Bahl&Gaynor Investment Counsel

October 2017

3Q 2017 Review and Outlook

In this issue:

"Natural Disasters"

Bahl & Gaynor's thoughts are with all of those impacted directly and indirectly by the most recent Hurricanes Harvey, Irma and Maria. We wish a strong recovery for all people and regions affected.

Source: Houston Transtar, 2017.

Peak Hurricane season has now passed and it came with a tremendous impact on the Southeastern United States and neighboring territories. Hurricane Harvey hit Houston dead-on and has the potential to become the second- costliest Hurricane since WWII. Not two weeks later, Hurricane Irma threatened Miami with a direct hit and raised the potential for the costliest Hurricane season since Katrina in 2005. Incrementally, Hurricane Maria devastated Puerto Rico which was already grappling with a suffocating debt load and underinvested infrastructure prior to the natural disaster.

While there is unquestionably a significant and immediate economic and humanitarian loss from these disasters, we have received many questions regarding their longer-term economic impact.

In this issue, we attempt to answer the following:

- How significant was Harvey? What were the unique aspects of Harvey which created such material losses?
- What is the immediate economic impact to the affected regions? Does Harvey have a national effect?
- What is the impact of these natural disasters on the longer-term economic trajectory?
- How does Bahl & Gaynor view these events in portfolio construction, both in hindsight and going forward?

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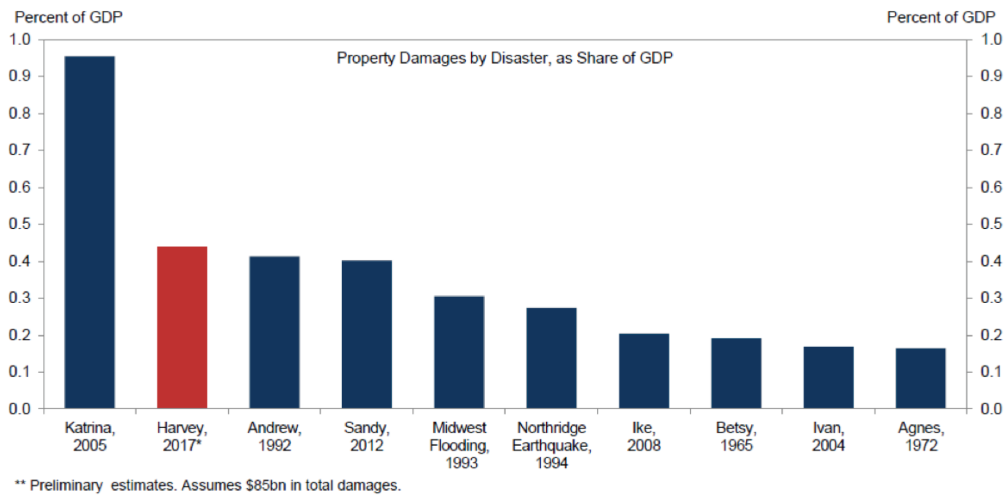
Natural Disasters *Continued*

In summary, Bahl & Gaynor believes there is compelling evidence that displays the resilience of affected regions. From a top-down perspective, economic pressure is localized for the month of the event and the scale of the losses are significant enough to be a temporary headwind to domestic growth. However, a subsequent surge in economic activity which has positive manufacturing, employment and domestic GDP implications is often observed. **From a long-term perspective, Bahl & Gaynor concludes that, while natural disasters are an unfortunate consequence of reality, they do not represent a reason to reduce equity exposure – neither proactively nor reactively. Instead, the tremendous resilience of affected regions serves as a catalyst for growth, which may extend the current economic cycle.**

Harvey: Second Costliest Natural Disaster Since WWII

Estimates of the damage for Hurricane Harvey escalated from $20.0 billion ahead of landfall to approximately $85.0 billion following a direct hit to the city of Houston and surrounding ports.

$85.0 Billion of Damages Put Harvey Only Short of Katrina



Source: National Hurricane Center, Goldman Sachs Global Investment Research, 2017.

Houston had some unique issues that have caused estimates to rise materially. Critically, Houston is the largest US city to have no zoning laws. The "city with no limits" may have reached the limit of its laissez-faire approach to urban planning. The hyper-growth of Houston has resulted in many new communities being placed in designated flood plains or other areas not suitable for weathering a large-scale storm. Incrementally, building over these wetlands with concrete eliminates the natural "shock absorber" for excess water earthen underpinnings would otherwise provide.

Crazy Fact: The Federal Flood Insurance program has paid more than $1.8 million between 1979 and 2015 to rebuild a **single** house in Kingwood, Texas. The house has flooded 22 times over this timeframe!

Source: Wall Street Journal, 538.com, 2017.

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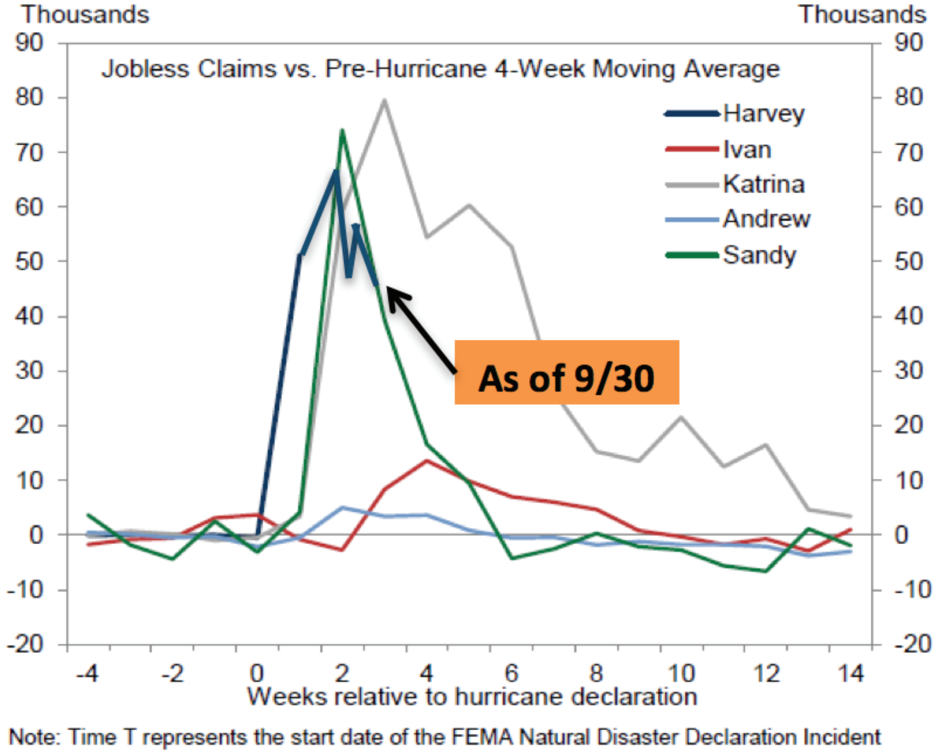
Employment: Surge in Jobless Claims

Harvey's Impact on Employment Following Same Path as Sandy



Source: Department of Labor, Goldman Sachs Global Investment Research, Bahl & Gaynor, 2017.

At Bahl & Gaynor, we do not make light of the humanitarian losses associated with natural disasters. Accompanying these tragic losses are other unfortunate consequences, including immediate and significant localized job loss. There is a high correlation between the damage inflicted by a storm and the severity of job losses. As shown in the chart above, the most significant job losses were associated with Hurricanes Katrina and Sandy. The current path of jobless claims with Harvey closely resembles the path of Sandy with a 70,000 employee surge in jobless claims immediately following the event, with claims gradually receding to pre-Hurricane levels after approximately six weeks. The magnitude of Katrina's devastation is apparent with jobless claims remaining elevated for almost five months!

Refining: Harvey's Uniqueness

Hurricane Harvey was unique in that the Houston region is one of the largest refining centers in the US.

As shown in the picture below, entire ports and refining facilities were taken completely offline in the wake of the storm. In terms of refinery outages due to weather events, Harvey was the largest on record, eclipsing Hurricane Rita from the 2005 season.

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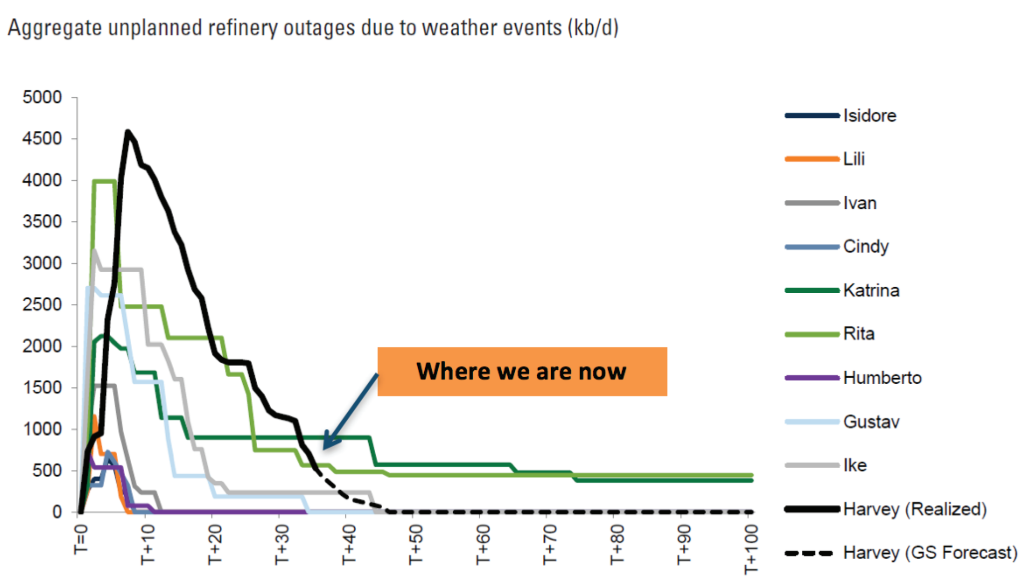
Refining: *Continued*

Source: www.mystock118.com, 2017.

When viewed in a vacuum, the largest unplanned refinery outage in history would theoretically have far-reaching implications. One could postulate such consequences as a nationwide gasoline shortage and skyrocketing prices in concert. But that is not what happened. First, there was excess domestic gasoline supply in storage prior to the storm, which helped buffer the temporary lack of new product. Gasoline prices, on average, increased less than 30 cents per gallon. Second, over 50.0% of the lost refining capacity was back online within three weeks and capacity is expected to be +90.0% recovered within a month of the event. The resilience of US refining infrastructure is incredibly impressive.

Refinery Capacity Nearly Fully Recovered!



Source: Company reports, IRR, ENT, Reuters, Goldman Sachs Global Investment Research, 2017.

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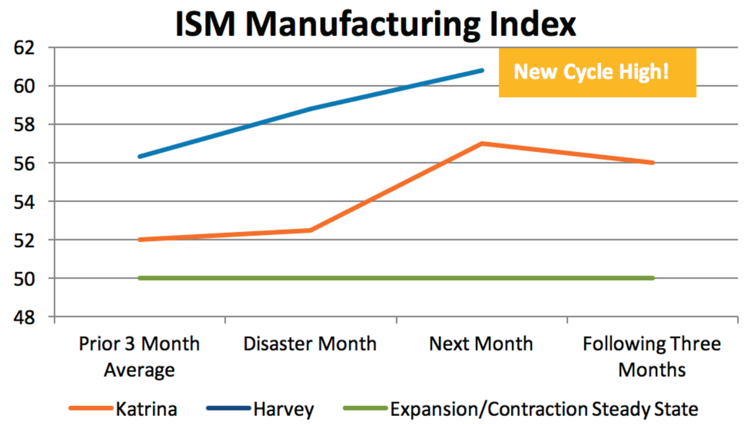
Rebuilding Effort: Resiliency on Display

U.S. Manufacturing Activity Hits Cycle High Post Harvey & Irma

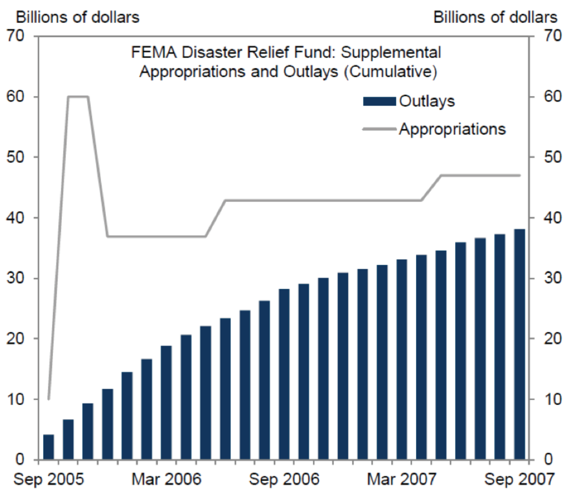


Source: Institute for Supply Management, Bahl & Gaynor, 2017.

Despite popular media clickbait of doom, gloom, gossip and non-sequiturs, the US has been in the midst of a manufacturing boom in FY2017. Heading into August, the ISM Manufacturing Index was at a strong level of 56 which indicates significant expansion (50 is a steady-state balance between growth and contraction). Historically, we have seen an immediate surge in manufacturing following large natural disasters. Katrina demonstrated a surge in manufacturing the following month and that momentum was sustained for an entire year following the event.

Early evidence from Harvey & Irma highlights a significant surge in manufacturing activity from an already very strong base. In fact, the September ISM Manufacturing reading of 60.8 represents a cycle high! Given historical precedent, we expect this positive momentum to continue into the intermediate future. Despite many anecdotal comments of this economic cycle being "long in the tooth," the rebuilding effort will very likely extend the current economic cycle and postpone any recession fears.

Regional Tailwind from FEMA Disaster Relief a Multi-Year Event



Source: Census Bureau, Federal Emergency Management Agency, Goldman Sachs Global Investment Research, 2017.

