SPRING 2018 ISSUE

Donaldson CAPITAL MANAGEMENT

RISING DIVIDEND REPORT

Security ▪ Income ▪ Growth ▪ Service

QUARTERLY
QUICK FACTS

1 The S&P 500 had its first correction (meaning decline of 10%+) since early 2016. This isn't surprising. Stocks correct, on average, once every year.

2 The outlook for company earnings is better than we've seen in decades. Growing fundamentals have helped eliminate concerns about stock valuations.

3 The US and global economies continue growing at a healthy pace. The odds of a recession over the next 12 months remains incredibly low.

4 Investor concerns about tariffs are likely overblown. The announced tariffs are tiny in comparison to the recent fiscal stimulus.

5 While interest rates have increased, they remain near all-time lows. Stocks won't be affected too much as long as rates increase at a slow, steady pace.

The Investment Policy Committee

An inside look at our decision-making process

DCM'S PROCESS for deciding what stocks and bonds you own has evolved substantially over the years. Twenty years ago, Greg Donaldson made every decision for how the portfolios were built. Slowly but surely, more experts were brought to the table. Eventually the Investment Policy Committee was created.

Today, our seven-member IPC votes on every stock bought or sold for DCM's three equity models. Reaching that vote requires several steps. While much of the groundwork happens during the week, we bring several factors together at each meeting:

- **Macro-Economic Outlook.** What US and global factors are and will be influencing the markets and individual economic sectors?
- **Market Messages.** What are the markets telling us about certain industries and sectors? Where is money flowing to or from?
- **Portfolio Specific Data.** Inside our model portfolios, where do we see opportunities or troubles? Is it time to act upon those signals?

As we get down to actually deciding which securities to buy and which to sell, two full-time Research Analysts step in and develop in-depth reports. Based upon those reports, the fun begins as we debate buys and sales that are in the best interest of our clients. Lastly, the IPC votes on each change.

Decisions made in the IPC meeting are final for our MODEL portfolios, but not necessarily for your individual portfolio. Every Portfolio Manager must decide for each client whether now is the best time to make the agreed upon change. What is going on with that client that might alter the decision to buy or sell? Large capital gains? An upcoming need for cash? A charitable gift on the horizon? To stay fully informed, all Portfolio Managers listen to the IPC meeting, and a written recap is shared with the whole firm.

While we have formalized this process over the years, and involved more people, the roots of our investment approach all come from the same principles developed and tested by Greg and the original Investment Policy Committee.

MD Hull

MIKE HULL
PRESIDENT & SENIOR PORTFOLIO MANAGER

A New Year, A New Tax Code

IT'S BEEN OVER FOUR MONTHS since President Trump signed the Tax Cuts and Jobs Act into law. The widest reaching revisions are the reductions in corporate and individual tax rates. As a result, many Americans have already noticed a slight bump in their paycheck.

But, with over 1,000 pages of legislation, you may be wondering how exactly the new tax laws will impact your financial lives and what changes you should be making. We've rounded up the most important changes that affect your financial and investment planning.

Deductions for State and local taxes (including property taxes) are now limited to $10,000.

All miscellaneous itemized deductions have been eliminated. Tax preparation fees, investment related expenses (including advisory fees), and unreimbursed employee expenses are no longer deductible.

The bill caps mortgage interest deductions at $750,000 (previously $1 million) for the purchase of homes in 2018 and beyond. Deductions for interest on home-equity loans are also eliminated.

