WINTER 2019 ISSUE

Donaldson CAPITAL MANAGEMENT

RISING DIVIDEND REPORT

Security ▪ Income ▪ Growth ▪ Service

Client Experience Evolved

IN 17 YEARS AS A DCM EMPLOYEE, I've seen a lot of changes. I've seen this place grow from 8 employees to 37. I've had the pleasure of seeing my colleagues excel and continually improve how they serve clients.

Most notably for me, these 17 years have allowed me to see DCM's client experience evolve. It has been a blessing to follow behind our firm's pioneers. Greg Donaldson, Mike Hull, Rick Roop, Randy Alsman, and Beth Dietsch always have led with servants' hearts and have put our clients' needs first in every decision. As we continue to grow, I have the pleasure of helping search for talented people that demonstrate the same hearts for serving others.

You, our clients, are the only reason we get the pleasure of coming to work every day. You are why DCM exists. That knowledge has led us to create an intentional and meaningful experience for our clients. Like we've said before, we want you to be pleased enough with your experience at DCM that you will tell someone you care for about DCM.

Client service at DCM always has been a priority. So much so that two years ago I was appointed DCM's Vice President of Client Experience. In this position, I serve as your advocate. As we've mentioned in our newsletter over the past year, DCM will inevitably go through some transitions over the next decade, as the next generation continues to come into leadership. Throughout that process, we knew it was important to have a person in place as a confidential ear for you. If you ever have a question, concern, a comment — maybe one that you'd rather not share directly with your advisor — please let me know. Even if you have an idea for how we might be able to better serve you, I want to hear it.

Always feel free to contact me directly. My phone number is 812-421-3204, and my email address is chartman@dcmol.com. I look forward to hearing from you.

Ciavon Hartman

CIAVON HARTMAN
VICE PRESIDENT OF CLIENT EXPERIENCE

QUARTERLY
QUICK FACTS

Don't have time to read the investment letter from the IPC? Here are your four Quick Facts:

1 A recession in 2019 is unlikely. The U.S. economy is strong. GDP will slow in 2019, but slowing is not the same thing as shrinking. Economic growth slowing from 4% to 2% or 2.5% is nowhere close to a recession.

2 Historically, the stock market's largest declines have happened during recessions. Since WWII, 1987 was the only time that stocks dropped 30% without a recession. If the economy continues to grow in 2019, it's unlikely that we see much more downside from here.

3 Unless earnings are reported a lot lower than estimates, stocks appear cheaper than at any time over the past few years.

4 Your dividends are still increasing. 18 of the 69 companies in our three investment strategies have increased their dividends at an average of 16% during the last quarter. If CEOs and boards were worried about the future prospects of their businesses or the economy, they wouldn't increase dividends at such a healthy rate.

New Year, New Tax Season

WITH 2019 OFFICIALLY UNDER WAY, now is a great time to review your current withholding and prepare for the upcoming April 15, 2019 tax deadline. Here are a few important reminders:

You can expect to receive **Form 1099** tax documents for all after-tax accounts in **mid-February**. These documents are issued by your custodian and report dividend and interest income and capital gains.

If you had a distribution from a retirement account in 2018, you can expect to receive your **Form 1099R** from your custodian in **late January**.

If you make quarterly estimated tax payments, mark your new 2019 calendars with each of this year's due dates; April 15, June 17, September 16, and January 15, 2020.

Employers often institute compensation changes at the beginning of the year, so now is a good time to review your elective withholdings from your paycheck to make sure you're taking advantage of any new compensation.

Over age 50? You're also eligible for additional catch-up retirement contributions (see below).

2019 Contribution Limits for Retirement Accounts	
401(k), 403(b), 457(b) Elective Deferrals	$19,000
Catch-Up Contribution Limit (age 50+)	$6,000
Traditional & ROTH IRA Limits	$6,000
Traditional & ROTH IRA Catch-Up Limits (age 50+)	$1,000
SIMPLE Employee Deferrals	$13,000
SIMPLE Catch-Up Deferral (age 50+)	$3,000

Defined Benefit Plan, Benefit Limit	$225,000
Defined Contribution Plan, Contribution Limit	$56,000
Annual Compensation Limit for Retirement Contributions	$280,000
Highly Compensated Employee Threshold	$125,000
Social Security Wage Base	$132,900

- Don't forget you have until **April 15, 2019,** to make contributions to your IRA (deductible), ROTH IRA, and HSA for 2018.
- Due to the Tax Cuts and Jobs Act, many items are no longer deductible (alimony, moving expenses, non-business tax preparation fees, investment related expenses, and unreimbursed employee expenses are a few examples). The standard deduction also has increased to $12,000 for single filers and $24,000 for those married filing jointly.
- If you claim the Earned Income Tax Credit or Additional Child Tax Credit, the IRS cannot issue refunds before mid-February.
- The individual penalty provision in the Affordable Care Act for not carrying health insurance is repealed for the 2019 tax year (still applies to the 2018 tax year).

DCM'S FIXED INCOME SPECIALIST

PRIOR TO 2011, Greg Donaldson managed most of our clients' bond portfolios. That year, we decided for the good of our clients, we needed to bring in a second Fixed Income specialist. That is when **Joe Zabratanski** joined DCM.

Joe's expertise in the Fixed Income space can be rare in today's wealth management industry. Here is why. Forty years ago, brokers purchased individual bonds for clients. Today, many investment advisors instead simply fill their clients' Fixed Income needs with Bond Mutual Funds. Or, many advisors create Bond Ladders for their clients. These Ladders have a portion of the client's bond portfolio maturing each year. This is supposed to minimize the risk of reinvesting in bonds. In reality, it generates tons of brokerage and transaction costs for the client. Through these Bond Ladders and the rising popularity of Bond Mutual Funds, the number of true bond managers has diminished dramatically. At DCM, we refuse to use either of these tactics.

And, as you can imagine, a talent like Joe had many opportunities. We remain thankful Joe saw a good match between his values and ours, and he left Bank of Montreal to join us in 2011.

Though you may not know it, as a DCM client, you have benefited greatly from the way Joe manages our bonds. As soon as the 2008/09 Financial Crisis abated, investment pundits began warning interest rates would rise (causing bond prices to fall). Joe astutely saw things differently, and 10 years later, it turns out he was correct. While the rest of the investment world was running for extremely short-duration bonds, we took a longer-duration approach. That certainly paid off. Over the last seven years our fixed income investments have consistently outperformed the bond benchmarks.

A delightful colleague, Joe is known for losing neckties by the handful; wearing ankle-high athletic socks under his suit pants; and keeping himself in incredible physical condition, much like our clients' bond portfolios.

While Joe could talk about the market all day, it's when he talks about his family that he really lights up. Why wouldn't he? Just look at that group. Joe lives and works in Park Ridge, Illinois, where he was born and raised and stays close to his extended family.

See his full bio at dcmol.com/JoeZ.html

The Man Who Wasn't There

A Letter from the DCM Investment Policy Committee

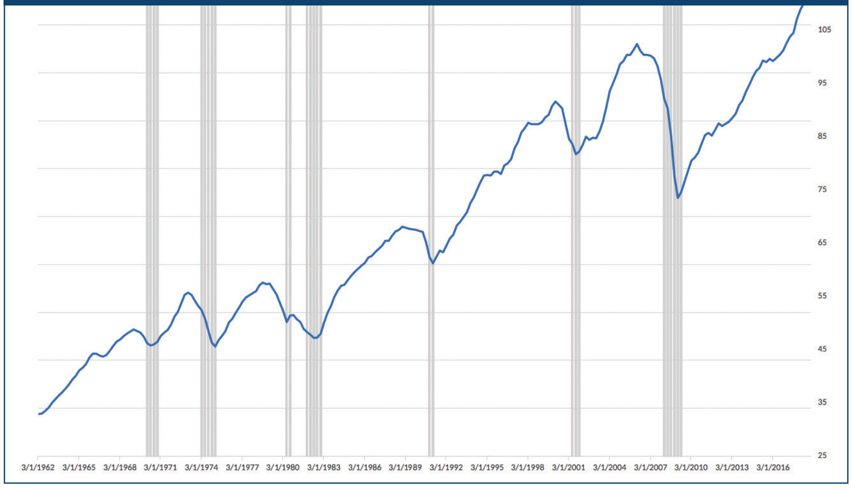
Randy Alsman, Author
Kyle Markle, Joe Zabratanski, Nathan Winklepleck, Contributing Editors

As I was going up the stair,
I met a man who wasn't there!
He wasn't there again today!
I wish, I wish he'd stay away!

