

3Q2026 Investor Letter

The Future Became More Expensive

A basic principle of finance is that a dollar expected far in the future is worth less today than a dollar received sooner. As interest rates rise, distant cash flows are discounted more heavily and the hurdle an investment must clear to create value rises.



Source: Bahl & Gaynor calculations. Present-value calculations assume annual compounding and discount \$1 received in 20 years at rates of 5%, 8%, and 12%. For illustrative purposes only. The illustration does not represent the performance or expected return of any investment, account, or strategy.

This quarter provided an interesting test of that principle. Long-term interest rates moved higher while enthusiasm surrounding artificial intelligence regained momentum. Some of the world's largest companies continued to commit extraordinary amounts of capital to data centers, semiconductors, power, and related infrastructure, while investors continued to assign substantial value to the future economic benefits those investments may produce.

These developments are not necessarily contradictory. A company capable of investing at returns substantially above its cost of capital may continue to find those investments attractive even as financing costs rise. But higher rates raise the hurdle those investments must ultimately clear. This raises a fundamental question that extends beyond today's AI investment cycle: **What evidence should we require that capital committed today is earning an attractive return on investment?**

The Burden of Proof

Every investment is an exchange between capital committed today and cash flows expected tomorrow. The further into the future those cash flows reside, the more assumptions an investor must make about revenue growth, margins, competitive position, technological change, and other variables. Higher rates make those assumptions more consequential.

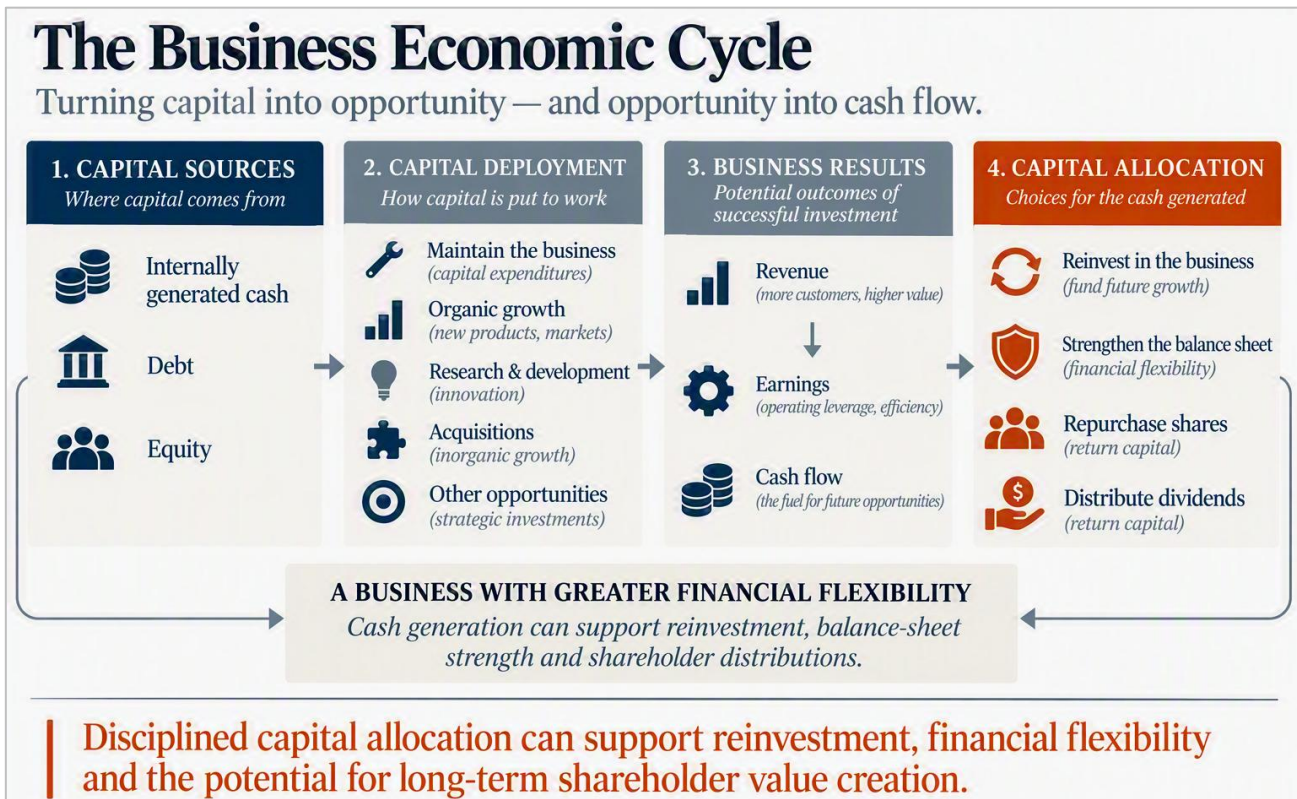
Today's AI investment cycle offers a large-scale illustration. In its September 2026 publication, *Can AI Investment Drive S&P 500 Earnings Even Higher?*, Goldman Sachs Research reports that the largest U.S. hyperscaler companies are on track to spend \$800 billion on capital expenditures in 2026, an increase of 94% over 2025. The scale and pace of that investment make the eventual return on that capital increasingly consequential. The relevant question is not whether companies are spending too much on AI—we do not know—but whether today's investment will ultimately earn the returns embedded in current expectations.

