Touchstone Dividend Equity Fund

Sub-Advised by: Fort Washington Investment Advisors, Inc.†

U.S. Equity – Large-Cap Value 1Q/2023

Fund Manager Commentary

As of March 31, 2023

Fund Highlights

- U.S. large capitalization companies
- Historically paid consistent, growing dividends
- Distinctive approach is centered on linking valuations with barriers to entry
- Seeks to invest in businesses that are trading below what is believed to be its estimate of the companies' intrinsic value
- Focuses on businesses that are believed to have a sustainable competitive advantage or a high barrier to entry in place

Market Recap

The hallmark of the first quarter was volatility. In January, markets were sanguine about growth, inflation, and future U.S. Federal Reserve Board (Fed) rate hikes. This calm was upended in February by strong economic data, highlighted by a blowout jobs report and firm inflation readings. Interest rates rose sharply and credit spreads widened as markets built in more Fed tightening and increasing concerns over a future recession. In March, the failure of Silicon Valley Bank and Signature Bank, and the forced merger of Credit Suisse Group AG and UBS Group AG shifted the narrative to strains within the U.S. financial system (especially in regional banks) that could create a negative feedback loop for the broader economy. Interest rates fell sharply and credit spreads widened further as future prospects were reassessed. Policymakers stepped in to limit immediate systemic risk, but the tightening in credit conditions because of these events is likely to negatively affect growth over coming quarters. Recession risk is elevated and expectations for the path of the Fed funds rate has fallen sharply to end the quarter.

Amid this volatility and stress in the banking sector, consumer spending thus far has remained resilient. The labor market continued to post healthy job gains and wage growth in the first quarter. Solid consumer income, supplemented by excess savings from pandemic-era programs, supports growth, but there is risk to the downside as the cumulative effect of Fed tightening is felt and banks further constrain credit in the economy.

The outlook for business spending is also challenged. Manufacturing surveys have been consistently weak for the past several months, indicating near-zero growth. The service sector is relatively strong when compared to manufacturing, but overall spending is expected to continue trending lower. Global growth has surprised to the upside, providing somewhat of a positive offset. Europe avoided a recession amid a mild winter and the outlook for China is brighter as they reopen from COVID restrictions. Importantly, inventories are plentiful and supply chains have largely normalized, removing barriers that affected businesses for several quarters. In addition, normalizing supply chains result in lower downstream inflation pressures to consumer goods.

In late 2022, inflation readings showed convincing deceleration for both headline and core inflation. Data released in January, combined with revisions to prior data, indicated the deceleration was less impressive than previously thought. Although good prices, inflation continued to move lower, sticky components of inflation, (including shelter costs) showed little signs of improvement. In addition, strength in the labor market heightened concern that inflation that is correlated to wages would remain firm. After raising rates 25 basis points (bps) at the February Federal Open Market Committee (FOMC) meeting, the Fed also indicated that interest rates may have to rise further than previously thought, prompting Treasury yields to rise sharply.

In March, stress in the banking system caused a reversal of these higher expectations of the Fed funds rates. Ultimately, the path of growth and inflation will drive the Fed. Recession concerns are elevated, and there are encouraging signs that inflation will fall further, supporting a lower path of rates. Goods price inflation is firmly on a downward trajectory. Shelter costs are a key driver of service inflation, and forward-looking data on the rental market indicates a gradual return to pre-COVID trends. As the economy slows further, the cyclical components of inflation will recede. All together, these factors are likely to result in inflation slowing on a trajectory to hit the Fed's target in 2024. In our view, the downside risk of recent events, combined with lower inflation, will continue to put downward pressure on rates in 2023.

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Performance data quoted represents past performance, which is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than performance data given. ***For performance information current to the most recent month-end, visit TouchstoneInvestments.com/mutual-funds.***

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Returns for most asset classes were positive in the first quarter. The breadth of the U.S. equities market in the first quarter was unusually narrow, with the top 10 names accounting for vast majority of the return. These names were predominately growth-oriented, non-dividend paying names.

Equity valuations remain fair relative to history, but are not pricing in the increased chance of recession. Earnings expectation shave also adjusted lower, but remain at risk to fall further should a recession materialize.

Portfolio Review

The Touchstone Dividend Equity Fund (Class A Shares Load-Waived) underperformed its benchmark, the Russell 1000® Value Index for the quarter ended March 31, 2023.

The Fund's relative performance was primarily driven by negative security selection and dividend style while sector allocation was a positive to relative performance. Non-dividend paying stocks within the Russell 1000® Value Index significantly outperformed dividend-paying stocks. This detracted from relative performance for the quarter.

Stock performance within Communication Services, Industrials, Consumer Discretionary and Information Technology (IT) sectors were the primary drivers of negative security selection. Energy was the only sector with positive security selection during the quarter.

An overweight allocation to IT was the primary driver of positive sector allocation. IT outperformed as higher growth, long duration stocks outperformed amid falling interest rates and outperformance of growth stocks.

The largest individual contributors to relative performance were overweight positions in Microsoft Corp. (Information Technology sector), Apple Inc. (Information Technology sector), Oracle Corp. (Information Technology sector), Broadcom Inc. (Information Technology sector), and Qualcomm Inc. (Information Technology sector).

The top 5 contributors to relative performance were all IT companies with a growth orientation. These stocks benefitted as investors boosted growth stocks following broad underperformance in 2022.

More specifically, Microsoft outperformed primarily due to strong fiscal second quarter results where the company outperformed on the top and bottom lines mainly driven by better than expected results in its Azure business.

The largest detractors from performance were underweight exposures to Meta Platforms Inc. (Communication Services sector) and Salesforce Inc. (Information Technology sector). Overweight exposures to Dollar General Corp. (Consumer Staples sector), UnitedHealth Group Inc. (Health Care sector), and CVS Health Corp. (Health Care sector).

Meta shares outperformed based on quarterly results that exceeded expectations, the announcement of more share buyback authorization, and the pullback in interest rates during the quarter. Meta does not pay a dividend so was not owned within the Fund.

Salesforce shares outperformed after the company reported significant upside to revenue and profitability during its fiscal fourth quarter and issued favorable margin guidance and buyback authorization. Salesforce does not pay a dividend so was not owned within the Fund.

UnitedHealth Group's underperformance in the quarter was largely due to nervousness around Medicare Advantage rate updates for 2024. However, final rates published early in the second quarter included a 3-year phase-in of one of the key drivers, which made the 2024 rate cut more manageable.

There were two new positions added to the Fund and one removed during the quarter. The Fund initiated positions in Accenture plc (Information Technology sector) and Micron Technology Inc. (Information Technology sector) and sold Deere & Company (Industrials sector).

The Fund initiated a modest position in Accenture, the largest IT services (consulting & outsourcing) provider in the world. Accenture is a moderate barrier to entry business based on economies of scale in distribution and delivery of consulting and IT services and switching costs in IT and business process outsourcing. The company has consistently increased market share over the past decade with significant free cash flow and ~40% returns on invested capital. They pay an average dividend of 1.70% with above average dividend growth of ~10% over the past 10 years. They maintain a robust capital allocation framework averaging ~40% dividend payout over the past 10 years with a similar amount of buybacks. Valuation presented a compelling entry point as the stock has been depressed due a potential slowdown in IT spending because of economic concerns.

The second position added to the Fund during the quarter was Micron. Micron is a leading supplier and manufacturer of memory and storage components. The company maintains high barriers to entry in their memory business DRAM, over 70% of revenue) based on economies of scale in manufacturing and Research & Development. The memory industry is an oligopoly protected by high barriers to entry, with the cumulative market share of the top three companies exceeding 92% (Micron has ~23% share). Micron has a solid balance sheet with cash exceeding debt and no significant debt maturities until 2025 along with high single digit returns on invested capital. Although Micron pays a below average dividend yield of 0.8%, they have ample capacity to increase it with a payout averaging only 10% and policy of 50% payout via dividends and share buybacks. Valuation presented an opportunity to add the name as industry overcapacity in both DRAM and NAND has resulted in depressed revenues and margins, but production cuts and significant reductions in capital expenditures across the memory industry should restore supply/demand balance.

The Fund exited its position in Deere & Company (Industrials sector) during the quarter. Deere had outperformed the broader Industrial sector by over 100% since the end of 2019, and its valuation became stretched as result. As economic growth is set to slow, the cyclical nature of the business puts it at risk for meaningful downside. Based on the limited margin of safety and poor risk/reward for the cyclical business, the Fund eliminated the entire position.

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Sector changes were largely the result of GICS reclassifications during the quarter. For example, the Financials and Industrials sector exposure increased while the Fund's IT sector allocation decreased as result of Visa Inc. moving to Financials and Automatic Data Processing Inc. and Paychex Inc. moving to the Industrials sector. Similarly, Consumer Staples sector exposure increased while the Consumer Discretionary sector decreased as Dollar General and Target Corp. moved from Discretionary to Staples.

Outlook and Conclusion

Looking ahead, the big question is whether the economy will remain resilient to Fed tightening or whether problems with regional banks will result in credit being curtailed, which would increase the risk of recession. The answer hinges, in part, on whether the problems are confined to a small group of banks or are more widespread following the collapse of Silicon Valley Bank (SVB).

As problems spread to other regional banks, however, there was concern that the bank run could spread. The Treasury, Fed and FDIC responded by taking actions to protect the financial system. They include protecting all deposits of SVB and Signature Bank and establishing a program that allows banks to swap Treasuries and mortgage-backed securities at par values for cash. These actions did not calm markets, however, because investors did not believe there was a blanket guarantee on all bank deposits.

In general, the more exposed banks are to interest rate risk, the more likely they are to curtail their lending. Small banks provide credit to many smaller businesses and start-ups that do not have access to larger banks, and also play an important role in funding commercial real estate. They had been expanding credit at a double digit pace over the past year. Meanwhile, large commercial banks have been tightening credit standards over the same period, which shows up in the Fed's survey of senior loan officers.

Faced with this predicament, the Fed opted to raise the funds rate by 25 bps to 4.75%-5.0% at the March FOMC meeting. The press release stated that "additional policy firming may be appropriate," but the Fed did not commit to a future course of action and it acknowledged credit could become tighter.

The basis for its decision is that inflation is still well above the Fed's 2% target while the labor market continues to be tight, with unemployment at 3.6% and the latest Job Openings and Labor Turnover Survey showing there are 1.8 openings for each available worker. Also, the Fed maintains that financial stability is not at risk, because the largest institutions are both well capitalized and liquid, which makes them less vulnerable to runs.

That said, while the Fed left the door open for another 25 bps rate hike, it could pause if the concerns about the banking system persist. By comparison, bond investors are more optimistic that inflation will come down significantly and they are more concerned about problems in the banking sector. Accordingly, the bond market is pricing in that the federal funds will end the year at about 4.25%, well below the consensus view of the FOMC of 5.125%.

Within the portfolio, we are maintaining a cautious stance but are selectively finding bottom-up opportunities. Valuations have adjusted to more normalized levels and earnings expectations have fallen, but continued slowing in economic growth will weigh on both valuations and earnings. We are prioritizing high barrier to entry companies with high returns on capital.

Although risks have risen, valuations have adjusted to reasonable levels and the long-term economic outlook is still promising. As such, we remain constructive on U.S. equities but acknowledge near-term headwinds exist. As investors seek to avoid the risks of inflation, higher interest rates, and recession, dividend strategies are a compelling option. Dividend strategies have the potential to provide both capital appreciation and a growing stream of income while also providing downside protection through lower volatility during times of distress, as evidenced by returns last year.

As of March 31, 2023, Microsoft Corp. made up 4.00%, Apple Inc. made up 2.14%, Oracle Corp. made up 2.43%, Broadcom Inc. made up 2.03%, Qualcomm Inc. made up 1.89%, Dollar General Corp. made up 1.14%, UnitedHealth Group Inc. made up 1.63%, CVS Health Corp. made up 1.22%, Accenture plc made up 0.51%, Micron Technology Inc. made up 0.48%, Visa Inc. made up 2.22%, Automatic Data Processing Inc. made up 1.01%, Paychex Inc. made up 1.02%, Target Corp. made up 1.12%, Silicon Valley Bank, Signature Bank, Credit Suisse Group AG and UBS Group AG made up 0.00% of the Touchstone Dividend Equity Fund. Current and future portfolio holdings are subject to change.

Fund Facts *(As of 03/31/23)*

Class	Inception Date	Symbol	CUSIP	Annual Fund Operating Expense Ratio*	
				Total	Net
A Shares	06/08/98	**TQCAX**	89155T482	1.00%	0.99%
C Shares	06/08/98	**TQCCX**	89155T474	1.76%	1.69%
Y Shares	05/15/13	**TQCYX**	89155T466	0.74%	0.74%
INST Shares	07/19/21	**TQCIX**	89155T458	1.80%	0.67%
R6 Shares	08/02/21	**TQCRX**	89155T441	1.76%	0.65%
Total Fund Assets	**$2.7 Billion**				

**Expense ratio is annualized. Data as of the current prospectus. Touchstone Advisors has contractually agreed to waive a portion of its fees and/or reimburse certain Fund expenses in order to limit certain annual fund operating expenses (excluding Acquired Fund Fees and Expenses "AFFE," and other expenses, if any) to 0.99% for Class A Shares, 1.69% for Class C Shares, 0.77% for Class Y Shares, 0.67% for Class INST Shares and 0.65% for Class R6 Shares. These expense limitations will remain in effect until at least 01/29/24.*

Share class availability differs by firm.

Annualized Total Returns *(As of 03/31/23)*

	1Q23	YTD	1 Year	3 Year	5 Year	10 Year	Inception
Excluding Max Sales Charge							
A Shares	0.56%	0.56%	-3.56%	13.39%	3.68%	7.51%	6.72%
C Shares	0.37%	0.37%	-4.21%	12.62%	2.99%	6.80%	6.03%
Y Shares	0.62%	0.62%	-3.33%	13.63%	3.91%	—	7.25%
INST Shares	0.63%	0.63%	-3.26%	—	—	—	2.14%
R6 Shares	0.58%	0.58%	-3.23%	—	—	—	1.07%
Benchmark^	1.01%	1.01%	-5.91%	17.93%	7.50%	9.13%	—
Including Max Sales Charge							
A Shares	-4.46%	-4.46%	-8.37%	11.18%	2.46%	6.87%	6.47%
C Shares	-0.63%	-0.63%	-5.12%	12.62%	2.99%	6.80%	6.03%

Max 5.00% sales charge for Class A Shares and 1% Contingent Deferred Sales Charge for Class C Shares held less than 1 year.

^Benchmark - Russell 1000® Value Index[1]

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[1]The Russell 1000® Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower expected growth values.

The indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible. Unmanaged index returns do not reflect any fees, expenses or sales charges.

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A Word About Risk

The Fund invests in equities which are subject to market volatility and loss. The Fund invests in stocks of large-cap companies which may be unable to respond quickly to new competitive challenges. The Fund invests in dividend-paying companies. There is no guarantee that the companies in which the Fund invests will declare dividends in the future or that dividends, if declared, will remain at current levels or increase over time. Securities that pay dividends may be sensitive to changes in interest rates, and as interest rates rise or fall, the prices of such securities may fall. The Adviser engages a sub-adviser to make investment decisions for the Fund's portfolio; it may be unable to identify and retain a sub-adviser who achieves superior investment returns relative to other similar sub-advisers. Events in the U.S. and global financial markets, including actions taken to stimulate or stabilize economic growth may at times result in unusually high market volatility, which could negatively impact Fund performance and cause it to experience illiquidity, shareholder redemptions, or other potentially adverse effects. Banks and financial services companies could suffer losses if interest rates rise or economic conditions deteriorate. The Fund invests in value stocks which may not appreciate in value as anticipated or may experience a decline in value. Current and future portfolio holdings are subject to change.

Please consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. The prospectus and the summary prospectus contain this and other information about the Fund. To obtain a prospectus or a summary prospectus, contact your financial professional or download and/or request one at TouchstoneInvestments.com/resources or call Touchstone at 800.638.8194. Please read the prospectus and/or summary prospectus carefully before investing.

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