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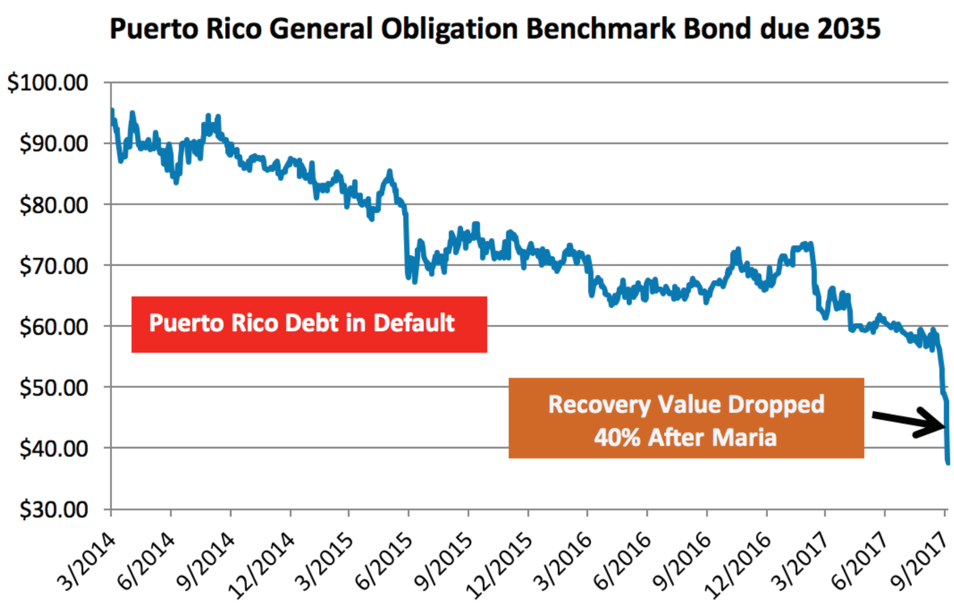
Rebuilding Effort: *Continued*

While the immediate need to rebuild public infrastructure is apparent, the timing and destination of appropriations and outlays for relief are unclear. Surprisingly, the tailwind for these appropriations tends to be years, not months, using Katrina as an example. During Katrina, approximately $50.0 billion of appropriations were designated, but the outlays were methodically distributed over the course of multiple years. Regionally, we should expect to see the same impact in Florida and Texas. Local banks will be flush with deposits and demand for new loans, which will buoy those regional economies in coming years.

All Events Not Created Equal: Puerto Rico Pushed Further Into Distress

Puerto Rico Debt Value Drops 40% Post Maria



Source: Census Bureau, Federal Emergency Management Agency, Goldman Sachs Global Investment Research, 2017.

Puerto Rico, which suffered a direct hit from Hurricane Maria, does not share the same charts of resilience and rising asset prices as regions affected by Harvey and Irma. For countries and regions already operating in financial distress, natural disasters can make recovery efforts even more difficult. Puerto Rico, which was already in default on more than $70.0 billion of debt, has likely seen its access to fresh capital become even more constrained as existing bondholders are faced with ever-escalating losses.

Puerto Rican debt, which was marketed to many individuals as triple tax exempt, now appears more likely to be triply exempt from paying interest, maturing and providing recovery of principal to investors. Given the extent of losses, which are widespread, any new financing will have a materially smaller audience that will demand higher returns. The recovery story in Puerto Rico has become significantly more complicated and will likely be an evolving crisis for the foreseeable future.

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Conclusion

At Bahl & Gaynor, we attempt to "control the controllables." Weather, specifically a natural disaster, is a prime example of something we cannot control. However, as students of the market and managers of client capital, we can learn from prior experiences and make decisions to guard against the worst consequences of unpredictable outcomes.

From our study, we conclude that, while natural disasters are incredibly unfortunate humanitarian events, they do not merit a reduction in portfolio equity exposure. In fact, we believe the case can be made that the resilience and rebuilding efforts of affected regions are likely to extend the current economic cycle and push recession risk further out into the future. Of course there will be company-specific earnings events related to the hurricane season, especially within the insurance industry, but on a portfolio level we do not see risk related to the events.

Revisiting our commitment to "controlling the controllables," Bahl & Gaynor's core principles have not wavered.
The qualities and characteristics we pursue in our investment approach remain:

- Companies and business models with competitive and sustainable moats;
- Management with an "ownership mentality;"
- Proven access to capital;
- Consistent dividend growth;
- Diversification;
- Scrupulous focus on downside protection.

In a word, we continue to define the core of our approach as a focus on "Quality." **Our view remains that a diversified portfolio of high-quality companies that pay, and importantly grow, their dividends is the foundation of a prudent strategy in a world beset by unpredictable environmental factors.**

Disclosure: