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Bahl&Gaynor
Investment Counsel

A letter from

Bahl & Gaynor's Chairman

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Co-Founder & Chairman
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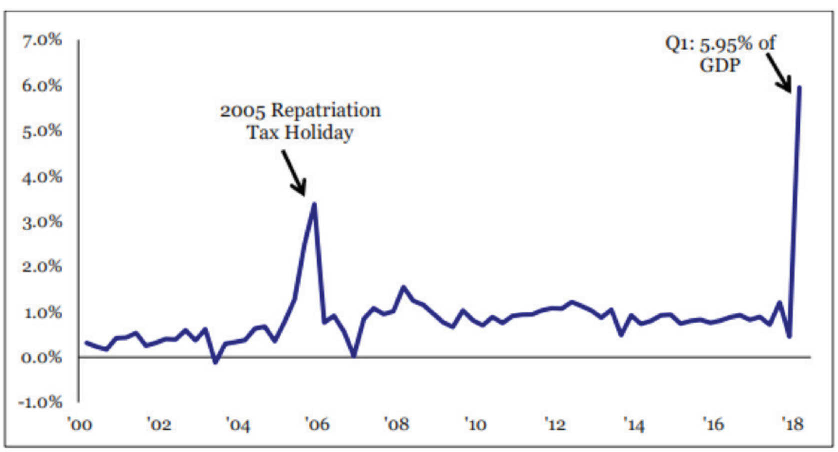
In this issue:

Repatriation Revisited

In our first quarter newsletter, we discussed deemed repatriation and the likely uses of these after-tax funds brought back to the US by domestic multinational companies. We identified five likely uses of this windfall as: 1. paying down outstanding debt; 2. increasing capital spending (capex); 3. engaging in merger and acquisition (M&A) activity; 4. repurchasing common stock, and; 5. increasing dividends.

The chart below illustrates the enormous scale of repatriated funds as a percentage of US Gross Domestic Product (GDP). This cannot be ignored in terms of both the near-term and likely longer-term positive impact on the US economy.

Net Dividends From Foreign Subsidiaries, % of Nominal GDP
(Federal Reserve Board, BEA, SAAR)



Source: Strategas, 2018.

Now six months removed from the enactment of the Tax Cuts and Jobs Act of 2017, investors are beginning to understand how these companies are deploying repatriated funds. In our prior newsletter, we de-emphasized the likelihood of corporate deleveraging due to low interest rates on outstanding debt. Interestingly, debt paydown or reduced debt issuance has been a primary use of repatriated funds thus far. This is corroborated by several large lending institutions posting slower

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lending growth among large corporate clients in the intervening quarter. This somewhat unexpected observation is likely due to the immediate benefits debt repayment imparts on a company relative to the longer-term benefits associated with capital investment projects. Returning capital to shareholders through share repurchases and dividend increases has followed debt paydown in priority. Evidence is beginning to mount that companies are planning to invest larger sums both externally (through M&A) and internally (through capex) as depicted in the two graphs below. While the uptick in capex spending in both cases is not specifically attributable to repatriation or perhaps the lower US corporate tax rate, we are confident there exists at least a modestly positive relationship.

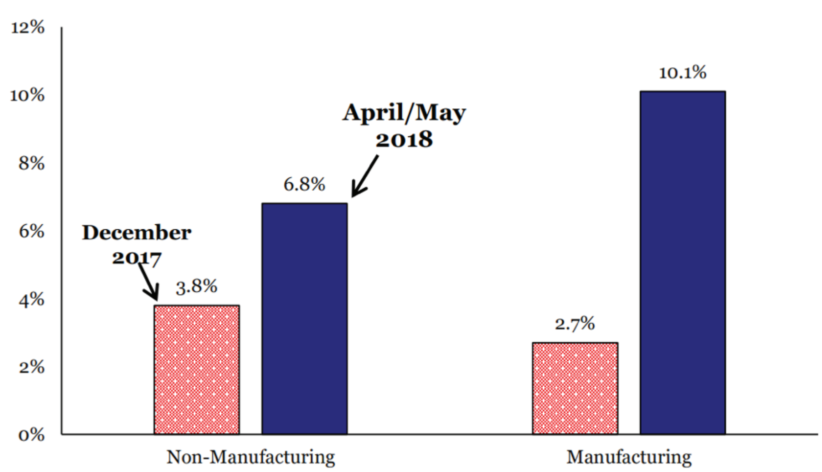
Evercore ISI Company Survey of U.S. Capex Plans

% MORE minus % LESS 2018: +56%

U.S. Nominal Capex Y/Y% (Right Axis) 2017: +5.8%

Source: Evercore ISI, 2018.

ISM Semi-Annual Capital Expenditure Forecasts for 2018



Source: Strategas, 2018.

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There is little doubt share repurchase activity has accelerated since the passage of tax reform. While we have no concrete proof, we believe the "one time" nature of deemed repatriation has exerted more influence on share repurchase activity than on dividends. In fact, there has not been a perceptible increase in the number of special dividends announced so far this year versus last year. Share repurchase activity, however, rose 43% in the first quarter of 2018 versus the first quarter of 2017. Leading the way in this trend is the Information Technology sector with net share repurchases increasing by over $30 billion.

Net Share Repurchases ($MM)

	1Q2017	1Q2018
Information Technology	$21,779	$52,410
Health Care	$30,666	$32,555
Financials	$25,780	$28,935
Industrials	$12,800	$15,389
Consumer Discretionary	$10,525	$14,630
Communication Services	$6,235	$8,257
Energy	-$394	$7,843
Consumer Staples	$9,306	$7,566
Materials	$863	$2,107
Real Estate	-$2,524	$48
Utilities	-$402	-$6,206
S&P 500 Total	**$114,634**	**$163,533**
S&P 500 Percentage (%) Change		***43%***

Source: Jefferies, 2018.

Bahl & Gaynor and other investors continue to expect an accelerated pace of dividend increases into the second half of 2018 supported by both tax reform and overall health of the domestic economy.

Dividends paid in the first quarter of 2018 are nearly flat relative to the fourth quarter of 2017. At first blush, this does not square with the large dividend increases announced thus far in 2018. However, the chart below depicts a predictable seasonality in most years with total first quarter dividends paid registering lower than total dividends paid in the fourth quarter of the prior year. This is attributable to special dividends and companies that pay dividends once annually near year-end. It is noteworthy that total 1Q2018 dividend payments are comparable to the seasonally-heavy 4Q2017 payment period and represents evidence of accelerated dividend distributions from corporations. The pace of annual dividend growth for the S&P 500 in aggregate has accelerated in each of the last three years to over 8% at the end of 1Q2018. Bahl & Gaynor expects this elevated dividend growth rate to continue for the rest of this year.

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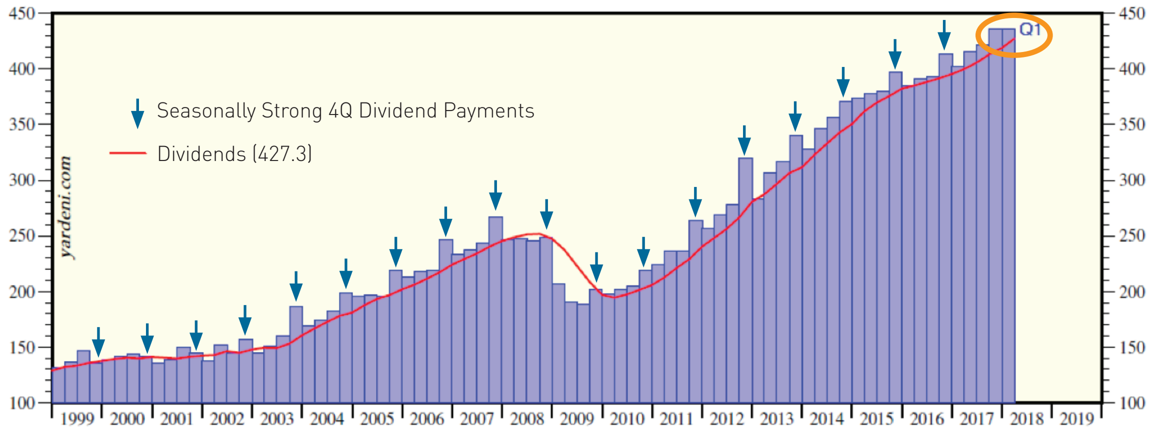
S&P 500 Total Quarterly Dividends Paid



Source: Standard & Poor's, 2018.

