Touchstone Large Cap Fund

Sub-Advised by: The London Company

U.S. Equity – Large-Cap Core 3Q/2022

Fund Manager Commentary

As of September 30, 2022

Fund Highlights

- Utilizes a bottom-up security selection process that screens potential investments against a proprietary quantitative model for return on capital, earnings to value ratio, free cash flow and return on equity
- Looks at a company's corporate governance structure and management incentives to try to ascertain whether or not management's interests are aligned with shareholder interests
- Seeks to identify the sources of a company's competitive advantage as well as what levers management has at its disposal to increase shareholder value
- Seeks to purchase generally profitable, financially stable large-cap companies that consistently generate high returns on unleveraged operating capital, are run by shareholder-oriented management, and are trading at a discount to their private market value

Market Recap

U.S. stocks traded lower during third quarter 2022 reflecting various concerns that have negatively affected the equity market all year including rising interest rates, high inflation, and geopolitical risk. The quarter started strong as declining commodity prices and some improvement in the broader inflation data led to a relief rally. However, stocks reversed course later in the quarter as the U.S. Federal Reserve Board (Fed) ratcheted up its more hawkish commentary and made it clear that it intended to continue raising interest rates and would maintain higher rates as long as needed to combat inflation. The U.S. dollar rose in value versus almost every other currency and bond yields moved higher. The yield curve remained inverted at the end of the quarter.

Stocks traded lower across the market cap spectrum, but those of smaller companies outperformed. Growth outperformed Value across the board, and cyclical stocks outperformed more defensive companies.

Turning to factors that affected individual stocks during the quarter, Volatility factors had a positive impact, while Growth factors had a neutral impact. Value, Yield, and Quality factors mostly presented headwinds. Momentum factors had a mixed impact.

Most of the data released during the quarter pointed to deceleration in the economy. That is not surprising considering the level of inflation and higher interest rates. Affordability challenges likely weighed on the sale of large ticket items, while consumer spending continued to rebalance more toward services. Housing data has weakened all year as mortgage rates reached close to 7% by the end of the quarter. Existing home sales declined for seven consecutive months while housing permits weakened as well.

One source of relative strength in the economic data has been the U.S. consumer. Personal balance sheets remain in good shape, buffered by savings accumulated during the pandemic. Unemployment remains low and wages are rising, which could lead to solid spending in the future. However, there is evidence that consumers are cutting back in some areas and trading down as well, reflecting the erosion of purchasing power from high inflation.

After showing some signs of moderation in recent months, inflation readings are still higher than the Fed desires. In the latest monthly reading, the consumer price index (CPI) rose 0.1% month-over-month (m/m) with year-over-year (y/y) growth of 8.3%. Core CPI, excluding food and energy, posted a 6.3% y/y increase. The Fed's preferred inflation measure, the Personal Consumption Expenditures Price Index (PCE) deflator, rose 0.3% m/m, while posting a 6.2% y/y increase. Core PCE inflation rose 4.9% y/y and remains higher than desired by the Fed (inflation goal remains roughly 2%). The longer-term risk is sustained inflation could lead to higher expected inflation in the years ahead, which could be a challenge for the Fed.

While inflation clearly remains elevated, there are some longer-term signs of deceleration. Import prices are declining, energy prices have come down, and supply chain pressures have eased according to the NY Fed's Global Supply Chain Pressure Index. Most importantly, longer-term inflation expectations appear anchored at roughly 2-3%.

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The labor market remains strong and the U.S. economy added over 1 million net new jobs during the quarter. The number of net new jobs showed deceleration in each month of the quarter, but the U3 unemployment rate declined a bit to end the quarter at 3.5%. The labor force participation rate ended the quarter at 62.3%. Average hourly earnings continued to increase at a mid-single digit rate. Looking ahead, we believe that the unemployment rate will likely move higher as economic growth may decelerate reflecting higher interest rates.

The survey data weakened a bit during the quarter, but still points toward economic expansion. In its latest reading, the ISM Manufacturing Index declined to 50.9 led by weakness in new orders and employment. On a positive note, supply chain disruptions continued to trend in a positive direction. The ISM Services Index declined slightly to 56.7. Any reading over 50 in the surveys suggests economic expansion.

