Bahl&Gaynor
Investment Counsel

A letter from

Bahl & Gaynor's Chairman

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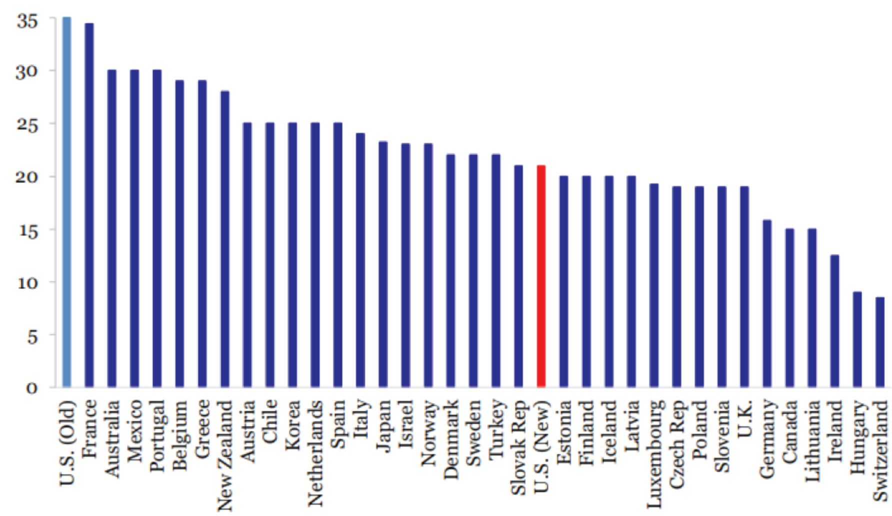
In this issue:

Corporate Tax Reform: Still a Really Big Deal

One of the major objectives of the tax reform bill enacted last year was to bring the US corporate tax rate more in line with the tax rates of other developed countries. The chart below depicts the stark contrast between the old tax rate (on left) vis-à-vis the current rate relative to our trading partners.

2018 Corporate Income Tax Rate



Source: OECD, Strategas, 2018.

While the average effective tax rate for large capitalization companies has declined from 31.8% to 22% (a 31% decline) the impact has been uneven across economic sectors. The capital-intensive Energy sector has benefited meaningfully, largely due to an accelerated depreciation provision in the new tax law. The Technology and Consumer Staples sectors have benefited the least due to their large international operations in localities with still-lower tax rates. Technology, however, benefitted meaningfully from the repatriation of cash held overseas – another effect of the

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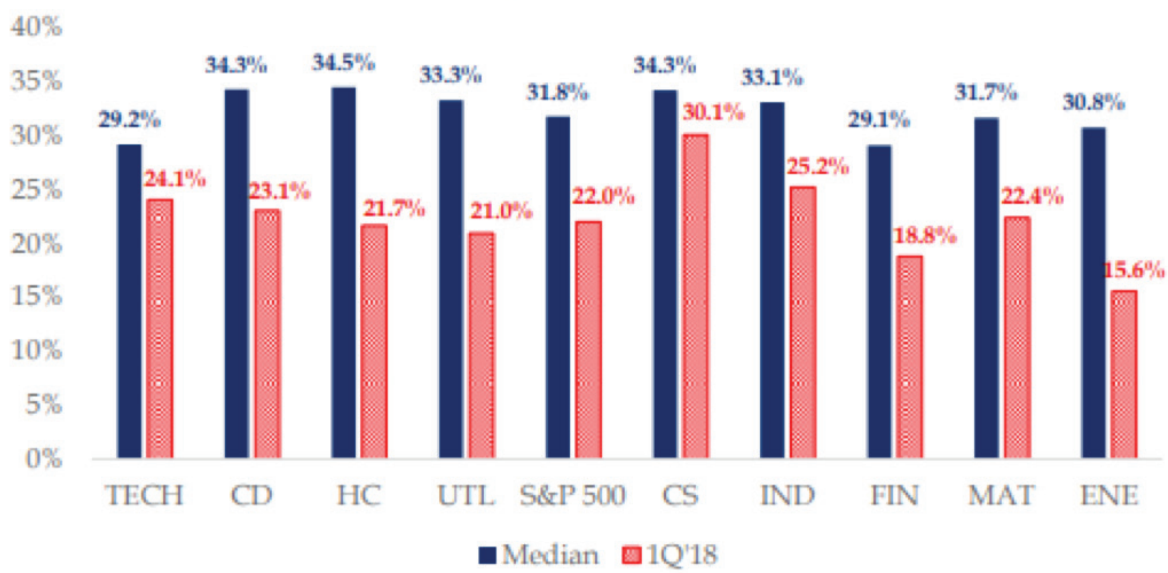
tax reform bill. The chart below illustrates this variability of tax rate change by economic sector.

