A letter from Bahl & Gaynor's Chairman:

Time in the Market

William F. Bahl, CFA, CIC
Co-Founder & Chairman
Bahl & Gaynor

In this issue:

Where Were You When?

In life, there are certain dates or poignant times that cause you to remember **exactly** what you were doing and where you were when an event occurred.

Over the past century, those dates include: the stock market crash that sparked the Great Depression (October 24, 1929), the bombing of Pearl Harbor (December 7, 1941), Richard Nixon's resignation (August 9, 1974) and, most recently, the devastating terrorist attacks on the World Trade Center (September 11, 2001).

BROOKLYN DAILY EAGLE
And Complete Long Island News
LATE NEWS
NEW YORK CITY, THURSDAY, OCTOBER 24, 1929.
32 PAGES
THREE CENTS

WALL ST. IN PANIC AS STOCKS CRASH

Attempt Made to Kill Italy's Crown Prince

STOCKS CRASH IN RUSH TO SELL: BILLIONS LOST

ASSASSIN CAUGHT IN BRUSSELS MOB; PRINCE UNHURT

Hollywood Fire Destroys Films Worth Millions

FEAR 52 PERISHED IN LAKE MICHIGAN; FERRY IS MISSING

PIECE OF PLANE LIKE DITEMAN'S IS FOUND AT SEA

High Duty Group Gave $700,000 to Coolidge Drive

ATTEMPT MADE ON LIFE

FOR MORE LOBBYISTS

JOSEPH R. GRUNDY

CARNEGIE CHARGE OF PAID ATHLETES

HOOVER'S TRAIN HALTED BY AUTO

WARDER SOUGHT TO KEEP SEA TRIP

SOMERS NAMED AS HEAD OF NEW

"All the News That's Fit to Print"
The New York Times
Late Edition
NEW YORK, TUESDAY, OCTOBER 20, 1987
30 CENTS

STOCKS PLUNGE 508 POINTS, A DROP OF 22.6%; 604 MILLION VOLUME NEARLY DOUBLES RECORD

U.S. Ships Shell Iran Installation In Gulf Reprisal

Offshore Target Termed a Base for Gunboats

A Huge Blow to the Five-Year Bull Market

Dow's Record Fall

WORLDWIDE IMPACT

Frenzied Trading Raises Fears of Recession — Tape 2 Hours Late

Does 1987 Equal 1929?

Source: Brooklyn Daily Eagle, The New York Times, 2018.

For the current generation of stock market junkies, like ourselves, certain other dates also stand out: the Dow Jones Industrial Average's first close over 1,000 points (November 14, 1972), the last time the Dow crossed over 1,000 (November 3, 1982), but the Black Monday crash (October 19, 1987) stands out as we compose this letter. On that day, the Dow tumbled 508 points, **losing 22.61% of its value in a single trading day.** Trading volume soared and back offices fell so far behind that the market had to be closed early and exchanges remained closed for over a week to allow for processing to normalize. For context, the Dow fell -11.73% on Black Tuesday in 1929 when panic selling reached its peak.

We reference the 1987 experience in order to put the market performance that followed into context. As can be seen in the chart below, the 22.61% decline in the