— "Antigonish" by Hughes Mearns

THE MAN WHO WASN'T THERE, OF COURSE, IS AN ALLEGORY FOR AN ECONOMIC RECESSION. As we move into 2019, U.S. investors are afraid of a man that isn't there. A recession. Is it here? Is it coming? Or is it a figment of investors' imaginations?

U.S. Leading Economic Indicators & Recessions



Data source: Bloomberg.

The U.S. Economy is Strong

The U.S. economy has been the strongest in the world since 2009. No other developed economy has even come close. "Real GDP" (total growth reduced by inflation) has increased by an average of 2.8% through the third quarter of 2018. In the second quarter, real GDP topped out at 4.2%. As a comparison, Germany, one of the strongest economies outside of the U.S., had negative real GDP growth in Q3. No one expects a recession in Germany or the broader European Union, but forecasts for GDP growth have been continually lowered throughout the year.

The U.S. economy stands alone in its strength, but our best days may very well be behind us for a while. The U.S. economy will likely grow more slowly this year as the impact from the 2018 tax law fades.

However, our economy still is expected to grow between 2% and 3% in 2019. The chart above comes from The Conference Board's November economic data release. Their Leading Economic Index is a combination of 10 data points that signal future economic activity.

The Index (blue line) tends to roll over well before a recession (grey bars). This most recently occurred in early-2006, roughly two years before the 2008-09 financial crisis. No rolling is evident today. In fact, the trend strengthened in November. Fed Chairman Jerome Powell recently summarized the current state of our economy as follows:

> **"…as the year's gone on, the economy has come in stronger than we expected, and that's a really good thing. And the economy, as I mentioned at the beginning, is strong, and there's good reason to expect that to continue. If you look back over the last decade, this is a pretty good moment for the U.S. economy." [1]**

Almost all data we see and companies we follow point to a robust U.S. economy. Yet, someone forgot to tell the stock market. At the close of 2018, the S&P 500 index had declined 14.5% from its high point on September 20. The S&P 500 posted its first negative calendar year since 2008. The index finished the year –4.4%, including dividends.

The Economy & Markets: Why the Disconnect?

THE ECONOMY IS STRONG, but the market is running scared. Others have noted this puzzling disconnect.

"We have been surprised at how quickly the many investors and members of the economic commentariat have started to conflate the likelihood of a slowdown in economic and profit growth from 2018 with a recession. …an almost pathological assumption that good times can't and won't last."[2]

"[The economy] hasn't been this divorced from the stock market since 2010."[3]

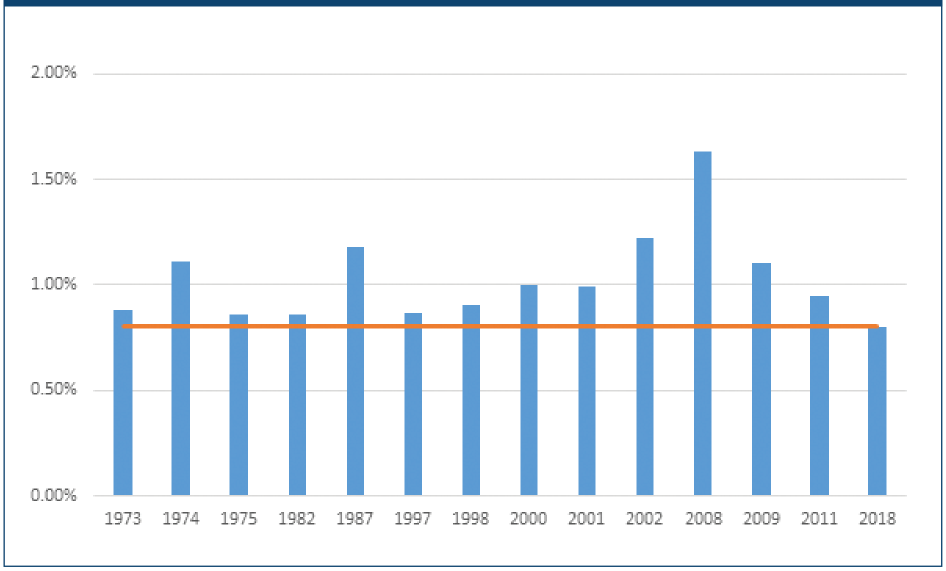
"So why is it that a recession [is said to be] imminent? […] there is a big difference between growth slowing to somewhere in the mid-2% area and a recession."[4]