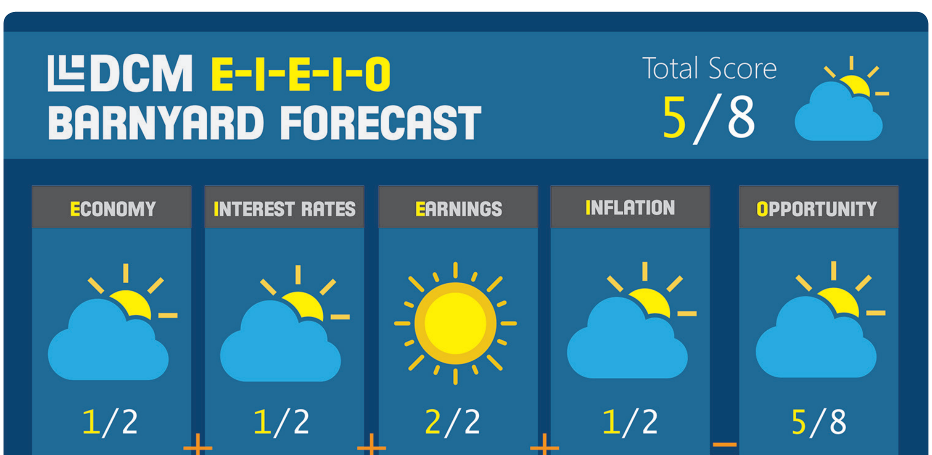
The threshold to deduct medical expenses lowered from 10% of your adjusted gross income (AGI), to 7.5%. Only medical expenses in excess of that threshold are deductible.

The standard deduction for married couples has been increased to $24,000 and $12,000 for individuals. As a result, it is estimated that the number of taxpayers who itemize will drop by 75% according to estimates (over 30 million people). All of these individuals will no longer have a tax benefit for gifting to charity. However, individuals older than 70½ may have an opportunity to deduct charitable contributions on top of the standard deduction. The opportunity is a Qualified Charitable Distribution (QCD) from a qualified retirement account, such as an IRA. Your DCM Portfolio manager can help you decide if this would be right for you.

The personal exemption of $4,050 for each individual and dependent was eliminated. However, the child tax credit doubled to $2,000 per dependent under age 17. This credit is now phased out at $400,000 of AGI (previously the phase out was $110,000 of AGI).

The bill doubles the estate tax exemption to $11.2 million for individuals and $22.4 million for couples. This exemption includes a sunset provision, meaning there will be a reversion back to current exemption rates in 2026 (barring a change in the law).

Please consult with your DCM Portfolio Manager and your tax advisor for a more comprehensive look at your individual tax situation.



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.

COMPANY SPOTLIGHT

Maxim Integrated Products (MXIM)

DCM portfolios are full of companies you would immediately recognize. Coca-Cola, Starbucks, and Apple are obvious household names. But what about Maxim Integrated Products? This name probably doesn't come up in everyday conversation. However, chances are that you use Maxim products on a daily basis. But how? Maxim designs many of the electronic chips that enable the devices you use.

Consider the phone in your pocket, the smartwatch on your wrist, the car in your driveway, or the keypad in the checkout line. In your phone, these chips gauge battery life, enhance audio inputs, and sense light and distance. On your wrist, they can help keep track of your heart rate and temperature. In your car, they manage the flow of power, allow for keyless entry, let you charge your phone, and help light your vehicle and the road. In the checkout line, they work to protect your sensitive information from potential hackers.

Maxim applies this type of technology in an industrial setting as well. Consider any modern factory. Their electronic chips manage the flow of power to robots, transmit signals, collect physical data, and protect electronic equipment from malicious actors. There has been a significant increase in demand for these products as manufacturers have boosted the level of automation in their facilities.

These are only a few examples of the functionality Maxim chips can provide. The company's unique designs are key ingredients in the rapid development of a "smart" and connected world. We see electronification, connectivity, and automation as some of the most powerful trends emerging today. Riding these tailwinds, we are confident Maxim will provide the security, income, and growth you depend on.

Seeing Through the Volatility

A Letter from the DCM Investment Policy Committee

THE EERIE CALM of the stock markets in 2017 came to a halt over the past couple months. After a white-hot January, the S&P 500 declined 10.2% in a mere 13 trading days. This marked the first correction (down 10% from high) since early 2016.

Through the end of February, the S&P 500 had notched 15 trading days with a 1% or more price change in 2018. This was double what we saw in 2017. We expected this increase in volatility. As mentioned in our Winter 2017 market commentary:

> "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% and 10% occur in an average year in the stock market. Remember, these are completely normal and are part of a healthy bull market. It's likely to happen in 2018. Don't be surprised or worried when it does."

THIS BOUT OF VOLATILITY has been a popular topic during our discussions with clients. Common questions emerge in times like these. We thought it would be useful to provide answers to a few questions.

What's causing the volatility?

What does it mean for your portfolio?

Has our view of stocks changed since the start of the year?

Let's put recent market volatility in historical context before we talk about reasons for it. How does this year's volatility compare with past years?

Going back to 1982, the S&P 500 has had a median daily price change of 1.2%. In other words, stocks either increased or decreased by at least 1.2% in half of all trading days[1]. So don't fear when stock prices jump by 1% or more. That's normal. What we've seen so far in 2018 is in line with past years.

The S&P 500 has declined by 10% at least once per year, on average, going back to 1927. Smaller declines of 5% happen every 2-3 months. And larger declines of 15% have happened every couple years[2]. These corrections and mini-corrections are necessary in a healthy bull market. In most cases, they represent buying opportunities. February's correction was long overdue and important. These declines prevent investors from getting too optimistic about stocks.

What's Causing Market Volatility in 2018?

1. INFLATION AND INTEREST RATE SCARE

The market tantrum began as a result of a better-than-expected jobs report on February 2nd. The U.S. economy added 200,000 new jobs in January, outpacing estimates by roughly 10%. Adding new jobs is a sign of a healthy economy. However, the report also indicated a sharp increase in wages. That caused investors to worry.

If wages rise, so does inflation. But why is inflation that big of a deal?

For one thing, the Fed has a mandate to keep prices stable. If inflation accelerates, the Fed may need to increase short-term interest rates to cool things down.

Second, higher wage inflation puts a dent in corporate profit margins. As employees' wages increase, profit falls if a company cannot pass the extra cost on to customers.

Third, price-to-earnings (P/E) ratios for stocks are inversely correlated with inflation. As inflation increases, the P/E ratios for stocks tends to decrease.

And, finally, higher inflation causes higher long-term interest rates. If interest rates get too high, bonds become an attractive alternative to stocks. You might not be interested in buying the 10-year U.S. Treasury at 2.8%, but what about 3.5%? Or 4%?

2. INVERSE VOLATILITY ETFS AND ETNS

The markets turned suddenly chaotic after the jobs report. Inflation and interest rates had something to do with declines. However, a lot of February's volatility came from something completely unrelated to fundamentals.

Over the past few years, "investing" in volatility has gained popularity on Wall Street. Investors can now buy funds that benefit if they predict whether the markets will be volatile or not.

After such a calm 2017, there was a lot of money betting that volatility would remain low. Speculators bought exchange-traded funds (ETFs) and exchange-traded notes (ETNs) that would increase if volatility declined. And vice versa.

In the first quarter of 2018, volatility reappeared in a hurry. Traders holding ETFs and ETNs designed to gain when markets were calm got hit hard. A few of these leveraged funds dropped by as much as 80% in a single trading day. Trading stopped on some of these funds because they were so volatile.

Making things worse, speculators were borrowing money to invest in these low volatility funds. When the funds imploded, many with leveraged positions had to sell other assets (like stocks) to satisfy their margin calls. This drove stocks even lower, causing more volatility. The increased volatility caused more losses in volatility funds, causing more stock sales. And the vicious cycle continued.

Some of these funds ended in such a disaster that they closed over the next few weeks. Credit Suisse, the issuer of VelocityShares ETN, closed the fund and redeemed the ETN shares. Nomura Securities followed suit, redeeming its S&P 500 VIX Inverse ETN.

Once again, it's a reminder that investors as a whole can't stay out of their own way. Many of these ETFs and ETNs were easy money in 2017, but that blew up quickly. Our advice? Stay invested in things you can understand and clearly see how the value can increase over time.

3. TRADE CONCERNS

On March 1st, President Trump announced a 10% tariff on imported aluminum and a 25% tariff on imported steel. The Dow fell by 400 points on the day of the announcement. In isolation, these tariffs aren't a big deal for the U.S. economy. The tariffs would cost only 411 jobs and decrease U.S. GDP by 8/1000s of 1%.[3]

More recently, the administration announced $15 billion in potential tariffs against China. This also represents a tiny fraction of our economy. To put it in context, there is $800 billion in fiscal stimulus from 2018's tax cuts and spending package.

The impact on U.S. corporations also appears small. Boeing (BA), for example, uses a large amount of aluminum in production of its airplanes. However, most of the cost comes from manufacturing and engineering, not materials. Initial estimates were for the cost of a Boeing 787 to increase by about 0.2%. That's not enough of a difference to cause serious concern for Boeing's business.

The bigger concern is how other countries will react. Not surprisingly, China has been quick to announce their initial rounds of retaliatory tariffs. Certain companies could be harmed if other nations add tariffs on U.S. products. Those that do a large percentage of their business overseas are at particular risk. Costs could also increase for U.S. consumers if the government adds additional tariffs to imported goods. Increasing costs may result in lower demand from the all-important U.S. consumer.

A full-blown trade war would be bad for the U.S. economy, consumers, corporations, and markets. The Trump administration is not going to back down from their "fair trade" agenda. However, the odds of a full-out trade war breaking out is low. The U.S. imports much more than we export. Many countries — including China — are heavily dependent on the U.S. consumer. Why would they risk harming such a profitable relationship with us?

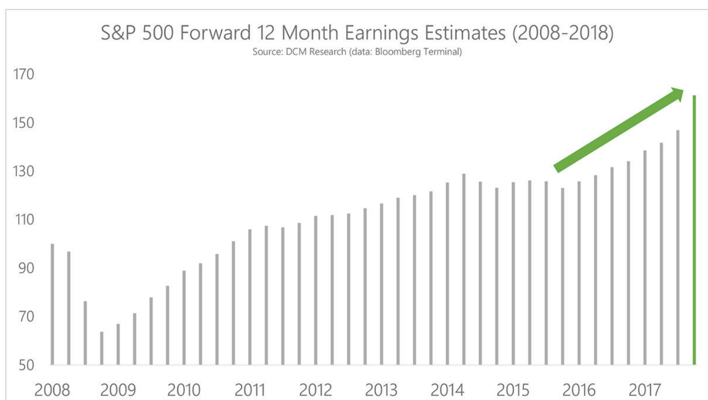
We remain vigilant to the negative consequences for our companies and will take action if necessary. At this point, we aren't concerned about trade derailing the current economic expansion.

Has Your View on Stocks Changed?

NO. IT HAS NOT.

We don't turn a blind eye to these events. Rather, we choose to focus our attention on underlying business fundamentals. Dividends, earnings, and sales eventually drive stock prices regardless of what else is going on in the world.

And, these fundamentals are increasing at a historically fast rate. The illustration below shows earnings estimates going back to 2008.



Since Q2-2015, estimates have been rising steadily. Q2-2018 estimates are accelerating even faster. Year-over-year growth for expected earnings are up 20.4% over the past 12 months. This is the highest growth rate since 1995.[4]

A similar trajectory exists for dividends and revenues. It's hard to be too negative on stocks with the economy and tax reform driving such incredible growth in corporate profits.

Your Portfolio Was Built for Volatility

"BUT, WHAT ABOUT [insert worry here]."

We know there are worrisome issues and headlines. U.S. politics are unpredictable, even chaotic at times. Protectionist attitudes threaten years of progress on global trade. Geopolitical concerns abound. Rising interest rates. National debt. The list goes on.

There is always something to worry about in the markets. If you wait until there is nothing to worry about, you'd never buy a single stock. However, we know that – for many of our clients – these worries have a day-to-day impact on their nest egg. Our job is to produce dependable income and to grow that income over time. But, first and foremost, our priority is to protect it.

Markets can and often do move quickly and unpredictably. It's impossible to foresee what the markets will do tomorrow, next week, or next month. The solution? **Invest for the worst of times, all the time.**

Our #1 tenant is Security. That means our first priority – above growth, even above income – is protecting your nest egg from permanent loss. We build our portfolios with the assumption that a recession could start tomorrow. If it does, we want to own the highest quality companies available. We focus on three factors when deciding whether a company is good enough for you to own.

1. PAYING A DIVIDEND

History is scattered with companies who manipulated their financial statements to look better than they were. The most obvious example was Enron. $74 billion in shareholder value was erased in months as the company went bankrupt.

While earnings can be manipulated or restated, dividends can't. Once a dividend is paid, there's no taking that dividend back. Paying a dividend indicates that a company makes real money, not just on paper.

2. DIVIDEND GROWTH

It's possible for a company to pay a dividend without real profits for one, maybe two years. They could borrow money, sell stock, or liquidate assets. After time, however, that must come to an end.

A company that is able to grow its

dividend is proclaiming to investors that it can pay its dividend for the rest of time. And managers and board members know that investors will demand future increases on top of that. Forever. They also know that a dividend cut will wreck their stock price. So increasing the dividend is not an easy decision.

Bad businesses don't grow dividends for 50 consecutive years. Only the highest quality businesses can sustain these increases over time. It's intuitive then that dividend growers should hold up better in down markets.

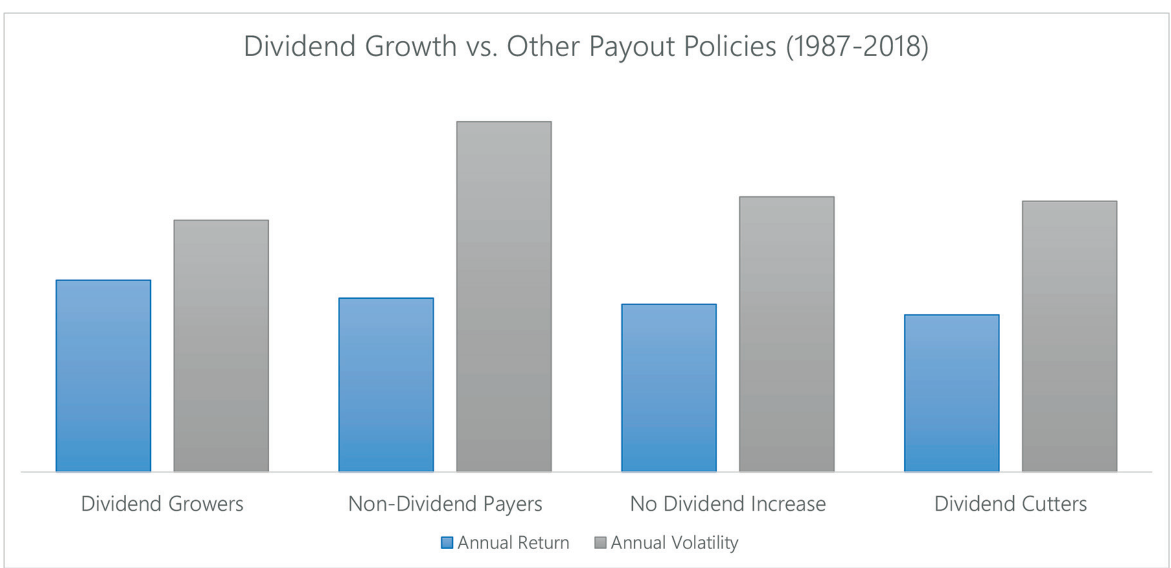
We can validate this with historical data. The chart below shows the performance of dividend growers during negative market years going back to 1988.

Year	Dividend Growers	S&P 500 Index
1990	-4.40%	-3.10%
2000	17.70%	-9.10%
2001	2.90%	-11.90%
2002	-8.70%	-22.10%
2008	-32.90%	-37.00%
Average	**-5.10%**	**-16.60%**

Figure 2: Declines in S&P 500 Since 1988. Data source: S&P Global

In all years but 1990, the average dividend growth stock did better than the S&P 500 Index. When the Tech Bubble collapsed from 2000-2002, dividend growers actually increased in value. The S&P 500, on the other hand, declined in value for three consecutive years. The technology stocks — almost none of whom paid a dividend — collapsed and dragged down the entire market. Companies that were able to continue increasing the dividend also did better during the Financial Crisis of 2007-09.

By sticking with dividend growers, you not only end up with a less volatile portfolio – but higher returns as well. The graphic to the right illustrates the return of dividend growers compared to non-dividend payers. Also showing are companies that either did not grow or cut their dividend.



Historically, dividend growers have outperformed their counterparts with lower annual volatility. The non-dividend payers may be red hot in a bull market. But they have not held up as well during pullbacks.

3. DIVIDEND SUSTAINABILITY

And finally, we focus on the sustainability of the dividend. We want to invest in companies that pay out a low percentage of their earnings by way of dividends. If a recession hits and earnings drop, we want to be sure they are able to continue paying their dividend.

By focusing on these three things, we can reduce volatility in your portfolio. And most importantly, keep your income sustainable and growing for many years to come.

What Portfolio Changes Should You Expect?

WE STILL FAVOR STOCKS over bonds and have shifted our sector allocation to prepare for a rising interest rate environment.

As it became clear that interest rates were beginning to move higher in September 2017, we began working to make our strategies less interest-rate sensitive. With just a few changes, we reduced the sensitivity to interest rate changes and maintained the growth and income.

In light of potential trade issues and rising interest rates, we're comfortable with our current holdings, but are keeping a close eye as events unfold.

Bottom Line

WE REMAIN OVERWEIGHT stocks and expect to continue that as 2018 unfolds. It's a noisy environment, but compelling reasons make us optimistic about stocks in 2018.

- **The outlook for company earnings is better than we've seen in decades.** Growing fundamentals have helped eliminate concerns about stock valuations.
- **The U.S. and global economies continue growing at a healthy pace.** The odds of a recession over the next 12 months remains incredibly low.
- A trade war would be bad for stocks, but **investor concerns are likely overblown.** The announced tariffs are tiny in comparison to the recent fiscal stimulus and the economy as a whole.
- **While interest rates have increased, they remain near all-time lows.** Stocks won't be affected too much as long as rates increase at a slow, steady pace.

2018 has been volatile so far, however, but not unusual. There remains plenty to be optimistic about as we look ahead.

1. Strategas Research Partners

2. Sterne Agree and Bloomberg, S&P 500 from 1927-2013

3. Ferry, Jeff. "Steel & Aluminum Tariffs Produce Minimal Impact on Jobs, GDP." Coalition for a Prosperous America (CPA). 2018, March 20.

4. Using year-over-year change in blended forward 12 month earnings estimates. Data source: Bloomberg Terminal.

We are excited to announce a new division of our firm:

DCM RETIREMENT PLAN SERVICES

For the past 20 years, our investment philosophy has demonstrated to be immensely useful for those in or near retirement. We now see the same opportunity for our strategy to be utilized for wealth accumulation – the primary objective of a retirement savings account.

While we already manage a number of 401(k) plans, this new department will allow DCM to offer comprehensive management and administration of retirement plans to companies of all sizes. Services offered will range from ongoing financial literacy, risk tolerance, fiduciary oversight, but most importantly, making DCM's investment strategies available to a new audience.

The truth is, most individuals are unprepared to truly enjoy a life in retirement. In fact, more than half of U.S. households have less than $25,000 in savings. In a world that increasingly places the burden on individuals to provide for their own retirement, and where two thirds of those 60 and older fear death less than they fear outliving their money, it is paramount for DCM to take our story to the masses.

There are several other key factors that have led DCM to this turning point:

- Over the last several years, **laws have changed** as the Department of Labor has forced transparency around fees and better oversight for all participants of retirement savings plans.
- With these regulatory changes, **the 401(k) industry has shifted** to the point where many firms are essentially offering the same or similar baskets of mutual funds. DCM's investment options, however, will be truly different.
- **Recent technological advancements have empowered DCM to pursue this opportunity,** with one of our partnering custodians, TD Ameritrade. TDA has launched a world-class platform that will allow DCM to bring low cost and great service to the Retirement Plan industry.

TDA's platform, also allows DCM to take our actively managed strategies, such as Cornerstone, and treat them like a mutual fund offering on a 401(k) investment menu.

Now, everyone from the CEO, down, has access to our industry-leading investment offering. This allows us to better serve pre-retirees with our differentiated service model and investment strategies. Our focus is to guide and empower retirement plan participants to take ownership of their retirement savings strategy.

If you are an employer who sponsors, or an employee who participates, in a 401(k) plan, the DCM RPS solution may be a good fit for you. Contact your Portfolio Manager for more information or visit www.dcmol.com/RPS.

Email: RPS@dcmol.com
Visit: www.dcmol.com/RPS

EMPLOYEE HIGHLIGHT

Brandon Roop, CFP®, CRPS®, brings Retirement Plan Services to life at DCM

Sr. Portfolio Manager and VP of Institutional Services, Brandon Roop, has led the effort to officially launch this new division of DCM. He has spent the past several years building his knowledge base and researching the Retirement Plans industry in order to determine how DCM can provide the most value.

In addition to being a Certified Financial Planner™ professional, Brandon pursued and obtained his *Chartered Retirement Plans Specialist,* (CRPS®) designation to dive even deeper into the Retirement Industry in order to understand all the components involved. As a result of his research and analysis, he presented a comprehensive Business Plan to DCM's Board of Directors within the past 12 months. Receiving the ultimate approval from the Board, DCM has formalized the RPS department and has spent the last several months preparing for the official launch of this new service.

Brandon and his wife Leah live in Newburgh, Indiana, with their daughter, Reagan, and son, Ramsey. They actively participate in many ministries and non-profits, as well as attend Onelife Church in Evansville.

A Sweet Gift

Where do the tasty Christmas treats come from?

FOR OVER 20 YEARS, DCM has given you the gifts of security, income, and growth. Most importantly, we've given you the **gift of chocolate.** These boxes of pecan turtle squares and toffee are such a hit every year, we thought it would be fun to share the history behind them.

Back when there were four employees at DCM and less than 100 clients, Client Services Manager Carol Stumpf experimented with a few Christmas gift options. For several years we tested out a few different options; small paintings, coffee baskets, and cookies. And then in 2003, a client from Indianapolis suggested to Greg Donaldson that we check out a small, local chocolate shop in Indy called The Best Chocolate In Town. That year, we ordered our first round of Christmas chocolates from the shop and haven't looked back since (well, there was one year that we did divert from the chocolates, and let's just say that our clients were less than pleased).

Elizabeth Garber founded The Best Chocolate In Town in 1998. Located in the Cultural Arts District of Downtown Indianapolis, all of their desserts are handmade. Their specialties are truffles, caramels, specialty chocolates, and cookies. We asked Elizabeth about the 15-year partnership with DCM. She said, "The gift has always been pecan turtle squares and toffee, but the number of gifts has changed. I believe the first order with us was around 40 gift towers, which was a huge order for us at the time. As the years roll by, and both of our companies have grown, we've been lucky enough to continue to supply Donaldson's clients with our chocolates. Last year's order was 1,077 gifts. It's been an honor to be your chocolate supplier for all these years!"

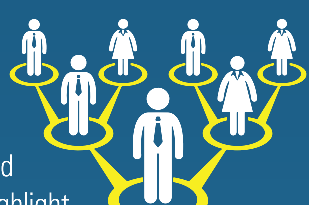
THE NEXT GENERATION

Our Succession Plan to help take DCM into the future

Hundreds of independent investment firms like DCM find themselves with a dilemma. Their founding partners are nearing retirement.Those founders, like DCM's, must decide how to best send the firm into the future. What's best for the clients we love serving? What's best for the employees who have become like family? What's best for their own families? Sell? To whom? Merge with another firm? Walk away? Invest in the firm so that it can continue for generations?

At DCM, we faced those questions about six years ago. Our Board of Directors feels strongly that DCM should remain independently owned; focus on serving our clients better every year; maintain our core investment philosophy; and protect the firm's unique culture.

Keeping in mind that our number one priority has been and will always be our clients, we decided to address a big issue: *most of your financial lives and retirement planning needs will extend long beyond the careers of many DCM employees.* Although this will happen **very gradually** over the next number of years, we have taken serious, and often expensive, steps to ensure that DCM continues to improve long after our founders have hung up their spurs.



In the next few issues of the Rising Dividend Report, we will highlight specific areas of focus for our Succession Plan. For example, Mike's note explained the decision-making process of the Investment Policy Committee. The committee has undergone many changes in the past five years to ensure that the appropriate procedures are in place and that all involved are equipped to take DCM into the next generation.

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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.