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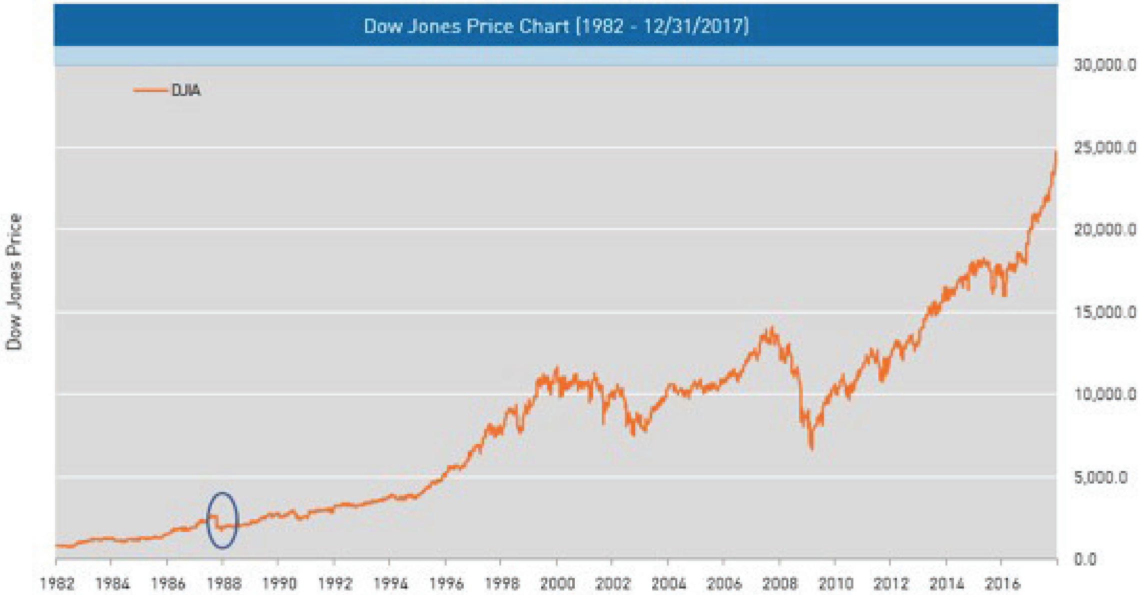
Where Were You When *Continued*

index is barely recognizable *(circled in blue)* before the composite's steady rise through the balance of time leading up to today. Had someone invested their hard-earned capital just prior to the 1987 crash, no doubt they would have felt very badly about their luck and loss of fortune. **But**, if that same investor had the fortitude to stick with their ill-timed investment, they would still be very well-off today. In fact, the compound annualized rate of return (including dividends) from October 16, 1987 through December 31, 2017 would be +11.07%. This return figure takes into account the initial drawdown of -22.61% experienced on Black Monday along with two greater than -50% market corrections, the bursting of a tech bubble and a terrible financial crisis. The point we attempt to illustrate in this example is an often-used maxim in our conversations with clients: **TIME IN THE MARKET** builds wealth rather than **TIMING THE MARKET.**



Source: Bloomberg, 2018.

2018: Will The Good Times Last?

As it became apparent in late 2017 that equity markets around the world were going to post very strong results (the Dow has recorded over 70 new highs this year), the most common concern or question we field from individual and institutional clients alike is: What are the chances of an imminent market sell-off?

Our response has been two-fold: 1.) It is impossible to know what is in store for capital markets near term, and 2.) A key element of successful investing remains staying in the game *throughout* market cycles – TIME IN THE MARKET!

As a follow-on to this question and response, we examined periods of time dating back to 1980 when markets advanced +20.0% or more in a given year, and what was the return profile enjoyed in the years immediately following these observed advances. The exhibit below lays out our findings in both tabular and graphical form. There have been 13 years prior to today when the Dow posted a +20.0% or greater return and in only two of these years (circled in red) did the market register a negative return the following year. In both cases, the negative return was contained to less than -5.00%. The median return for the year following a +20.0% return was +10.04%. The median annualized return for the **second** and **third** years following a +20.0% advance were even more attractive at +12.06% and +12.72%, respectively.

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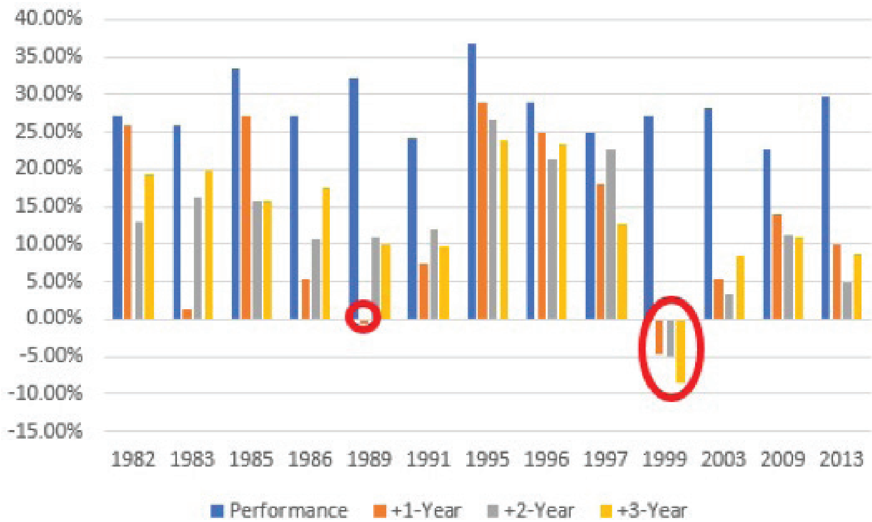
Dow Jones 20%+ TR Performance Analysis

Year	Performance	+1-Year	+2-Year	+3-Year
1982	27.11%	25.97%	12.95%	19.43%
1983	25.97%	1.31%	16.27%	19.77%
1985	33.55%	27.10%	15.79%	15.90%
1986	27.10%	5.48%	10.68%	17.45%
1989	32.19%	-0.56%	11.10%	9.85%
1991	24.20%	7.41%	12.06%	9.67%
1995	36.92%	28.91%	26.79%	23.84%
1996	28.91%	24.94%	21.48%	23.36%
1997	24.94%	18.13%	22.58%	12.72%
1999	27.20%	-4.71%	-5.07%	-8.49%
2003	28.25%	5.31%	3.50%	8.45%
2009	22.68%	14.06%	11.20%	10.86%
2013	29.65%	10.04%	5.01%	8.71%
2017	28.11%	?	?	?
Average	28.34%	12.57%	12.64%	13.19%
Median	27.66%	10.04%	12.06%	12.72%
%Positive		84.62%	92.31%	92.31%

*2-Year & 3-Year Performance Figures are Annualized



Source: Bloomberg, Bahl & Gaynor, 2018

What's Driving the Market?

In reviewing the fundamental backdrop for each of the spans of market strength outlined in the prior section, we note that many periods were characterized by rising corporate profits.

In both instances when equities performed poorly after a strong preceding year, a recession was to blame. In the first instance, the invasion of Kuwait in 1990 bore responsibility for the ensuing downturn. In the second instance, the bursting of the tech bubble in 2000 was the culprit for scuttled continued gains. Internationally-regarded macro research firm, Strategas, notes that the US economy has *never* experienced a recession with corporate profits rising. The graph below indicates healthy corporate profit growth of late among S&P 500 constituents in aggregate. Further, the outlook for corporate profits in 2018 is especially bright given the pace and uniformity of world economic growth accelerated as 2017 progressed and the relief of lower tax rates legislated by Congress just before year-end.

S&P 500 Trailing 12 Month Y/Y Earnings Growth

Source: Bloomberg, Strategas, 2018.

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GDP Growth: Regime Change?

Given the corporate profit growth backdrop, bear in mind that the pace of economic activity following the 2008-2009 financial crisis has been anemic at a +1.5% annualized rate – far below the post-World War II trend closer to +2.9% annually.

Notable academics Reinhart and Rogoff have postulated that the recovery following a recession born of a financial crisis takes much longer to normalize than a more typical inventory recession. In fact, economic growth can be expected to materially lag long-term averages for the better part of a decade before growth converges back in line with the long-term potential output of an economy. Conveniently, 2018 is a decade removed from the most significant stresses of the financial crisis and as the graph below illustrates, sub-par economic growth has finally given way to a pace much more congruent with potential output. We believe there remains considerable slack in the industrial economy as well as in the labor force, implying the ability of the US economy to continue delivery of strong growth.

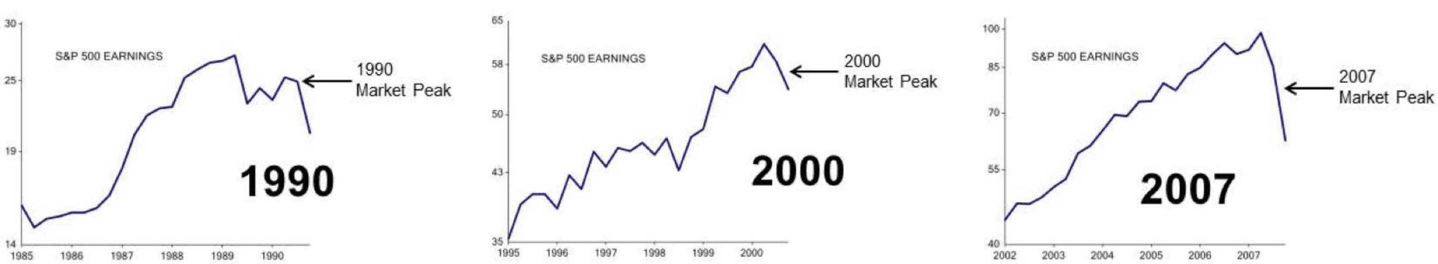
Actual vs. Potential GDP

Source: CBO, BEA, Haver Analytics, Deutsche Bank Global Markets Research, 2018.

Studying the Past: 1990, 2000 and 2007

There is no doubt the current bull market will come to an end.

But the frequently uttered adage "Bull markets don't die of old age" seems appropriate to recall in our present situation. In reviewing past market peaks in 1990, 2000 and 2007, the bull market peaked *after* corporate profits *(pictured below)* rolled over and began to decline.



Source: Bloomberg, ISI, 2018.

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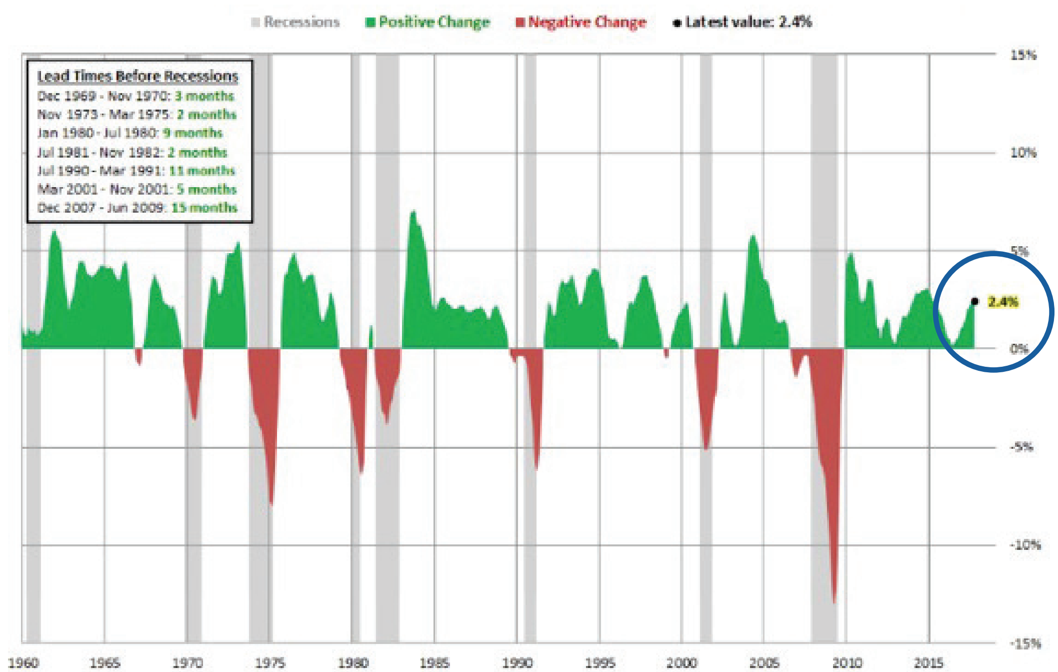
Studying the Past: *Continued*

In the case of the 1990 and 2007 market peaks, the Conference Board of Leading Economic Indicators, a composite of economic indicators believed to foreshadow future growth trend, had peaked about a year in advance of the market top *(also pictured below)*.

Source: Bloomberg, ISI, 2018.

Today, we believe the positive earnings momentum going into 2018, bolstered by tax relief and the continued uptrend among Leading Economic Indicators *(circled below in blue)*, bodes well for another good year of stock price action.