S&P Median 1Q Tax Rate From '13 to '17 vs. 1Q'18 Tax Rate



Source: Strategas, 2018.

Ironically, since the enactment of the tax law the stock price performance of various sectors has not been highly correlated with the level of benefit received by the reduced US-based tax rate. For example, Energy sector companies have performed poorly and Technology sector companies have performed well.

We believe, however, the benefits bestowed by tax reform have been a principal driver of aggregate stock market performance so far this year and that this performance has far outpaced the predictions of many respected pundits issued at the beginning of the year.

Bahl & Gaynor does acknowledge and appreciate the continuing tone of caution expressed by pundits in the near term. To this point we wish to make a distinction between shorter-term market fluctuations and durable long-term trends.

Cyclical vs. Secular Markets: A Big Difference

In recent weeks there has been a great deal of commentary that the bull market in stocks is now the longest in history. These comments relate to price changes and are generally dated from significant market lows to significant market peaks – in this case from the March 9, 2009 low to present highs. It is interesting to note that, although the secular bull market currently in progress is now the ***longest*** in modern history, it still falls well short of the ***altitude*** achieved in the secular bull market operative from 1990 to 2000 as indicated in the dot plot on the next page.

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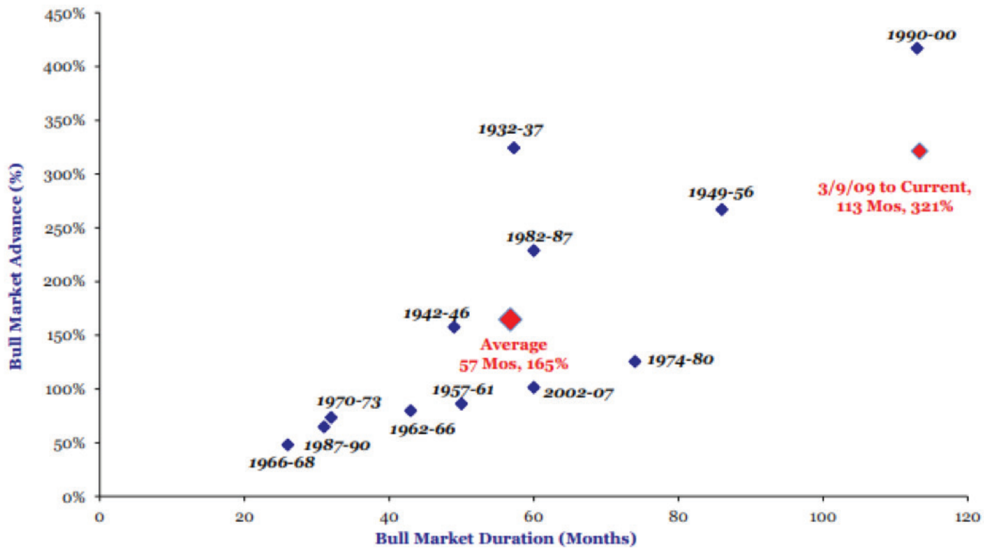
S&P 500 Historical Bull Markets
1928 to Present

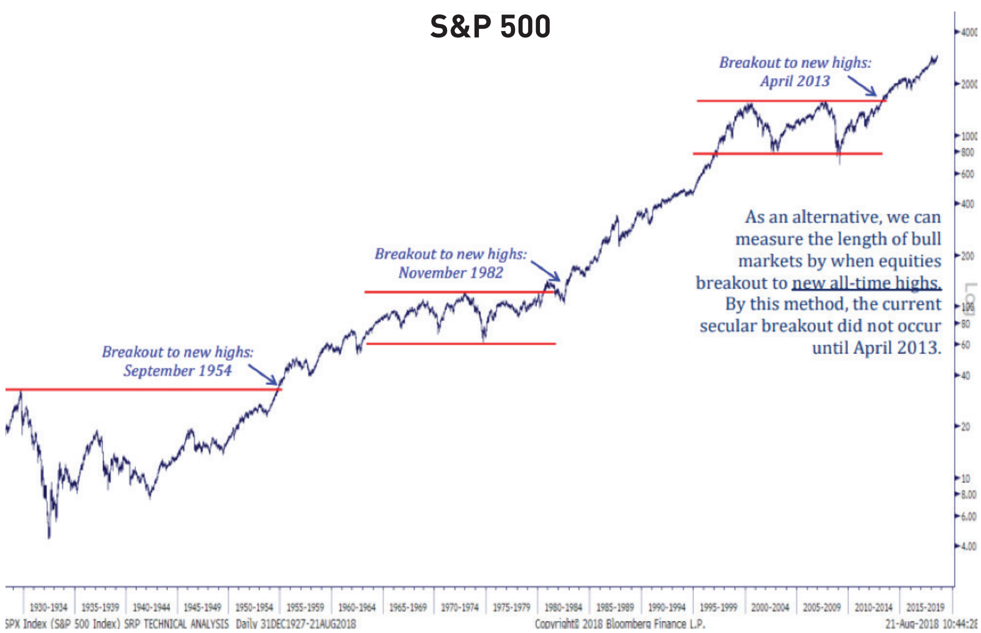


Source: Strategas, 2018.

The current rise in stock prices coincides with what is about to become the longest post-WW II economic expansion. This ***is not to say*** stock prices are on the precipice of a major decline.

We believe it is important to draw a distinction between secular trends and short-term market fluctuations. Secular trends tend to last between 15 and 20 years. Within secular trends there are often many cyclical swings which generally last between six months and two years. Although shorter-lived, these cyclical swings are significant and can be violent (consider the crash of 1987, for example). This can be seen in the chart below which indicates the beginning of the last three secular bull markets (years 1954, 1982 and 2013) with intervening secular bear markets (horizontal channels). Within either secular trend there are many fits and starts. The primary difference between secular bull and bear markets is the presence of "higher highs and higher lows" (secular bull market) and range-bound stock prices (secular bear market).

S&P 500



Source: Standard & Poor's, 2018.

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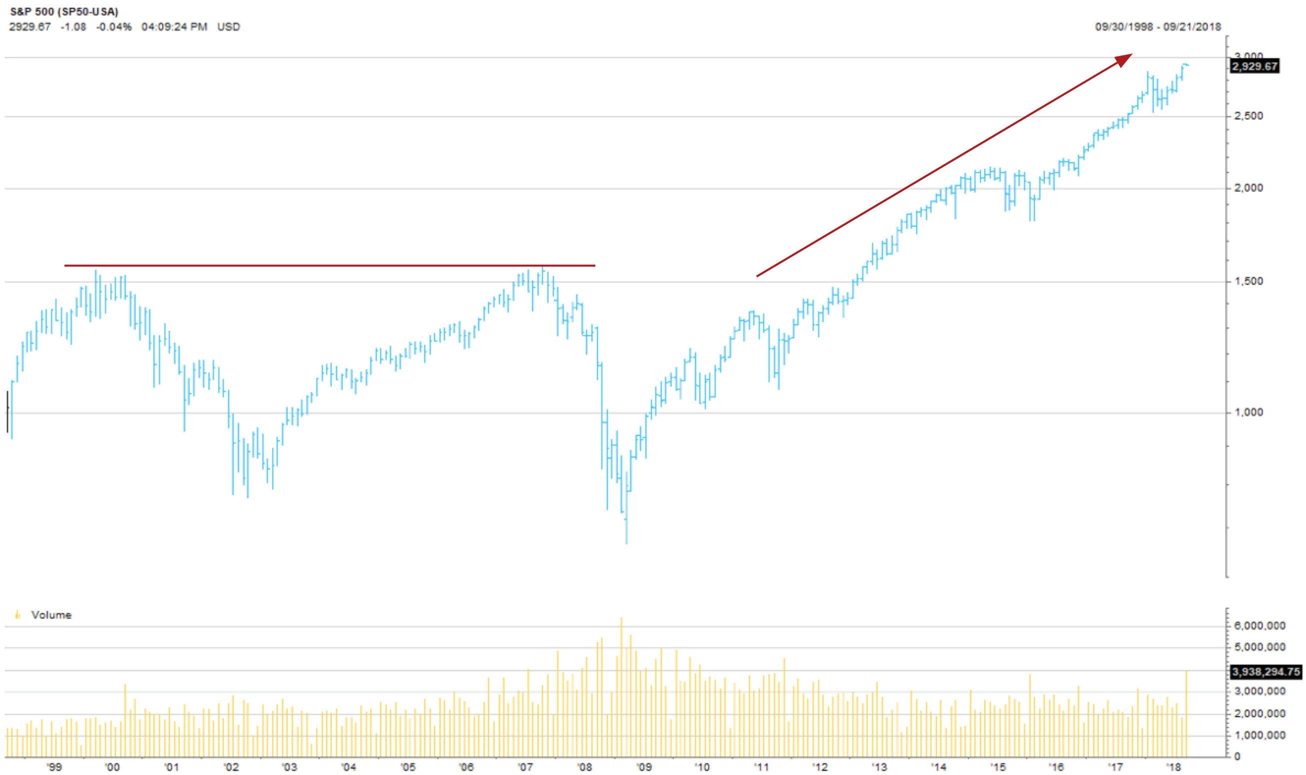
The left-hand portion of the price chart below highlights the secular bear market which began after the demise of the tech boom in 2000 and lasted until a breakout to new highs in 2013. During this period, the S&P 500 made no upward progress from a price perspective for over 10 years. In fact, stock prices fell over 50% twice: first from 2000 to 2002 (tech bust) and then from 2008 to 2009 (global financial crisis).

S&P 500



Source: Factset, 2018.

This aforementioned secular bear market followed the 1982-2000 secular bull market. During this period, the S&P 500 rose almost twelvefold! It is important to note that such a sizeable advance in stock prices was not without some heart-wrenching cyclical bear markets along the way. The most notable decline was the one-day, 23% free-fall in October 1987. A more typical example of a cyclical bear market within a secular bull uptrend was the 1990 correction represented in the graph on the next page. In this instance, equity markets peaked in late-July 1990 and troughed in mid-October of the same year. Broad stock indices fell about 15% but, more importantly, around 80% of constituents in these indices fell by more than 20% – inflicting serious pain on many investors. Keep in mind this cyclical bear market occurred about half-way through the 1982-2000 secular bull market.

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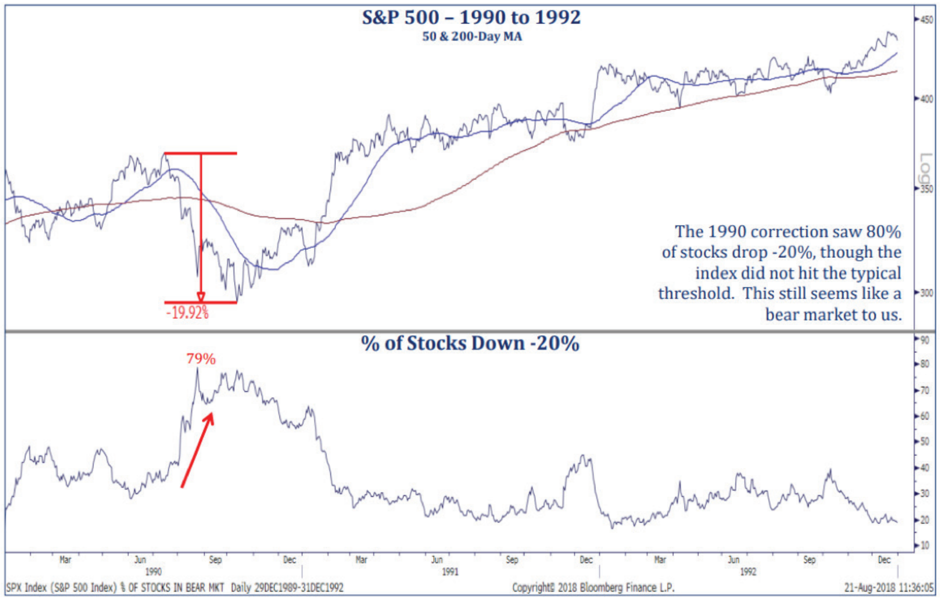
1990 Correction Saw 80% of Stocks Drop -20%

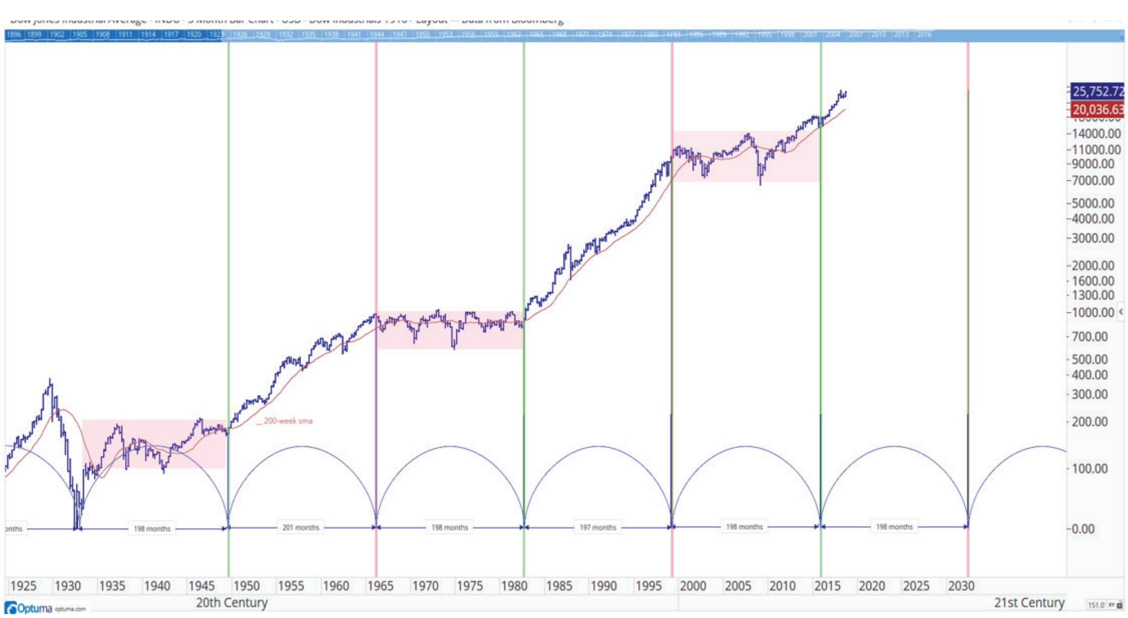


Source: Strategas, 2018.

We believe the most recent secular bear market ended in the first quarter of 2013 when the prior S&P 500 stock price peaks of 2000 and 2007 were decisively exceeded. Since the new secular bull market began, stock prices have doubled in the past 5½ years.

Using the 1954-1966 and 1982-2000 secular bull markets as a guide, these cycles lasted 12 and 18 years, respectively. Prior history would suggest the secular bull market in progress is about mid-way through its overall course. Going back to the mid-1920s, both secular bull and bear markets have lasted approximately 200 months (over 16 years). The graph below suggests we may still be closer to the beginning of this *secular* bull market than its conclusion.

Dow Jones Industrial Average - INDU- 3 Month Bar Chart- USD - Dow Industrials 1910+



Source: Fundstrat, 2018.

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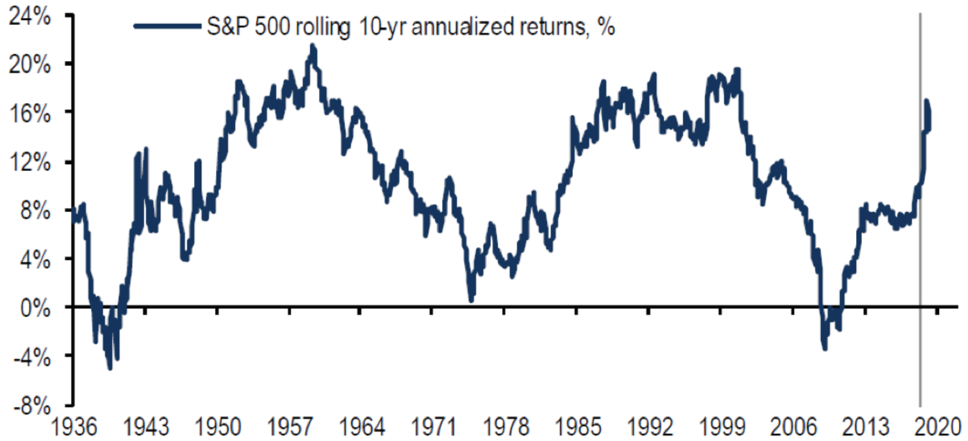
Consider the rolling 10-year annualized return of the S&P 500 below. This plot suggests that stock returns over the past decade since the Great Financial Crisis ended are approaching their historical upper bound (~20% annualized return). This does not imply stock returns for the next 10 years must be negative. Rather, it suggests returns could be either consistently lower or more variable – including possible negative return periods interspersed with positive periods. Thus, the often-observed volatility or cyclical fluctuations within the context of a secular uptrend.

S&P 500 10-year Rolling Return



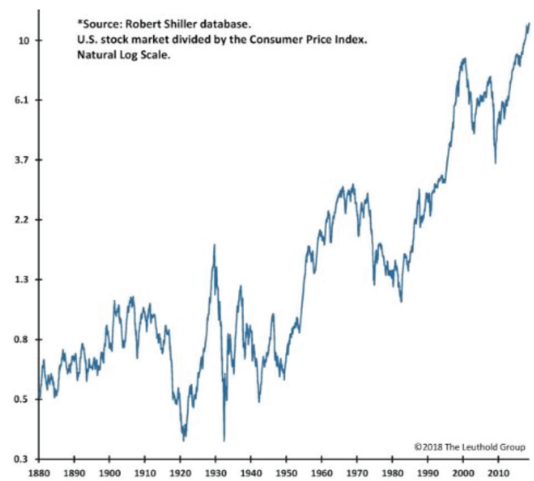
Source: Bank of America/Merrill Lynch, 2018.

So, what is an investor to do?

It should come as no surprise that Bahl & Gaynor's approach to addressing secular and cyclical trends centers upon a continued commitment to stock ownership over long periods of time. One need only look at the chart below to grasp the awesome ability of stocks to grow wealth in ***real*** (inflation-adjusted) terms over the course of more recent recorded history. However, Bahl & Gaynor's philosophy also recognizes the need to manage risk in client portfolios through selectively owning high-quality, dividend-growth stocks. These selections should provide a smoother ride for investors adhering to the approach by emphasizing income generation (important in a world of likely compressing future total returns) and downside protection.

Real Inflation-Adjusted US Stock Market

(1880 to 2018)



Source: Leuthold Group, Robert Shiller database, 2018.

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These qualities, we believe, make it easier to own stocks through the emotionally challenging parts of any secular or cyclical progression, because staying invested is the most important determinant in long-term wealth creation or maintenance. Time in the market, not timing the market, builds wealth.

We thank you for the opportunity to serve your investment needs and we wish everyone an enjoyable autumn.

Sincerely,

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Bahl&Gaynor
Investment Counsel

Dividends Pay Dividends®

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