So what's going on? Why is there such a disconnect between stocks and the economy?

Let's take a look back to 2017. The U.S. economy was improving and the back half of the year finished with synchronized global growth stories dominating the headlines. The market was remarkably strong as the S&P 500 returned nearly 22%. Much of the year was smooth sailing, and volatility was seemingly absent.

[1] Federal Reserve Chairman Jerome Powell, December 19th news conference. [2] Strategas Research Partners, December 2018. [3] Kawa, Luke. "The Stock Market Is the Most Divorced It's Been From the Economy Since 2010." Bloomberg, 14 December 2018. [4] Szczurowkski, Andrew. "The yield curve is flattening … just like it does every Fed hiking cycle." Eaton Vance Advisory Blog, 6 December 2018.

Years with Average Daily % Moves Greater Than 2018



Data source: Bloomberg.

2018 was quite different. **We had 63 days where the S&P 500 advanced or declined by at least 1% compared to just eight in 2017.** We had two "corrections" (market index dropping 10% or more from its previous high) during the past year. Even so, volatility during 2018 was not exceptional. The chart above shows the Dow Jones has had more volatile years than 2018 in 13 of the past 45 years. Our 2017 experience spoiled us.

That said, the market's behavior in 2018 seemed exaggerated at times. There were significant moves higher and lower as well as big intraday swings between the two. This type of trading isn't abnormal, but it's the speed and the depth of the moves that we question. The logical culprits very well may be the high frequency and algorithmic trading systems which can push the market around at an extraordinary pace. During these significant moves, automated trading programs become self-perpetuating and amplify the magnitude of the move. This often leads individual traders and investors to make knee-jerk decisions that further exacerbate the volatility.

On December 19, the Fed announced its latest 0.25% increase to the fed funds rate along with their projections for additional increases in 2019. The Dow Jones Industrial Average swung nearly 900 points that day, closing down almost 400 points. The Fed believes our economy is strong enough to withstand the increases yet the equity markets seem to disagree.

The market's volatility in 2018 has caused anxiety among investors. They are seeing a recession that isn't there. At least, not yet. Emotion, not data, is playing a big role in the market's volatility.

What about the inverted yield curve?

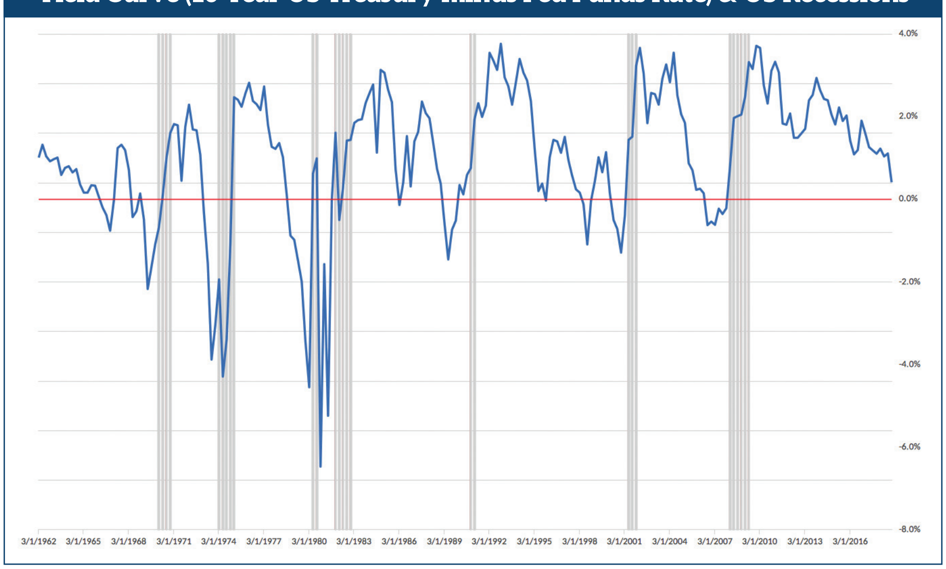
THE SUPPOSED IMPENDING INVERSION of the yield curve has been all over the news. The most widely followed yield curve inversion happens when the fed funds rate is higher than the 10-year U.S. Treasury yield. In theory, this should never happen. Bond investors need a higher return in exchange for waiting longer to get their money back.

When the yield curve inverts, it can both signal and create problems. As banks and other lenders pay more to borrow funds, they are forced to either raise rates they charge or earn less on the new loans they make. In either case, both theoretically slow lending activity. Our economy runs on borrowed money so a decline in lending would result in less economic activity – and potentially lead to a recession.

The first thing to address is the infallibility of a yield curve inversion as a recession predictor. The chart below shows the U.S. Yield Curve since 1960 as measured by the 10-year U.S. Treasury yield minus the fed funds rate. Any time the blue line dips below 0, the curve is inverted. The grey shaded areas are recessions. You can see that there are many times when the curve inverted, yet reversed without a recession occurring.

The inverted curve can cause problems within banking, especially if a bank's cost of funds moves in lockstep with the fed funds rate. However, keep in mind that banks primarily use their deposits to create loans. They often pay a fraction of the fed funds rate to depositors, which still allows them to keep their cost of funds down and profit from lending to consumers and businesses. The difference in the interest banks pay vs. the interest they earn is called the bank's "Net Interest Margin."

Yield Curve (10 Year US Treasury minus Fed Funds Rate) & US Recessions

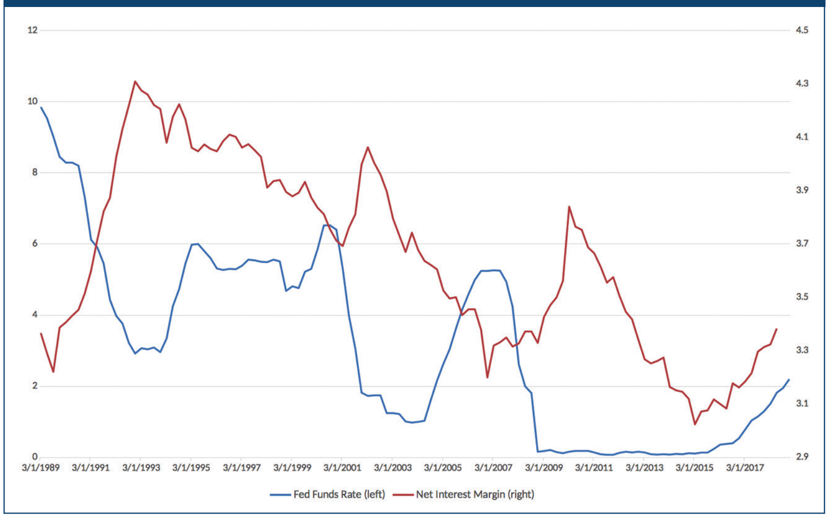


Data source: Bloomberg.

Where does the Net Interest Margin stand today?

THE CHART BELOW shows that net interest margins for FDIC-insured financial institutions have increased from a recent low of 3% in Q1 2015 to 3.5% during Q3 2018. The fed funds rate has increased by 2% from late-2015 to today. As a result, banks are earning more interest income.

Fed Funds Rate & Net Interest Margins (1989-2018)