Conference Board Leading Ecomomic Index
Six-Month Moving Average of the Six-Month Rate of Change



Source: Advisor Perspectives, The Conference Board, 2018.

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Caveat

Source: DoD, 2018

Donald Rumsfeld (the former Secretary of Defense under George W. Bush) famously stated the following in one of his press briefings:

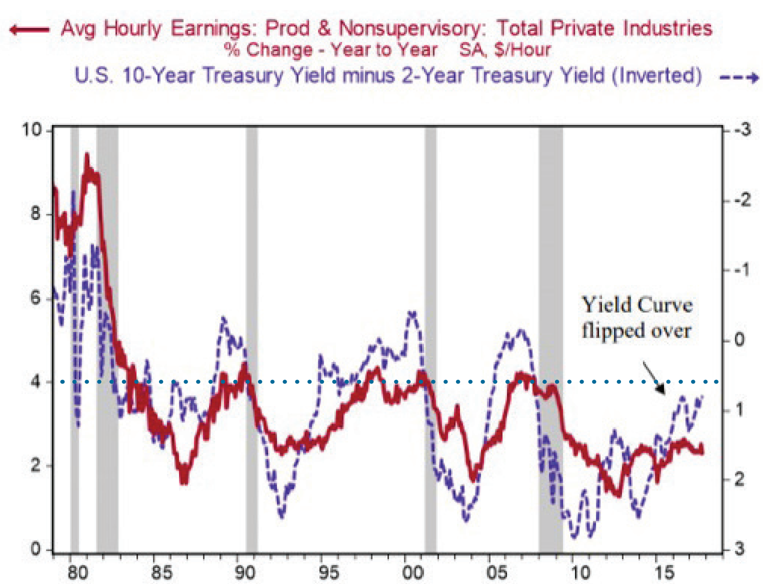
"...[T]here are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know. And if one looks throughout the history of our country and other free countries, it is the latter category that tend to be the difficult ones."

At the time, Rumsfeld was discussing the war in Iraq, but this message is especially applicable to market forecasting. **What we know today leads us to be positive on the market's future prospects.**

As we noted earlier in this letter, a recession has never been observed to occur in the face of rising corporate profits. Recessions have typically resulted from one (or more) of three developments:

1. Rising inflation (which eventually crimps corporate profits);
2. A policy error (either fiscal or monetary in nature), or;
3. An unexpected negative exogenous shock (like an act of terrorism).

What we know we don't know are the future paths of these first two variables. At the present moment, inflation appears tame with average hourly earnings growth well below the +4.0% annual run rate that typically pressures corporate profits *(solid red line pictured in graph below)*, precipitating recessionary pressures.



Source: Bureau of Labor Statistics, Strategas, 2018.

From a policy standpoint, the "baton" appears to have been successfully passed from monetary policy to fiscal policy in the form of receding quantitative easing efforts on the part of the Federal Reserve and a step-up in fiscal stimulus with Congress's passage of the recent tax package.

What we worry about is what we do not know – for example an unexpected negative exogenous shock.

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Conclusion

At Bahl & Gaynor, we invest client capital based on the notion that there are certain elements of a portfolio our investment approach can seek to control: quality, dividend growth profile, strength of competitive advantage. Yet there are other elements of the investment environment over which we exert no influence: interest rates, inflation, economic growth, investor sentiment, exogenous events. We seek to control what we can and therefore emphasize high-quality companies that pay and grow dividends. We also seek to remain fully invested at all times because time in the market, not timing the market, builds wealth. We believe our disciplined investment approach should afford our clients reasonably stable cash flows to support their goals, a favorable risk-adjusted return profile over a full market cycle and a measure of protection from the "unknown unknowns" encountered during those cycles.

Happy New Year

We wish our clients, partners and readers a happy, healthy and prosperous new year and thank you for the opportunity to serve your investment needs.

Sincerely,

William F. Bahl, CFA, CIC | Co-Founder & Chairman
255 East Fifth Street, Suite 2700 | Cincinnati, OH 45202
www.bahl-gaynor.com

Bahl&Gaynor
Investment Counsel

Dividends Pay Dividends®

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