In terms of fiscal policy, the Inflation Reduction Act passed during August. The new law focuses on climate initiatives and improvements in healthcare (expanding coverage while lowering prescription drug prices), financed by a new alternative minimum tax for corporations as well as a tax on net share buybacks.

With regard to monetary policy, a strong labor market combined with high inflation resulted in a shift toward tighter monetary policy earlier in the year from the Fed. The Fed began to raise rates in March with a 25 basis points (bps) rate increase, followed by a 50bps increase in May, and then three consecutive increases of 75bps in June, July, and September. Following the September increase, the target for the funds rate is now 3.0%-3.25%. Separately, the Fed began reducing the size of its balance sheet in June via Quantitative Tightening, which should continue, and may add upward pressure to longer-term interest rates. The futures market assumes that the Fed funds rate will reach roughly 4.5% by the end of 2022, which is consistent with the latest dot plots from the Fed.

The yield curve remains inverted as longer-term treasuries point to expectations of either weak economic growth, lower inflation, or a Fed pivot; while short-term rates reflect the Fed's attempts to curb the rate of inflation and balance the tight labor market. An inverted yield curve is often a sign of a pending recession and the consensus of many economists places the odds of a recession at roughly 50% over the next 12-18 months.

Portfolio Review

The Touchstone Large Cap Fund (Class A Shares Load-Waived) outperformed its benchmark, the Russell 1000® Index, for the quarter ended September 30, 2022.

The Consumer Discretionary and Energy sectors led the benchmark, while Communication Services and Real Estate were weak. Turning to attribution for the quarter, stock selection was a tailwind partially offset by the impact of sector allocation. At the sector level, an underweight position in Energy had a negative impact on relative performance, partially offset by the positive impact of an underweight position in Information Technology.

Turning to stock selection, the best performing stocks based on relative performance vs. the benchmark during the quarter were STORE Capital Corp. (Real Estate sector), O'Reilly Automotive Inc. (Consumer Discretionary sector), The Charles Schwab Corp. (Financials sector), Martin Marietta Materials Inc. (Materials sector), and Fiserv Inc. (Information Technology sector). STORE Capital rallied after announcing the potential acquisition of the company by two private equity firms for $32.25 per share. The deal is anticipated to close in early 2023.

O'Reilly Automotive outperformed during the quarter led by share gains and the recovery in its Pro customers. Auto parts stocks have historically outperformed when consumers experienced higher inflation. However, lapping stimulus payments and the severity of winter weather along with the delay in spring weather impacted ticket count. O'Reilly remains the gold standard for service, parts availability, and logistics in this industry. The average age of cars on the road continues to rise and is now in the sweet spot for auto repairs and failures. O'Reilly has a strong balance sheet and recent insider buying activity has been favorable.

Charles Schwab held up well despite the volatility in the market, as the company is a net beneficiary of rising rates through their banking arm. Client cash sorting also came in lower than expected. We still like the company for its strong competitive positioning and the prospects for better monetizing on client assets going forward.

Martin Marietta benefitted from a strong pricing environment, which will continue to drive earnings growth in the near-term. The majority of Martin Marietta's demand is tied to infrastructure and commercial spending, and higher pricing should help offset cost inflation as well as any private sector construction weakness. Results showed underlying demand trends remain strong and the new infrastructure package increases highway funding and provides greater visibility into future demand for aggregates. Martin Marietta's leadership position and exposure to financially healthy states gives us confidence that it will continue to benefit from infrastructure growth for many years.

Fiserv held up well in third quarter as the company's diversified business model appears well positioned to navigate a potential downturn. The company reported strong second quarter results and raised guidance for the remainder of the year. Growth in Merchant Acceptance was driven by strength in its Clover platform and e-commerce share gains, while the Fintech and Payments segments (~60% of revenue) continue to provide stability and recurring revenue. We remain confident in the company's ability to generate durable earnings growth through its robust product offerings and disciplined capital allocation.

The more challenged positions based on relative performance during the quarter were FedEx Corp. (Industrials sector), Alphabet Inc. (Communication Services sector), CarMax Inc. (Consumer Discretionary sector), Church & Dwight Company Inc. (Consumer Staples sector), and Verizon Communications Inc. (Communication Services sector).

FedEx underperformed late in the quarter after the company significantly lowered guidance reflecting declining global shipping activity, as well as capacity issues in Asia and service problems in Europe. As a result, the company enacted an extensive multi-year restructuring plan to regain its competitive position. Further, it used $1.5 billion of capital to repurchase company shares after the downdraft.

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Alphabet underperformed the broader market due to increasing macro risks and concerns around digital a slowdown in ad spending. The Search business continues to remain resilient but investors worry about the sensitivity and margin pressure during a slowdown as advertisers reduce spending. YouTube ad revenue is up more than 80% pre-COVID-19 and Cloud is still in the early innings. Alphabet's capital allocation priorities have been favorable as the company continues to invest in the business and return capital to shareholders via its buyback program. Alphabet has a solid balance sheet, significant market share, and the stock trades at reasonable valuation.

CarMax underperformed the broader market during the quarter as concerns around affordability and macro conditions worsened. Consumer spending on big-ticket discretionary items has slowed and consumer confidence has weakened. Despite the weak macro environment, CarMax continues to gain market share and maintain- high gross profits per unit. Management is focused on growing profitable market share in multiple channels by offering a seamless experience across all platforms. CarMax continues to disrupt the used car ecosystem and we maintain our conviction in the stock.

Church & Dwight suffered from slowing demand for discretionary products and material cost inflation. Inflationary pressures are starting to impact consumer spending habits, particularly among discretionary categories, while supply constraints have weighed on profitability. Fortunately, the business is well positioned for a downturn as ~40% of Church & Dwight's portfolio consists of value-oriented products housing their largest businesses (laundry, vitamins, cat litter) with limited private label competition. The balance sheet remains strong and management continues to execute on their disciplined merger and acquisition strategy. We believe Church & Dwight's leading portfolio of diversified consumer staples provides durable cash flow generation and a quality source of downside protection.

Verizon underperformed this quarter as competition from other telecom carriers and cable companies accelerates in the wireless space. Verizon's strategy of offering a premium product to the market is not resonating as well with consumers amidst high inflation and improving 5G networks at peers. We will monitor if Verizon's new offerings in the market as of this quarter will accelerate subscriber growth.

In late September, we used cash in the portfolio to initiate a position in Starbucks. Starbucks operates thousands of specialty coffee shops across 83 markets. Its primary markets include the U.S. (~50% of store base), where it holds 60%+ share of specialty coffee stores, and China (~15% of store base), which is a more nascent market for coffee consumption. Starbucks is known for its premium and customizable beverages. In addition to company-owned stores, Starbucks licenses stores in many of its international markets and recognizes a royalty fee as a percentage of retail sales. Starbucks also has licensing partnerships with Pepsi and Nestle for the manufacture and distribution of ready-to-drink beverages and coffee beans/pods at consumer retail locations.

In terms of its balance sheet, Starbucks has a net leverage ratio of 1.5x (excluding lease liabilities). When including the $9B in operating leases, net leverage is closer to 3x. We believe the company has the flexibility to raise debt in the future. Assuming an optimized capital structure and modest growth, we believe the stock trades at an attractive discount to intrinsic value.

Starbucks generates ~$6B in cash flow per year and expects to spend $2B on capital expenditure in 2022 to fund expansion in China. As mentioned above, this capital expenditure generates high return on investment. The remaining free cash flow will be used for dividends as well as investments in stores and labor. Share repurchases have been delayed for now, but will likely begin again in 2023.

Outlook and Conclusion

Looking ahead, as the Fed attempts to navigate a soft landing; economic growth may continue to decelerate. With persistently higher than desired inflation combined with a tight labor market, additional rate hikes are likely before year-end, while Quantitative Tightening will continue. This more restrictive monetary policy will continue to influence the economy. We recognize the lagged impact of monetary policy on the broader economy, so the odds of a recession over the next 12-18 months remain elevated.

On a positive note, the U.S. consumer remains in reasonably good shape. Unemployment is low, wages are rising, and there are still excess savings remaining from the pandemic. With consumer spending such an important part of U.S. GDP, the strong labor market could limit the downside risk to the economy over the next few months. Longer term, we remain positive on the U.S. economy and expect real GDP growth in the 2-3% range driven by growth in the labor force and improving productivity.

In terms of the equity market, we hope that much of the bad news is reflected in current prices. That said, multiple compression may continue in the near term and a slowing economy may lead to weaker earnings from many companies. In this more challenging environment, we continue to expect greater volatility in stock prices and lower expected returns relative to the strong returns generated from 2009-2021.

Longer term, we continue to believe that quality attributes and solid company fundamentals will lead to strong risk adjusted returns over time. The companies in Touchstone Large Cap Fund historically have generated higher returns on capital, had strong balance sheets, and trade at attractive valuations relative to the broader market.

We believe the quality of the portfolio positions it well for the next few years, even if the market trades modestly higher. The portfolio may struggle to keep up in an environment of double-digit returns. In an environment of possibly lower expected returns and greater volatility, we believe the portfolio offers an attractive option for equity investors. Our goal remains to outperform the broader market over full market cycles with less volatility.

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As of September 30, 2022, STORE Capital Corp. made up 3.88%, O'Reilly Automotive Inc. made up 5.07%, The Charles Schwab Corp. made up 4.78%, Martin Marietta Materials Inc. made up 3.78%, FISERV Inc. made up 3.07%, FEDEX Corp. made up 2.38%, Alphabet Inc. made up 5.27%, CarMax Inc. made up 1.87%, Church & Dwight Co. Inc. made up 2.69%, Verizon Communications Inc. made up 1.94%, Starbucks Corp. made up 2.57% Nestle made up 3.38% and Pepsi made up 0.00% of the Touchstone Large Cap Fund. Current and future portfolio holdings are subject to change.

Fund Facts *(As of 09/30/22)*

Class	Inception Date	Symbol	CUSIP	Annual Fund Operating Expense Ratio* Total	Net
A Shares	07/09/14	**TACLX**	89154Q554	1.48%	1.05%
C Shares	07/09/14	**TFCCX**	89154Q547	2.12%	1.80%
Y Shares	07/09/14	**TLCYX**	89154Q521	0.88%	0.80%
INST Shares	07/09/14	**TLCIX**	89154Q539	0.82%	0.70%
Total Fund Assets	**$248.8 Million**				

**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 1.03% for Class A Shares, 1.78% for Class C Shares, 0.78% for Class Y Shares and 0.68% for Class INST Shares. These expense limitations will remain in effect until at least 10/29/23.*

Share class availability differs by firm.

Annualized Total Returns *(As of 09/30/22)*

	3Q22	YTD	1 Year	3 Year	5 Year	Inception
Excluding Max Sales Charge						
A Shares	-4.55%	-23.05%	-13.88%	4.28%	5.63%	6.40%
C Shares	-4.71%	-23.45%	-14.48%	3.51%	4.84%	5.65%
Y Shares	-4.47%	-22.84%	-13.62%	4.55%	5.90%	6.67%
INST Shares	-4.47%	-22.82%	-13.58%	4.65%	5.99%	6.77%
Benchmark^	-4.61%	-24.59%	-17.22%	7.95%	9.00%	9.35%
Including Max Sales Charge						
A Shares	-9.32%	-26.88%	-18.17%	2.50%	4.39%	5.64%
C Shares	-5.66%	-24.22%	-15.32%	3.51%	4.84%	5.65%

^Benchmark - Russell 1000® Index[1]

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

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.*** *From time to time, the investment advisor may waive some fees and/or reimburse expenses, which if not waived or reimbursed, will lower performance. Performance by share class will differ due to differences in class expenses. Returns assume reinvestment of all distributions. Returns are not annualized for periods less than one year.*

[1] The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index.

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 is non-diversified, which means that it may invest a greater percentage of its assets in the securities of a limited number of issuers and may be subject to greater risks. The Fund may focus its investments in specific sectors and therefore is subject to the risk that adverse circumstances will have greater impact on the fund than on the fund that does not do so. 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. Current and future portfolio holdings are subject to change. The Advisor engages a sub-advisor to make investment decisions for the Fund's portfolio; it may be unable to identify and retain a sub-advisor who achieves superior investment returns relative to other similar sub-advisors.

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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