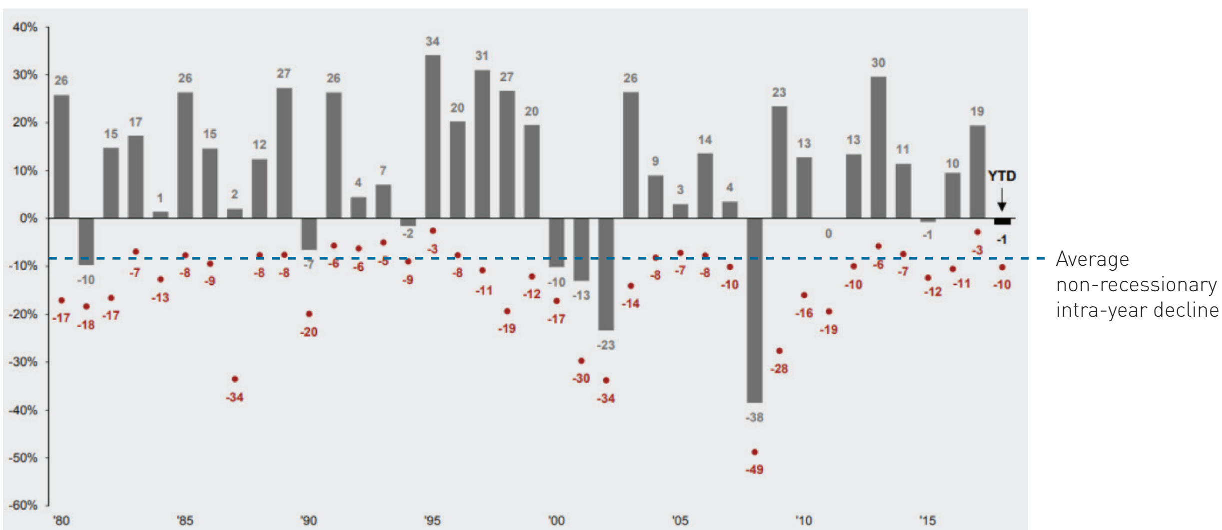
So…Is There a Bear Market on the Horizon?

Paul Samuelson, the first American to win the Nobel Prize in economics, coined the epigram: "The stock market has forecasted nine of the past five recessions." The context of this statement was a broader discussion at the time about the reliability of asset price fluctuations in predicting economic downturns. Samuelson obviously did not have a high opinion of asset prices as an economic indicator.

Earlier this year the market dropped about 10% from its January highs, spawning fears of an economic slowdown or even a recession. The chart below presents 38 years of annual percentage returns for the S&P 500 as of year-end along with the maximum drawdown (peak-to-trough decline) the market experienced in that year. While 2017 was widely heralded as a year of low volatility, it was by no means historically unique. In non-recessionary years, the average annual intra-year market decline is between 9% and 10%.

S&P 500 Intra-Year Declines vs. Calendar Year Returns

Despite average intra-year drops of 13.8%, annual returns positive in 29 of 38 years



Source: Factset, J. P. Morgan Asset Management and Standard & Poor's, 2018.

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While big market declines are often associated with recessions, there are a multitude of fundamental economic factors that likely paint a clearer picture of potential future economic and market dynamics than asset price fluctuations can predict on their own. The dashboard below places current economic conditions in context with the last six US recessions, starting with the 1973 oil crisis.

Fundamental Economic Indicators

Start of Recession	Yield Curve	Inflation Trends	Job Creation	Credit Perform	ISM Mfg.	Earnings Quality	Housing Market
Nov-73	↓	↓	↓	↓	↓	--	↓
Jan-80	↓	↓	↓	↓	↓	--	↓
Jul-81	↓	↑	↑	↓	↓	--	↓
Jul-90	↓	↓	↓	↓	↓	↓	↓
Mar-01	↓	↓	↓	↓	↓	↓	↔
Dec-07	↓	↓	↔	↓	↓	↓	↓
Present	↑	↔	↑	↑	↑	↑	↑

Key: ↓ Recessionary ↑ Expansionary ↔ Neutral

Source: BLS, Census Bureau, Credit Suisse, Federal Reserve, Haver Analytics, ISM, NBER, National Statistics Agencies and Standard & Poor's, 2018.

Some pundits argue that because of the length of the recovery since the financial crisis, we are due for a recession. However, we argue that the confluence of a more business-friendly regulatory environment, lower taxes, repatriated capital and strong economic indicators outlined above suggest a more sanguine environment will prevail into the near future. As such, while volatility has returned to more normal levels versus the last several years, recessionary pressures appear to be further out on the horizon.

As we often state, Bahl & Gaynor's investment philosophy is predicated on long-term ownership of high-quality, dividend-growth companies. While we are attentive to economic and market fluctuations, the success of our approach relies considerably more on variables within our control, like company fundamentals, quality of management and positioning for future dividend growth. We do not seek to predict the ebb and flow of economic or market cycles. We remain confident that our approach is appropriate for the risk-averse investor and look forward to continuing to capitalize on the myriad favorable considerations outlined in this note.

We thank you for the opportunity to serve your investment needs and we wish everyone a wonderful summer.

Sincerely,

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Bahl&Gaynor
Investment Counsel

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Disclosure: