WINTER 2018 ISSUE

Donaldson CAPITAL MANAGEMENT

RISING DIVIDEND REPORT

Security ▪ Income ▪ Growth ▪ Service

QUARTERLY
QUICK FACTS

1 2017 was a good year for stocks driven primarily by the return of earnings growth and a surprisingly strong global economy.

2 US economic growth continues to accelerate in tandem with virtually every other economy across the globe.

3 Earnings and dividend growth in 2017 were healthy with expectations for 2018 nearing 10% even before tax reform.

4 The impact of the 2017 tax cuts could be an immediate boost to earnings with an improved trajectory for future revenue and profit growth.

5 Inflation and interest rates remain low, providing few attractive alternatives to stocks as we head into 2018.

A New Letter, With You in Mind

Change is a good thing, right?

AS YOU CAN SEE, we've decided to make a change to our Quarterly Letter. No. We are not changing the Letter just because we felt the need to change. The reality for all of us is that over the last two decades, you, our clients, have changed. Not only have we all grown older … your lives have changed.

- Scores of you have **moved into retirement**.
- Some of you have **moved**.
- For many, **grandchildren** have been added to your families.
- What once seemed critical to your existence **may no longer be all that important**.
- Perhaps, you have gone from building your nest egg to **living from it**.
- Or, maybe you're part of the new generation of DCM clients who is **still working on building up your nest egg**.

And, while all of this was happening, the financial landscape, indeed the entire world, has changed dramatically. Even more daunting is that the changes are accelerating.

At DCM, we want to be of more value to you each year. To do that, we have added experts who can now advise on income taxes, estate planning, 401(k) and other retirement plans, and about any financial planning topic you might encounter.

Our Founder, Greg Donaldson, penned the first Quarterly Letter before DCM even existed. Since then, the letter has been published each quarter, primarily focusing on investments and the economy. While managing portfolios remains at the forefront of what we do today, to keep up with your changing lives, we too have changed. Today, you need a Quarterly Letter that addresses more than our outlook for the markets. So, here it is.

We would love to know what you think. If you would like us to address any particular topics or issues, simply ask. We work for you, and we want to make sure you get what you need. And of course, please feel free to share this with friends or family if you feel they would benefit from any of the information included.

On behalf of all us at DCM, thank you for letting us serve you and your families.

MIKE HULL
PRESIDENT & SENIOR PORTFOLIO MANAGER

THE DCM MEDICARE ROADMAP

We are now offering Medicare benefit analysis at no extra fee.

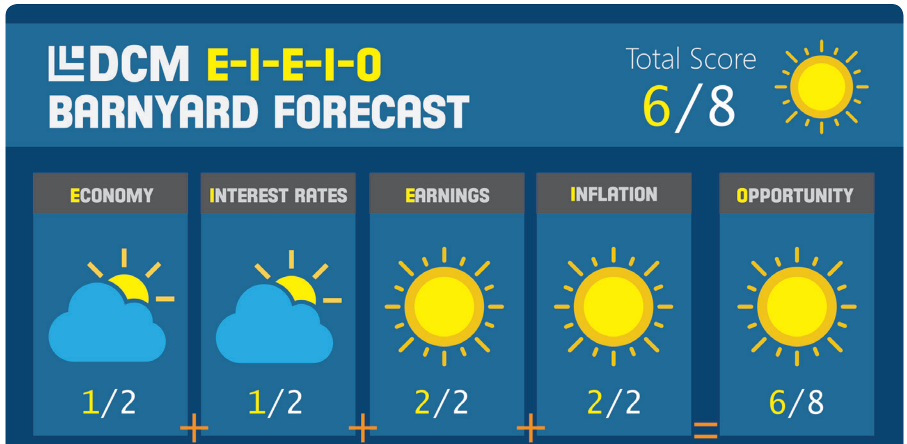
Turning 65 might mean retirement, checking off some items from your bucket list, or spending extra time with family. But turning 65 also means that you must now navigate the Medicare health system. It can be difficult to know which way to turn with thousands of state-specific regulations and several options to choose from.

There is no shortage of companies giving Medicare advice. Unfortunately, most of that advice either comes at a price or from a biased source. However, not seeking advice and reviewing your Medicare coverage annually can have costly effects. Choosing the wrong type of insurance, the wrong time to enroll, or the wrong plan could cost you thousands – even tens of thousands – of dollars!

As more of our clients reach age 65, we recognized the need to help you through the Medicare maze. That's why we are excited to announce our new partnership with i65 Medicare Software. After answering a few simple questions (online or with your advisor), you'll receive a custom "Medicare Roadmap" detailing the best plan for you, steps to getting enrolled, and tips to avoid costly mistakes.

Even if you've already enrolled in Medicare, we can help you review your coverage and save money. Medicare's annual Open Enrollment, October 15th through December 7th, is the one time every year that you can make policy changes. Last year, 100% of i65 Software users saved money by switching plans. The average savings for 2015 was $2,147.

We would also like to offer all clients one free referral for a friend or family member who isn't a DCM client to receive a complimentary Medicare benefits analysis. So, if you or someone that you know would benefit from reviewing your Medicare options, please contact your DCM Portfolio Manager.



This forecast provides DCM's evaluation of the overall economic climate. Each category is rated between 0 and 2 (0 being negative, 1 neutral, and 2 positive) and the cumulative score is measured as the opportunity. A total score between 0 and 2 indicates a negative outlook, 3 and 5 a neutral outlook, and 6 and 8 a positive outlook.

Our Continued Fiduciary Duty

What is a Fiduciary? Who must comply? What questions should you ask?

BY NOW, YOU HAVE LIKELY READ OR HEARD about the Department of Labor (DOL) Fiduciary Rule regarding financial advisors. If you haven't, the Fiduciary Rule helps ensure that investment advisors are not putting their compensation above client's best interests in any type of retirement account, such as an IRA or 401(k). We wanted to provide some clarity on how the rule may impact you.

This new rule will not change the way that we (DCM) serve our clients or how we invest your money. It may increase the amount of paperwork we create, but fundamentally, nothing will change for us or you, as our client. We have always conducted our business as fiduciaries – the highest standard in our industry. If the term "fiduciary" is new to you, it simply means that we are legally obligated to act in your best interests.

You may think, "Of course, if I'm paying someone for financial advice, they must HAVE to put my interests above their own." Unfortunately, that can be far from the truth. Some firms may only be required to ensure that your investment choices are "suitable." In other words, they may be able to choose Mutual Fund A over Mutual Fund B because A pays a higher commission than B. As long as Mutual Fund A is "suitable" then it is OK. You can see why this is a much lower standard than the fiduciary standard that DCM is held to.

We believe the new DOL Fiduciary Rule will ultimately be a good thing for you as an investor. It will hold all firms accountable to a level of transparency that has not been applied to certain firms in our industry.

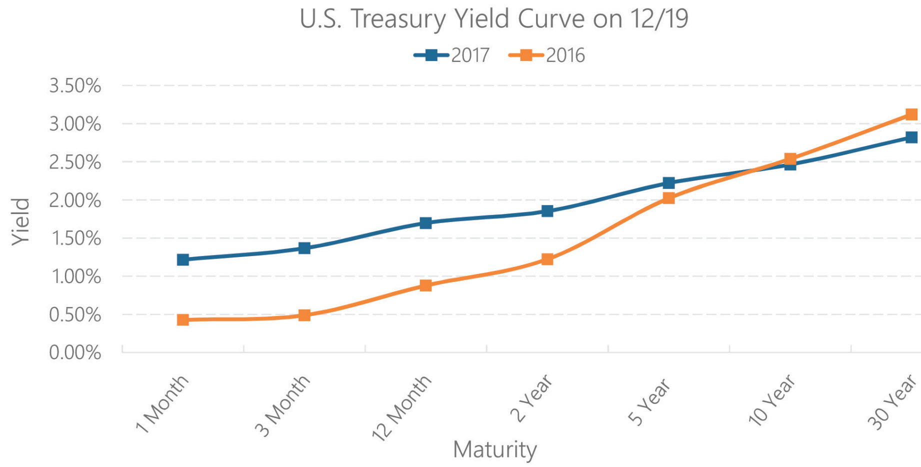
If you have assets held outside of DCM and you are unsure whether or not your other advisor is following the same fiduciary standard, just ask them. If you don't know what questions to ask, Jason Zweig wrote a very helpful article in the August 25, 2017 Wall Street Journal titled, "19 Questions to Ask Your Financial Advisor." The list of his questions can be found on our website. Feel free to ask your DCM Portfolio Manager for a copy, as well.

The Most Hated Bull Market, No More

A Letter from the DCM Investment Policy Committee

Executive Summary

- **2017 was a good year for stocks** driven primarily by the return of earnings growth and a surprisingly strong global economy.
- US economic growth **continues to accelerate** in tandem with virtually every other economy across the globe.
- Earnings and dividend growth in 2017 were healthy with **expectations for 2018 nearing 10%** even before tax reform.
- The impact of the 2017 tax cuts could be an **immediate boost to earnings** with an improved trajectory for future revenue and profit growth.
- **Inflation and interest rates remain low,** providing few attractive alternatives to stocks as we head into 2018.



2017 in Review

PRESIDENT TRUMP has recently taken a lot of credit for the stock market runup in 2017. There was a lot more to the market's returns than politics. As we noted in our Q3-17 letter, More Than the Trump Trade, "[The] markets are probably underestimating Trump's agenda. The economic benefits of whatever passes through Washington are more likely in front of us rather than behind us … Regardless of what happens in Washington, the market will likely continue to grind higher."

We argued that healthy economic underpinnings and earnings growth were the real driver of stocks, not yet Trump's policies. We saw a significant pickup in economic activity after years of sluggish economic growth around the world. The Global Purchasing Managers' Index for manufacturing hit a 2-year high at 54 as of the last reading in November. This synchronized global growth occurred for almost all developed and emerging economies.

The solid economic backdrop provided a tailwind for corporate sales and earnings. In the 4th quarter of 2016, the S&P 500 posted its first positive earnings growth number since 2015. Earnings accelerated through the middle of the year with 3rd quarter profits up 8.4% on revenue growth of 5.4%. Based on the initial batch of 4th quarter reports, this trend looks to continue into the New Year.

Longer-term interest rates remained low despite the improving economic environment. The 10-year US Treasury bond started the year at 2.45%, spent most of the year in the 2.30% range and ended at 2.49%.

Without longer-term interest rates moving higher, there was little competition for stocks in 2017. Interest rates remained too low to entice investors away from equities.

The combination of low-interest rates, robust global economic activity, and accelerating earnings growth created the perfect backdrop for stocks to move higher. The S&P 500 finished the year up 21.8%.[1]

Most Frequently Asked Questions About 2018

WE'VE HAD MANY CLIENTS questioning whether stocks can continue hitting new highs in 2018 coming off such a strong 2017. Three of the more common questions we're getting in our meetings with you and prospective clients are:

"Since stocks are up so much this year, we're bound for a crash in 2018, right?"

"We haven't had a bear market since 2011 and haven't had a correction since 2016, aren't we due?"

"What impact will the upcoming midterm elections have on the market?"

We wanted to address those three questions by looking back at what happened in past years. While we know history never repeats itself, it does often rhyme. So what does the past have to teach us about each of these questions? Below we summarize the results of a study we did looking back at more than 60 years of S&P 500 market data.

YEAR FOLLOWING A +20% YEAR

In 2017, the S&P 500 increased by more than 20%. One's intuition suggests the following year should be a bad year for stocks as investors take profits from the prior year. The study shows that hasn't been the case. Since 1954, the S&P 500 has continued higher in 82% of years following a >20% increase in stocks. The return in those years was an impressive 14% per year, on average.

FOLLOWING A LOW VOLATILITY YEAR

2017 is likely to be remembered more for its lack of volatility than its price gains. From 1900 through 2016, stocks have dropped by 5% or more three times per year, on average.[2] That didn't happen a single time in 2017. The largest selloff occurred early in the year and saw stocks drop a mere 2.9% from peak to trough. Stocks have rarely (if ever) had such little volatility.[3]

Doesn't that mean we're "due" for a fall in the market? Again, intuition here is that a low-volatility year should be followed by a high-volatility year. Once again, history proves that to be false. Since 1954, stocks have risen in 78% of years following a low volatility year. On average, those years produced a 9% return for stocks.

S&P 500 Since 1954				
Scenario	% of Years Positive	Average Performance	Best Performance	Worst Performance
Year Following a +20% Year	82%	14.10%	33.32%	-8.66%
Year Following Low Volatility Year	78%	8.70%	31.41%	-14.69%
Mid-term Election Year of New President	60%	5.70%	52.27%	-22.10%

*Low volatility is defined as an intra-year selloff of less than 6%

*Dividends included

Despite the positive results from our study, we don't expect 2018 to be like 2017. Volatility is likely to return to a more "normal" level moving forward. Stocks almost always have patches of volatility throughout the year. At least one correction of 10%+ and multiple drops between 5% to 10% occur in an average year in the stock market. Remember, these are completely normal and are part of a healthy market. It's likely to happen in 2018. Don't be surprised or worried when it does. Stocks almost always move higher after these small selloffs.

MID-TERM ELECTION YEAR OF NEW PRESIDENT

Based on our study, the 2018 midterm elections pose the biggest headwind for stock investors. Midterm elections during a President's first term tend to cause increased volatility and below-average returns. Despite this being the least positive of our three studies, stocks have still gone up 60% of the time with an average return close to 6%.

WHAT DOES IT ALL MEAN?

History is clear: just because stocks had a good year doesn't mean they are "due" for a bad one the next. If anything, the evidence suggests the opposite. A good year for stocks has historically been an indicator of above-average returns the next year.

The market tends to move higher on earnings growth and/or a strengthening economy. Those drivers don't reverse simply because the calendar turns over. **Expecting stocks to fall because 2017 was a good year or because volatility was so low is a loser's bet.** Both are favorable signs for stocks heading into 2018, and our optimism is only partially muted by the potential for political uncertainty.

However, the 2017 tax reform gives companies both the means and confidence to pursue new growth opportunities. That could be the biggest reason for optimism as we move into 2018.

Tax Bill: What Impact Will It Have?

STOCKS RALLIED at the end of 2017 largely because of the potential for lower taxes. However, we don't believe the markets reflect the level of stimulus the recently passed tax plan will provide. The package results in $205 billion remaining with individuals and corporations rather than being paid in taxes. That represents over 1% of GDP, making it the second largest tax package in history.[4]

We don't believe all that money will sit under mattresses. We expect it will result in increased activity for:

- **Increased business investment**
  At minimum, the tax bill provides some clarity for business leaders moving forward. We could see a fresh round of investment unleashed as the tax and regulatory environment gets clarity.
- **Increased consumer spending.**
  Consumers may be better at saving than they used to be, but we expect larger after-tax paychecks to result in additional spending. That's a big deal for an economy that's 70% driven by consumer spending.
- **Increased dividends and share buybacks.** Many companies will use their newfound cash to boost dividends and share buybacks. We also may see a hefty number of special dividends.
- **Increased merger & acquisition activity.**
  More cash means more money to acquire competitors, increase market share, and boost revenue growth.

Regardless of how companies use their resources, the result is going to be good for shareholders. Early estimates from our research sources indicate it could add $10 per share to S&P 500 earnings. That alone would add up to just under 10% year-over-year growth. That is on top of what was already expected to be a strong year for earnings growth. Add it all up, and we could see 2018 earnings growth pushing 20%. The longer-term impact depends largely on whether companies choose to invest in their businesses or not. If they do, this investment could fuel the next wave of technological innovation, automation, efficiency, and profit growth. Buckle up.

The New Federal Reserve Chairman: Business as Usual

JEROME H. POWELL will be the new Federal Reserve Chairman when Janet Yellen's term expires in early 2018. Mr. Powell is widely expected to communicate and respond in a similar fashion as his predecessor, Janet Yellen.

One key difference we'll note is their backgrounds. Yellen spent most of her career working in the public sector as an economist and an academic. Powell is an attorney with both extensive private sector success and public service. He comes to the Fed with a business slant that Yellen did not.

> "Bull markets are born on pessimism, grown on skepticism, mature on optimism, and die on euphoria."
> — JOHN TEMPLETON

Another difference to highlight is that Powell has stated that he's in favor of less financial regulation. This change continues the trend of a more pro-business administration, which continues to be good for stocks.

Conclusion

THE BULL MARKET IS ALIVE and well with few warning signs from the economy or market fundamentals.

Research suggests that 20% returns and low volatility has been a positive signal for stocks in the next year.

Our Bull Market Checklist suggests that none of the eight market conditions that were present at the market peaks in 2000 or 2007 are present today.

Our investment models suggest stocks are about fairly valued with upside from tax reform not yet included.

The Barnyard Forecast remains bullish for stocks in the near-term (6-18 months).

And, critical to us, dividends continue to grow at a double-digit clip.

These are all tremendous positives for the market and DCM client portfolios. The biggest warning we see right now is the increased appetite for risk. Investors have been pessimistic and skeptical ever since the 2008 Financial Crisis. We've seen increasing optimism starting in 2016 and progressing through 2017. If interest rates and inflation remain muted in 2018, we could see the "optimistic" stage of bull market progress further. This will eventually give way to "euphoria" and signal the end of the bull market.

We currently see few warning signs of overly optimistic investors at this point. That could change in 2018. We've been overweight stocks for the past five years and remain tilted that way heading in 2018. That won't change unless we start to see cracks in the economy, company fundamentals deteriorating or until irrational exuberance starts to kick in. Until then, the bull market lives on in 2018.

1. Source: Morningstar S&P 500 Index TR

2. Source: Capital Research and Management Company

3. Before 2017, the CBOE Volatility Index (or "VIX") closed below 10 on 9 out of 6,804 trading days. In 2017, the VIX closed below 10 on 32 separate trading days - more than 3x the previous 26 years combined.

4. Second only to President Reagan's 1981 tax cut.

bitcoin

WHAT IS IT?
AND SHOULD I BUY SOME?

Over the past few months, we've been fielding many questions about Bitcoin. The top inquiry we've gotten is: "What is it?" closely followed by "Should I buy some?"

Bitcoin is a digital currency. Unlike other currencies, there is very little regulatory oversight. No government, central bank, or other authority controls it. Owners of Bitcoins are anonymous and aren't linked by names or tax ID numbers, but rather by "encryption keys." There is no issuance from a central bank. New Bitcoins get awarded when a supercomputer successfully creates code out of the ledger including all previous transactions. This process is called "mining."

If you still don't understand it, you probably shouldn't invest in it. But let's just assume for a second that you did know what it was. Is it a good investment? Let's take a step back and ask ourselves a basic question: What makes anything a good investment?

You have to expect to make money before investing in something. To know whether you will make a positive return or not, you have to be able to value the asset.

Take a chicken, for example. Is it possible to determine the value of a chicken? Yes, of course. The value of a chicken is simply the current sum of all future eggs it will produce discounted at some rate of interest. A chicken that lays no eggs has no value.

Is it possible to determine the value of rental real estate property? Yes, the value of the building is equal to all future rental income discounted by an interest rate. No rent, no value.

Can you value a business? Once again, the value is the sum of all future cash flows paid to owners (i.e. dividends) plus whatever assets the company can sell. No future profits, no value.

And if you can value a business, you can value a stock. Since a stock represents ownership in a business, it's value is also tied to the sum of all future cash flows (i.e: dividends). Without dividends (or the ability to pay them in the future), a stock has no value.

We've long argued against the merits of owning gold. Unlike a chicken, property, or business - gold doesn't produce any cash or tangible items. However, gold is used to make real goods. So that gives it some intrinsic value beyond speculation. Bitcoins are not used to make anything.

So how do you determine the value of a Bitcoin? What does it produce? Eggs? Rent? Dividends? Does it create anything at all?

Now, we're not suggesting that Bitcoin has no value today. If someone offered you a Bitcoin we wouldn't recommend turning it down. We're merely suggesting that there is no underlying fundamental that allows anyone to measure what that value is. In our opinion, it is far more a gamble than it is an investment. By purchasing Bitcoin, you are speculating that some other person will be willing to pay more for it in the future. Will that be the case? Your guess is as good as ours…

DCM Employee Highlights

Marvin Wright

2017 Distinguished Accountant Award

WE ARE PLEASED TO ANNOUNCE that Marvin Wright, Chief Financial Officer and Senior Portfolio Manager, has been named the 2017 Distinguished Accountant by the University of Southern Indiana's Romain College of Business in conjunction with the USI Accounting Circle. The award recognizes professional achievement, service to the region and the University and service to the accounting profession.

Since joining DCM in 2014, Marvin has been the firm's go-to resource for all tax related questions. Marvin's professional affiliations include the American Institute of CPAs, the Indiana CPA society, the Kentucky Society of CPAs, the Institute of Management Accountants, and the Evansville Estate Planning Council.

Marvin is married to his high school sweetheart, Nancy. They have four children and six grandchildren. We thank Marvin for his continued dedication to his clients, to the accounting profession and to DCM.

Nathan Winklepleck

Chartered Financial Analyst (CFA) Designation

AFTER THREE YEARS OF EXAM PREPARATION, we are thrilled to announce that Nathan Winklepleck, Portfolio Manager and Research Analyst, has become the first DCM employee to earn the Chartered Financial Analyst (CFA) designation. The CFA designation is often regarded as the most respected and recognized investment management designation in the world.

The requirements include three rigorous, six hour exams that are taken over the course of several years. Not only did Nathan complete all requirements while maintaining his full time duties at DCM, he passed all three exams in his first attempts – something that fewer than 20% of all CFA candidates are able to do[1]. Since 1963, only 15.5% of candidates who sat for the Level 1 exam ultimately passed the Level 3 exam and earned the CFA designation[2].

Nathan has become an integral member of the Investment Policy Committee and has continued to add value to all DCM clients since he joined the team in 2012. He and his wife, Courtney, have two young children, daughter Riley, age 2, and son Levi, 4 months.

1. https://www.investopedia.com/articles/analyst/060302.asp
2. http://financeresume.net/cfa-exam-pass-rates/

Thank You

AN UPDATE ON OUR 2017 DCM CLIENT SURVEY

We would like to take this opportunity to say thank you to all that participated in our 2017 Client Survey this summer.

We are very grateful for your input and the quality of your responses which have allowed us to concentrate on several areas of improvement. A common theme we heard was that you want more customized communication from us. We are aware that each client's needs and preferences are different when it comes to frequency and methods of communication. To help address this issue, DCM has recently made an investment in technology that will assist in providing enhanced communication based upon your preferences. This new quarterly letter, providing new types of content, is another tool we have implemented to meet the interests and needs of more of our clients. Our goal will always be to provide you with valuable and timely communication. Accordingly, we will be seeking additional feedback from you as we continue to improve and enhance our client experience.

As promised, DCM has made a charitable contribution of $25 for each completed survey. With your high participation rate – 270 responses – we are very pleased to announce that we were able to make a $6,750 donation to the American Red Cross, to help with the devastation from Hurricane Harvey and the other unfortunate natural disasters that have struck over the past few months. TD Ameritrade, one of our partnering custodians, offered a dollar for dollar match during Hurricane Harvey, which allowed our gift impact to double.

On behalf of all of us here at DCM, thank you for letting us serve you, and thank you for the time, effort, and thought you put into our survey.

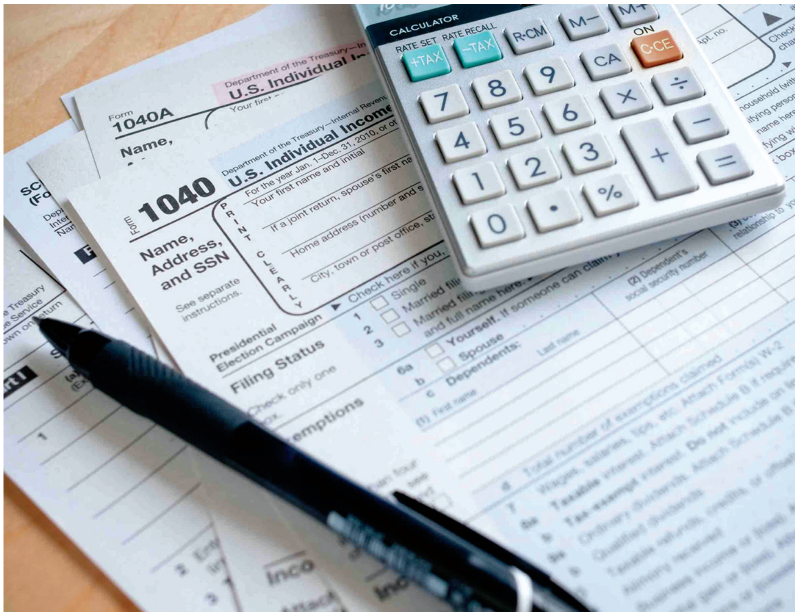
Tax Time, Once Again

What you need to know for the 2017 Tax Season

THE NEW YEAR OFTEN MEANS NEW BEGINNINGS AND NEW RESOLUTIONS, but one thing remains constant: tax time is here again. After the Equifax breach occurred in 2017, there is an increased risk for fraudsters to file phony tax returns.

Many sources suggest that filing your tax return as soon as possible is the best way to protect yourself from this type of fraud. However, this isn't always possible for investors with brokerage accounts because tax documents often don't come until mid-February or after. And, even if you're able, there are considerations that should be made before rushing to file your taxes. DCM Chief Financial Officer, Marvin Wright, CPA, CFP®, gathered some important considerations and tips on this matter.

- **Don't rush to file.** You're much better off waiting until you have the appropriate tax documents and information so that you can file an accurate and complete tax return.
- **You cannot beat the crooks.** If someone has your information and they plan to file a fraudulent tax return in your name, they've already beaten you to it.
- The IRS states that it has **safeguards in place** that already prevent the vast majority of fraudulent tax returns. They have implemented additional safeguards in light of the recent data breaches.
- **Warning signs of tax related identify theft include:**
  - » Your attempt to file online gets rejected because a return with the same SSN has already been filed.
  - » You receive any sort of letter from the IRS that contradicts your actual tax history, or a letter asking you to confirm information from a previously filed tax return.



- **If this happens to you – do not panic.** The IRS will send you detailed instructions to file a Form 14039. This will delay any refund that you are owed, but rest assured that the IRS has a process in place that will ultimately resolve the issue.

If you have any further questions or concerns, please don't hesitate to contact your Service Team at DCM.

As a reminder, Form 1099 tax documents for after-tax accounts are available in mid-February (showing dividend and interest income, capital gains, and management fees). If you had a distribution from a retirement account in 2017, you can expect to receive your Form 1099R in late January. These documents are provided by your account custodian, who will provide more specific release dates in mid-January.

DCM Initiates Last Minute Tax Savings for Clients

The Tax Cuts and Jobs Act brought a last minute opportunity for some clients to prepay fees and save on taxes.

The new tax law is a great example of how DCM strives to be more than just your investment advisors. Historically, many clients have been able to deduct DCM's Management Fees from their taxable income. The ability to deduct those fees comes from the right combination of Adjusted Gross Income and the amount of the fees (fees taken from IRAs were never deductible). The new "Tax Cuts and Jobs Act" eliminates that deduction, beginning in 2018. Immediately after President Trump signed the new tax law, DCM Portfolio Managers and Client Services Managers got busy contacting clients most likely to benefit from paying some of their 2018 fees before the end of 2017. All in, we estimate that by these actions, our clients conservatively saved as much as $400,000 on their 2017 tax bills.

We also advocated for the elimination of the First In First Out rule for capital gains recognition. In effect, Congress was proposing to take away your ability to lower your taxable gains by choosing which tax lots of a security you would sell. We contacted our State Representatives, and sent a message to DCM clients with instruction of how they could do the same. While we were just one voice among many, it worked. The so-called FIFO provision was removed from the final tax bill.

Donaldson
CAPITAL MANAGEMENT

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Index and sector performance information in the Newsletter sourced from Morningstar.

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INDEX DEFINITIONS S&P 500: Standard & Poor's (S&P) 500 Index. The S&P 500 Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad U.S. economy through changes in the aggregate market value of 500 stocks representing all major industries.