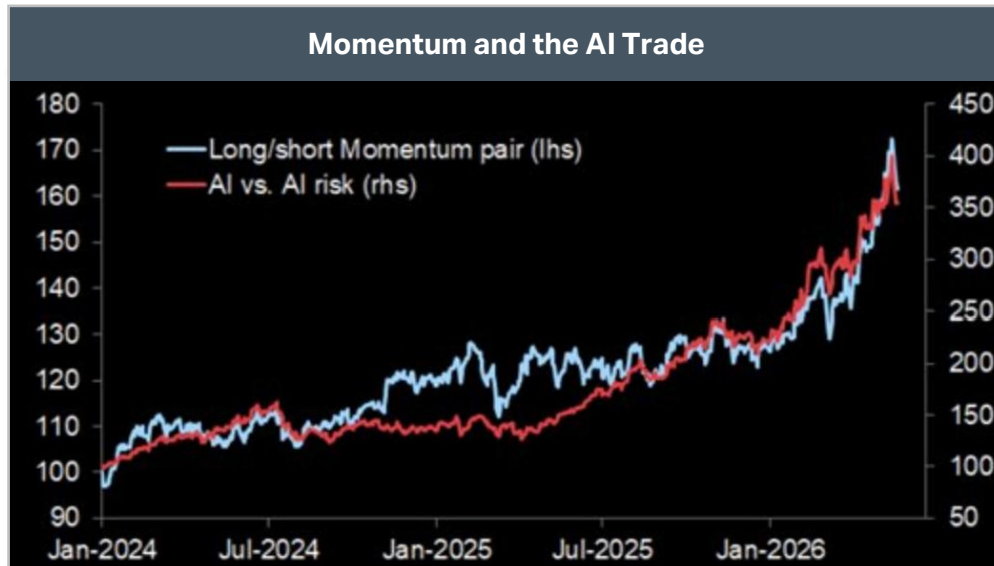
WTI crude oil has traded in a range of roughly \$55 to \$115 over the past 12 months, settling below \$80 a barrel today¹—a volatility profile reflecting a genuine supply disruption, as the near-closure of the Strait of Hormuz following the US-Iran conflict cut off meaningful Persian Gulf supply from global markets. Equity markets largely looked past this. The recent memorandum of understanding (MOU) between the United States and Iran, which includes the reopening of the Strait of Hormuz and the resumption of oil flows, may resolve this disconnect. However, the path to normalization is unlikely to be linear. Since the MOU was signed on June 17th, military actions have already been executed by both sides in and around the Strait. It remains uncertain whether traffic through Hormuz will return to pre-conflict levels within the 30-day timeframe committed to by Iranian officials. Should oil prices remain elevated, they would continue to act as a tax on corporate margins and consumer spending, a dynamic that equity valuations have yet to fully reconcile.

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3. Breadth and Internals

Only about 60% of S&P 500 constituents are trading above their 200-day moving average even as the index makes new highs. Implied correlation among constituents has also fallen, suppressing headline volatility while individual stock risk remains elevated—a reminder that suppressed implied correlation can mask individual stock risk until it doesn't. Today, momentum factor performance and AI risk exposure are highly correlated—and both went parabolic in early 2026 (see graph below). When that trade corrected sharply late in the quarter, the index's narrow foundation became visible with unusual clarity.



Source: Goldman Sachs Global Investment Research, 2026.

The constructive counterweight to these conflicts is that today is not like 1999 in a few important ways. S&P 500 earnings have grown approximately 79% from 2021 to 2025 while the index returned roughly 85% over the same period. In the dot-com era, index returns far outpaced earnings growth (see below). This picture holds at the sector level as well—global IT earnings have genuinely grown into rising prices since the ChatGPT launch in late 2022, in stark contrast to the late 1990s when price simply left earnings behind. The market has real fundamental support; it is not obviously detached from reality. Market advances are, however, likely contingent on continued earnings delivery—and that conditionality deserves respect.

Unlike 1999, Total Returns Today Are Consistent With Earnings Growth

	EPS Growth %	Total Return %		EPS Growth %	Total Return %
1995	16%	38%	2021	40%	29%
1996	11%	23%	2022	5%	-18%
1997	7%	33%	2023	0%	26%
1998	0%	29%	2024	14%	25%
1999	20%	21%	2025	15%	18%
1995-1999	67%	220%	2021-2025	79%	85%

Source: Strategas, 2026.

The point of presenting these signals is not to predict specific outcomes. It is to acknowledge that conflict exists, that certain parts of the market are in tension with others, and that pretending otherwise is not analysis—it is comfort-seeking behavior. Our role is to take these signals seriously, position accordingly, and remain honest with you about what we do and do not know.

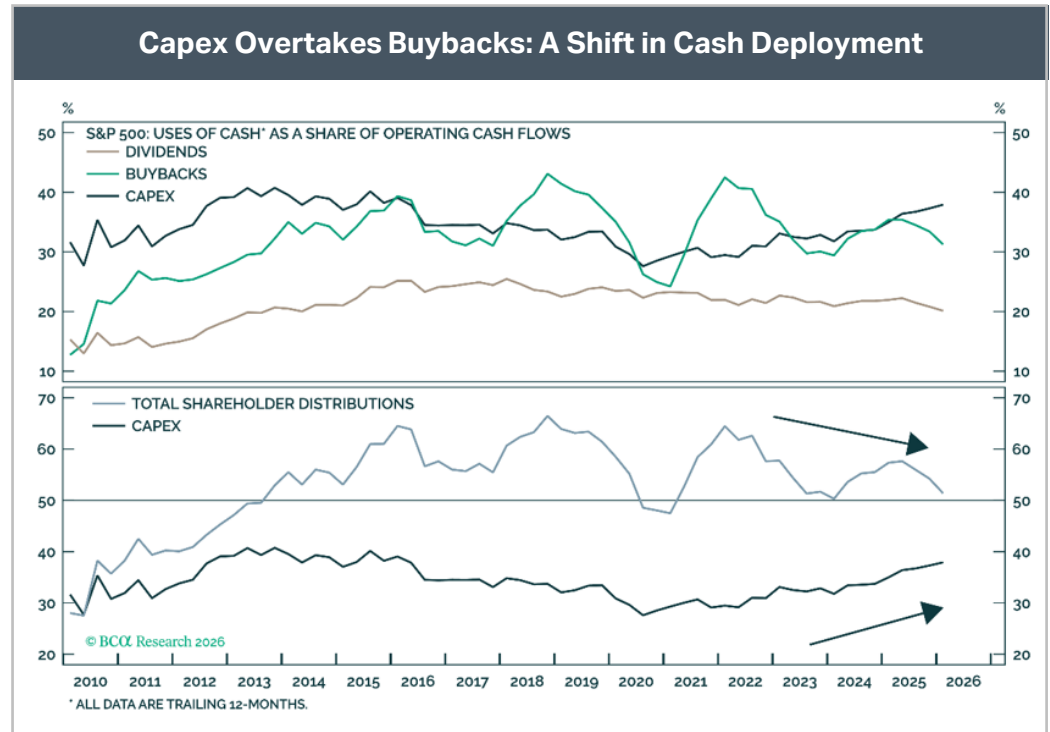
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A Market Regime in Transition

Beneath headline index performance, the market's underlying structure has been shifting in ways we believe matter for longer-term positioning. Several developments are worth naming directly:

1. The capex regime has displaced the cash-return regime.

For most of the post-GFC period, S&P 500 cash deployment was dominated by dividends and share repurchases — together absorbing 50-60% of operating cash flow. Since late 2025, capital expenditure has surpassed share repurchases as the primary use of cash for the first time in the post-GFC era (see graph to the right). Companies spending aggressively on AI infrastructure are applauded; companies generating and returning cash are receiving less attention. Importantly, we do not view this as a permanent condition or an adverse development for our dividend growth discipline. Rather, it is a feature of the infrastructure phase of a general-purpose technology cycle—one that has historically given way to a broader diffusion phase.



Source: BCA Research, 2026.

2. Free cash flow "alpha" was largely a sector bet in disguise.

Recent research confirms what the current cycle has revealed in practice: the premium that free cash flow and share repurchase factors commanded in the post-GFC period largely disappears when controlling for sector exposure. Investors who believed they were selecting high-quality cash generators were often simply holding Technology companies. AI has now inverted that factor, with capex intensity rewarded over share repurchase activity. For our portfolios, this reinforces the value of genuine sector diversification—owning durable cash generators across the economy rather than concentrating in the sector where "quality" and "technology" have temporarily meant the same thing.

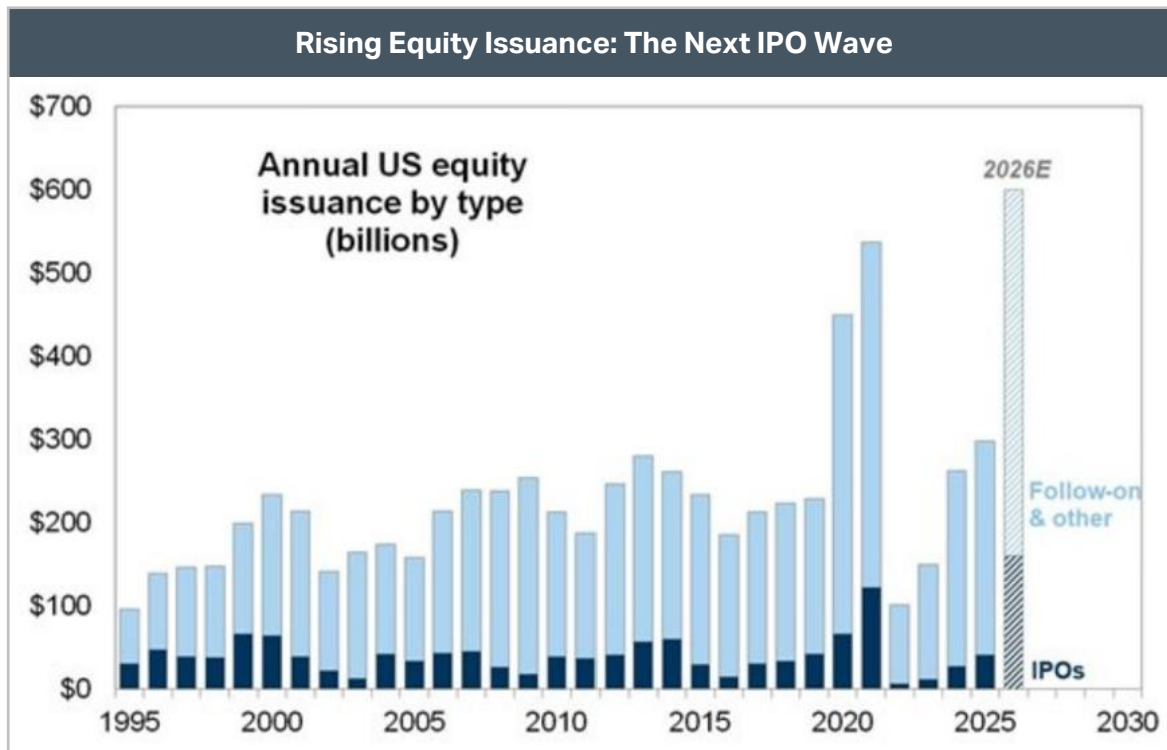
3. Current AI leadership represents the infrastructure phase—and history suggests the diffusion phase looks different.

Past general purpose technology cycles have followed a similar arc. Canal builders, railroads, and internet infrastructure providers built the networks that enabled transformation but rarely captured the majority of long-term value creation. Electrification took decades to show up in broad productivity statistics because diffusion requires adaptation. When it arrived, the beneficiaries were the manufacturers and service businesses that learned to use electricity—not primarily those that generated it. AI may follow a similar pattern. The diffusion phase, when AI productivity compounds through non-Technology sectors like Industrials, Health Care, and Financial Services, may prove more durable and more broadly distributed than the infrastructure investment phase. These are sectors with established cash generation and meaningful dividend histories—and in many cases, sectors our portfolios already emphasize, positioning us for the diffusion phase alongside the infrastructure phase investments we have held for some time. We are not making a timing call with our exposure. Diffusion cycles are notoriously difficult to time. We are making a structural observation about where the next chapter of value creation may reside and attempting to position our portfolios for this evolution.

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4. The coming IPO wave deepens concentration and our active share with it.

The recent public listing of SpaceX (SPCX) and anticipated listings of OpenAI, Anthropic, and others represent a pipeline of over \$4 trillion in private market valuations—a potential record measured against S&P 500 market cap. We welcome these companies to public markets and are genuinely enthusiastic about the economic potential they represent. That enthusiasm does not change our investment process. These businesses remain in their capital-consumption phases—not yet generating the stable free cash flow required to initiate or sustain a dividend—so our investable universe is unchanged, by design. For passive investors, however, the calculus is different. Index providers are adapting their rules to accelerate mega-cap inclusion; Nasdaq's recently implemented Fast Entry rules effectively waive historical seasoning periods to speed the process. Passive benchmarks will absorb this new cohort automatically, deepening an index concentration that is already historically elevated. The result for our portfolios is a structural increase in active share—not a residual characteristic, but a deliberate source of diversification at precisely the moment the benchmark is becoming more concentrated. We also note, gently, that the infrastructure investment phases of prior technology cycles have tended to produce their heaviest public market issuance near the peak of investor enthusiasm.



Source: Goldman Sachs Global Investment Research, 2026.

Volatility as Opportunity: What We Are Doing

The late-quarter drawdown in AI-related equities did not change the technology or materially alter the earnings trajectory of the companies involved. It did, however, reveal how much of current valuation in the AI complex rests on sentiment—on the market's willingness, at a given moment, to pay a particular price for a particular vision of the future—rather than on realized fundamental progress. Sentiment can shift faster than earnings. Fundamental investors have historically sought to capitalize on periods when market prices diverge from underlying business fundamentals.

We think about this in both directions, and we want to be explicit about that. Upside opportunities that have been fully realized, where sentiment has driven prices well ahead of fundamentals, can mark the point at which the risk-reward has shifted unfavorably. The capital that we move away from these situations, patiently and deliberately, becomes available to take advantage of the mispricing where value may be underappreciated. This is not market timing. It is the consistent application of fundamental discipline through noise and signal alike.

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The question we ask ourselves in periods of volatility is not: "What is the market feeling today?" It is: "What does this business actually earn, and is the price we are being offered for those earnings reasonable relative to their durability and growth?" In the current environment, that question continues to point us toward profitable, dividend-paying companies with strong balance sheets and established cash generation. Incidentally, many of these businesses serve as suppliers, infrastructure providers, and downstream beneficiaries of AI-driven demand without requiring AI sentiment to remain permanently elevated to justify their valuations.

Our portfolios are built to compound through the range of outcomes a complex market environment can produce—not optimized for any single scenario. This means maintaining genuine sector diversification at a moment of historic index concentration. It means emphasizing balance sheet durability at a moment when the market is rewarding leverage for growth. And it means remaining attentive to the opportunities that sentiment-driven volatility creates, in both directions, as the market continues to work through the tensions this quarter has so clearly put on display.

Closing: The Discipline of Not Knowing

The most honest thing we can say about this market is that it is genuinely uncertain—not in a hand-waving way, but in the specific sense that several important variables remain unresolved and could resolve differently than market expectations: inflation's trajectory, the Fed's response, the pace and breadth of AI earnings delivery, and the durability of narrow market leadership. These are not small questions.

We are not in the business of predicting which resolution occurs. We are in the business of building portfolios resilient enough to compound capital through the range of plausible outcomes. And we strive to be disciplined enough to recognize opportunity when volatility makes it visible. Every period of noise contains signal if you think carefully about what questions to ask. We are asking them—and we are grateful, as always, for the trust you place in us to do so on your behalf.

IMPORTANT DISCLOSURES AND DEFINITIONS

¹U.S. Energy Information Administration, Crude Oil Prices: West Texas Intermediate (WTI) - Cushing, Oklahoma [DCOILWTICO], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/DCOILWTICO>, June 29, 2026.

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Buybacks/Share Repurchases are when a company buys back its own shares from the market, which can reduce the number of shares outstanding. **Downside Protection** is an investment characteristic or objective intended to help reduce losses during market declines. It does not guarantee that losses will be avoided. **Federal Funds Rate** is the interest rate that U.S. banks charge each other for overnight lending of reserves. It is set indirectly by the Federal Reserve as a key policy rate. **Implied Correlation** is a market-based estimate of how closely stocks or other assets are expected to move together. Lower correlation means individual securities may behave more independently. **Risk Premium** is the extra return investors expect for taking on more risk instead of holding safer assets like cash or high-quality bonds. **Volatility** is the degree to which an investment's price moves up and down over time. **WTI Crude Oil** represents the West Texas Intermediate crude oil, a widely used benchmark price for U.S. oil. **200-day moving average** is the average closing price of a security over the most recent 200 trading days, used by many investors as a trend indicator.