Capital expenditure itself does not create shareholder value. It creates capacity and opportunity. Value is created when the eventual economics justify the resources consumed. **Eventually, capital going into a business must produce something observable coming out.**

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From Investment to Cash Flow

Every business operates some version of the economic cycle pictured below. Capital is obtained and deployed into the business. When successful, those investments contribute to revenue, earnings, and cash flow. Management must then decide whether that cash is best reinvested, used to strengthen the balance sheet, deployed toward acquisitions or share repurchases, or distributed to shareholders.



For illustrative purposes only. Outcomes are not guaranteed. Capital investments may not generate expected returns, and dividends may be reduced or discontinued.

Some of the businesses we find most attractive can simultaneously invest in their futures, preserve financial flexibility, and generate more cash than those activities require. That flexibility gives management choices: invest when prospective returns are attractive, strengthen the balance sheet during periods of uncertainty, pursue acquisitions opportunistically, or return capital when internal opportunities do not meet an appropriate hurdle.

It is in this context that dividends become relevant. At Bahl & Gaynor, we do not view the dividend as the source of a company's economic value, but as one piece of evidence about the economic engine producing that value. Before a company can sustainably grow its dividend, it must compete successfully, generate earnings, convert those earnings into cash, fund necessary reinvestment, and maintain sufficient financial flexibility. **That makes dividend growth a recurring test rather than a one-time signal.**

A growing dividend does not guarantee future success, nor does the absence of one make a business unattractive. For our process, however, the repeated ability to grow a distribution provides observable evidence that the cycle from investment to cash generation has worked historically. It asks a straightforward question: **After funding what is necessary to sustain and grow the business, can it return more cash to its owners than it did before?**

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Knowing What We Don't Need to Know

Investing will always require assumptions about the future. A sound process cannot eliminate uncertainty, but it can be deliberate about which uncertainties it accepts.



For illustrative purposes only. The factors shown are examples and are not intended to be exhaustive. Investing involves risks, including the possible loss of principal. Past performance is not indicative of future results. No investment strategy can guarantee positive returns or eliminate risk.

Our process emphasizes businesses where previous investment has already produced observable evidence of attractive economics: durable demand, healthy cash generation, financial flexibility, and the capacity to return a growing amount of cash to shareholders while continuing to invest for the future. At times, that may mean participating less where valuations depend more heavily on outcomes that may not be observable for many years.

We accept that tradeoff. Our objective is not simply to maximize potential return, but to be deliberate about the risks and uncertainties we accept in pursuing it. Our focus on dividend growth reflects that choice and our broader objective of providing increased certainty to clients—not certainty of investment outcomes or protection against loss, but greater emphasis on the kinds of businesses we own and the evidence we require from them.

A Long-term Discipline

Ultimately, this discipline matters because client objectives extend well beyond any single quarter or market cycle. Growing income can help support spending needs that tend to rise over time, while durable businesses with financial flexibility can be better positioned to navigate periods of economic and market stress.

This quarter illustrated how quickly the value assigned to future cash flows can change. Our response is not to predict those changes, but to remain focused on businesses that can invest for tomorrow while generating cash and maintaining financial flexibility today. ***In our view, the further markets ask investors to look into the future, the more valuable evidence about the present becomes.***

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Capital expenditures (capex) are funds a company uses to acquire, upgrade, or maintain long-term physical assets such as property, equipment, and technology infrastructure. **Discount rate** is the rate of return used to convert expected future cash flows into a present value. A higher discount rate reduces the present value of cash flows received further in the future. **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. **Long-Term Interest Rates** are yields on debt with longer maturities, such as the 10-year U.S. Treasury note. They reflect market expectations for inflation, growth, and future short-term rates. **Present value** is the current worth of a future sum of money or stream of cash flows, given a specified discount rate.