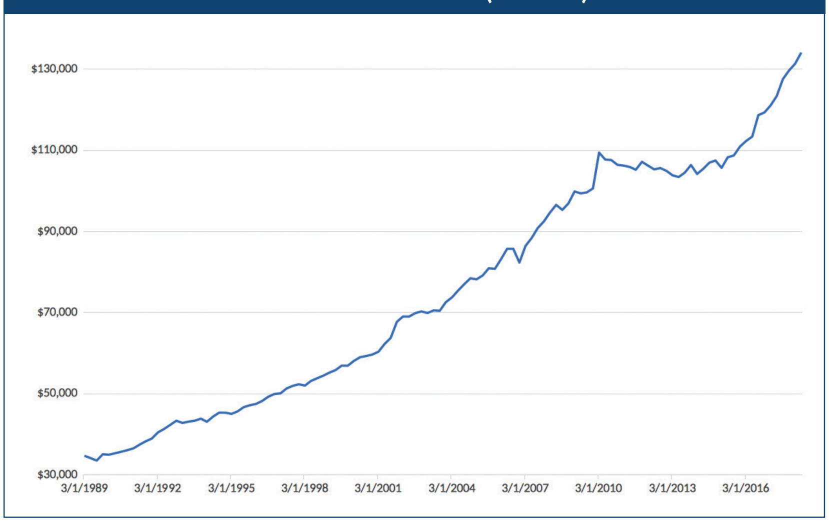


Data source: Bloomberg.

The chart below shows that net interest income for FDIC-insured institutions reached a record high of $137 billion during Q3 2018[5].

Healthy banks are critical for a healthy economy. Despite a flattening yield curve, banks have continued to see their net interest margins expand. Further, banks are continuing to increase their interest income. At this point, there is little actual data that signals a slowdown in banks' willingness to lend.

Net Interest Income (billions)



Data source: Bloomberg.

Bottom Line: Stocks Look Attractive Despite Volatility

THERE ALWAYS ARE SOME LEGITIMATE CONCERNS about certain companies, industries, markets, and the economy. Today is no different. Concerns about the Fed, trade, and the global economy have spilled into consumer and business confidence. Readings for both consumer and business confidence declined more than expected in November, which opens the door for the U.S. economy to slow down further in 2019. The continued U.S.-China trade war continues to elevate risk, both here and for China's economy. Political volatility in the U.S. creates uncertainty for businesses. And there is a possibility for continued deterioration of the European Union as Brexit looms.

The market certainly has several real issues to worry over, but that's nothing new. There always is something to worry about. The question is whether stocks have dropped more than they should. At current prices, we think that's the case. The market seems to be pricing in a very high probability of a recession. Therefore, there is room for an upside surprise in 2019. Here's why we think stocks will rebound from here:

- **A recession in 2019 is unlikely. The U.S. economy is strong. GDP will slow in 2019, but slowing is not the same thing as shrinking. Economic growth slowing from 4% to 2.0% or 2.5% is nowhere close to a recession.**

- **Historically, the stock market's largest declines have happened during recessions. Since WWII, 1987 was the only time that stocks dropped 30% without a recession.[6] If the economy continues to grow in 2019, it's unlikely that we see much more downside from here.**

- **Stocks are cheap again according to our long-term valuation models. Unless earnings are reported a lot lower than analyst estimates, stocks appear cheaper than at any time over the past few years.**

- **Stock prices have been declining, yet dividends continue to grow. 18 of the 69 companies in our three investment strategies have increased their dividends at an average of 16% during the last quarter. These are real businesses. If CEOs and boards were worried about the future prospects of their businesses or the economy, they wouldn't increase dividends at such a healthy rate.**

Headlines and emotions rule the short-term. Over long periods of time, however, the markets will follow dividends and earnings. Don't fear this illogical, emotion-driven market. It, too, will pass. While you wait, your companies will continue to pay and increase their dividends.

Thank you for your confidence in DCM. If you have any questions or concerns, please don't hesitate to give us a call. We know these times are difficult, but we're here to walk through them with you.

[5] Yardeni, Ed. "Morning Briefing." Yardeni Research, 18 December 2018. [6] LPL Financial Research. Data from FactSet, 20 December 2018.

The Power of the Rising Dividend

THERE ARE MANY REASONS that DCM uses Rising Dividend investment strategies. As we've said before, our investment priorities are security, income, and growth – in that order. Investing in strong companies, with proven track records of increasing their dividends each year has historically provided a consistent and reliable vehicle to achieve these investment goals. This principle is supported in a recent study by Strategas Research Partners. Part of the study analyzes our most recent recession, the 2008 financial crisis.

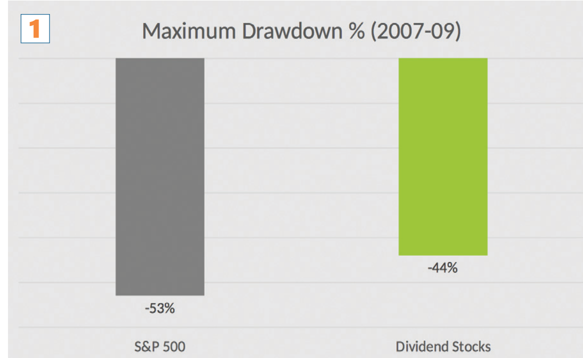
During this time period, if you compare the maximum drawdown from the previous all-time high, **the S&P 500 was down 53%,** while the **Dividend Growth Stocks in the index were only down 44%.** That may not sound like much, but also consider it takes a larger gain to recover from a loss. For example, a **53% drop** requires a **127% gain** to get back to even. A **44% loss,** on the other hand, only requires a **78% gain** to reach full recovery.

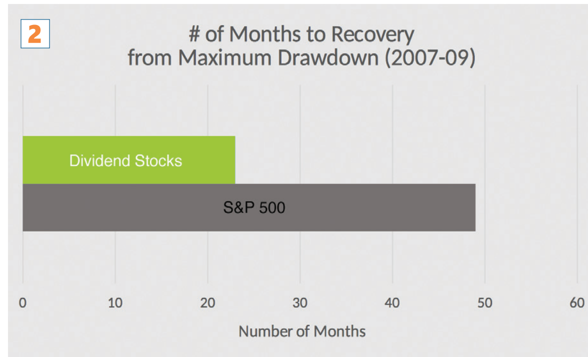
On that note, the length of time it takes to recover also is a significant consideration. When looking at the same comparison, it took the **S&P 500 more than four years** (49 months) to recover from the maximum market drop. Alternatively, it took **Dividend Growth Stocks less than two years** to recover (23 months).

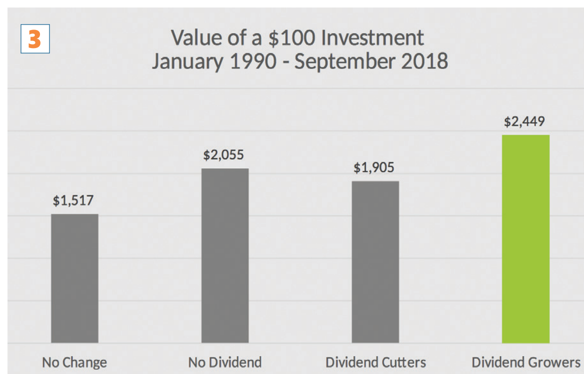
Dividend Growth Stocks also support your return on investment. A $100 investment in the Dividend Growers in January of 1990 resulted in a higher return, when compared to the other three dividend categories.

The fact Dividend Growers did not fall as far during market drops ***(chart 1)***, they did not take as long to recover ***(chart 2)***, and the companies are generally financially and strategically stronger, all suggest that Dividend Growers can contribute to a higher long-term performance ***(chart 3)***.

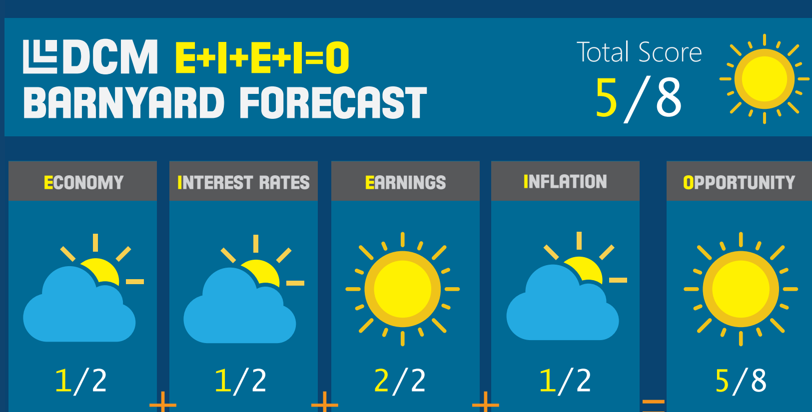
Each of these dynamics reinforce each other to support DCM's investment priorities. Each are woven in the same piece of fabric; all a part of the DCM Rising Dividend Strategy.







***The above graph represents the change in value of a hypothetical $100 investment in each of the four categories from January 1990 through September 2018. The reinvestment of dividends is included in the performance. Source: Strategas Research Partners, October 25th 2018*



This forecast provides DCM's evaluation of the overall economic climate. It is subjective in nature and represents the Firm's outlook and interpretation of the market as of the date of this publication. 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.

California COMMUNITY Foundation

WILDFIRE RELIEF RECEIVES SUPPORT, THANKS TO YOU

WE WOULD LIKE TO EXTEND OUR SINCEREST GRATITUDE to all of you who completed our client survey in October. We don't take it lightly that you took time out of your day to help us continue to improve our service. As promised, a donation was made for each completed survey. We're pleased to announce that the participation results increased from our last client survey, and as a result, **a donation of $6,875** was made to the **California Community Foundation Wildfire Relief Fund.** Our thoughts and prayers continue to go out to our clients affected by this horrible disaster.

DCM RETIREMENT PLAN SERVICES

THE NEW RETIREMENT LANDSCAPE

AT DCM, one of our core values is "development." We define that as, "we create opportunities and provide resources that help our employees, clients, and company reach their full potential." DCM's Retirement Plan Services division is particularly dedicated to this value. Not only is it our duty to educate and advise employers and their 401(k) participants, but the current financial landscape makes financial literacy more important than ever before.

According to the Employee Benefit Research Institute, employees are less prepared for retirement today than they were decades ago. One reason is the structure of employee benefits has changed drastically. No longer are companies providing that "lifelong stream of income" through pension plans to loyal employees. Instead, the responsibility of saving for retirement has shifted almost completely to the shoulders of the employee. In addition, one used to work "cradle to grave," as they saying goes. Many Baby Boomers worked for a single company for 40 years, retiring with a lifetime annuity paid out by the company. Today, this scenario is almost unheard of.

In a recent survey, almost half of workers reported having less than $25,000 saved for retirement, and only 41% had even tried to figure out how much they need to save for retirement. In addition, 44% of workers stated they will need to work longer because they do not have enough saved up for retirement. As we age, that may not always be possible.

Social Security is another major factor to consider. Especially for the younger generations, the prevailing consensus is that eventually Social Security won't be available, and if it is, it won't be in its current format. Perhaps future generations will receive pennies on the dollar to what they have contributed.

For those still saving for retirement, the responsibility now rests on your shoulders to answer these questions. Should I participate in my employer-sponsored plan? What are the costs involved? How much should I contribute? What investments should I choose?

DCM's Retirement Plan advisors are committed to helping our participants answer these questions. We partner with employers to help educate employees on why they should save early and save often. We advise on the proper investment options based on time horizon and appetite for risk. We also have expertise to help with other topics like basic budgeting and cash flow management. Our goal is to help deliver people successfully to and through retirement.

[1] Employee Benefit Research Institute (EBRI), Issue Brief No. 431, "The 2017 Retirement Confidence Survey. Many Workers Lack Retirement Confidence and Feel Stressed About Retirement Preparations." March 21, 2017

In the Life of DCM

▲ **IN OCTOBER,** DCM team members and their families had the pleasure of volunteering together at the Value Every Child Community Project, benefiting children entering foster care. The project provided more than 1,000 bags of age appropriate necessities such as diapers, formula, toothbrushes, and pajamas, as well as a stuffed animal or blanket. DCM also sponsored and served lunch to all of the volunteers at the end of the event.

▲ **OUR 4TH ANNUAL BOO IN THE U** was celebrated on Halloween this year. The DCM kids had a blast trick-or-treating around the office and enjoyed games and crafts in the "DCM University" room afterwards. As you can see, it wasn't just the kids that got into the Halloween spirit.

▲ **OUR FIRST IMPRESSIONS MANAGER, JODIE CHAPMAN,** organized a company tour of the Reitz Home Museum in December. As a nonprofit museum, the Reitz Home is on the National Register of Historic Places and serves as an educational resource for the Evansville community.

Donaldson
CAPITAL MANAGEMENT

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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.