Donaldson CAPITAL MANAGEMENT

SPRING 2021

RISINGDIVIDEND REPORT

QUARTERLY QUICK FACTS

1 Navigating the 2021 investment environment may feel a bit like embarking on discovering a new world. Like Christopher Columbus, you need a 'North Star' to guide your investments where you want to go.

2 Your investment North Star should be measurable, stable and compelling, and provide direction.

3 Growing the market value of your portfolio is a fine long-term goal, but a lousy North Star. Not only is it incredibly unstable, but it tells you to 'sell' when you should be doing the opposite.

4 Earnings are important but can be manipulated to look better than reality. In some cases, accounting fraud can destroy a stock within months (Luckin Coffee fell 97% in 2020).

5 Dividends improve upon earnings, but seeking the highest current dividend income can lead investors into riskier companies and income traps.

6 Focus on growing your dividend income as much as possible ten years from now. That is a North Star that can help you make better long-term decisions and maximize your chances for success.

We Can't Wait to See You

THEY SAY THE KEY TO EVERY HEALTHY RELATIONSHIP IS CHOCOLATE. Wait, that's not right. The key to every healthy relationship is communication. As DCM's Manager of Communications, my job is to ensure that the messages coming from DCM contain information that is timely, accurate, and helpful to you. Before the pandemic, so much of how we communicated and shared information was in person. Not being able to be with you has left us with a void. Despite the rapid and prolonged change, we hope you feel we haven't missed a beat.

The pandemic moved us a decade or more into the future in terms of technological innovation in communication. We accelerated the adoption of technologies that could bring us together in ways that felt familiar. We don't know what will be next, but we know the business community and economy won't look back. We are investing in new communication technologies to expand your access to learning opportunities and enhance your experience as a client. One example we are excited to announce is DCM Video, coming later this year. As a DCM client, you will gain exclusive access to videos from experts on market updates, quick educational topics, and DCM's view on market trends.

What hasn't changed is our commitment to bringing you timely information that helps you make better-informed decisions about your finances and investments. Whether we deliver that to you over the phone, through dcmol.com, or in video, we hope we build your trust in us as your advisor.

We are grateful for your willingness to be flexible and communicate with us through new technology. We believe this shared connection and sense of community at DCM has helped us all thrive in these difficult times. But nothing will replace the feeling of being with you, face to face, in our offices, or at your home or business. And we can't wait for that.

Sara Williams
Communications Manager

Sara Williams

Your Retirement Journey:

Steven H. Nichols, M.D. — Retired 13 Years

Dr. Nichols is a retired pathologist and long-time client of DCM. We consider it a privilege to work with him and his family. Read more about Steve below, as he gives us a glimpse at his retirement journey and shares tips for those nearing retirement.
— Kyle Markle, DCM Investment Advisor

1. What has been the best change in your life since embarking on Your Retirement Journey?

No imposed schedule! Life is not quite schedule-free, but in retirement, you make your own schedule—for the day, the week, and the year. It is important to have a schedule, even just a simple 'to do' list; otherwise, you can fritter away much time. That said, sometimes, a schedule means doing nothing of consequence. Another thing: making one's own commitments. In my earlier years of retirement, I enjoyed volunteering, something I didn't have much time for during my active career. As time went on, I began to peel away some things which weren't as integral to my personal well-being and self-worth.

2. Have you seen any struggles that you did not expect?

Early on, I recognized I didn't want to spend my free time away from practicing medicine in investing and realized I didn't have the expertise anyway. Soon after beginning my investing with Greg Donaldson, I told him not to call me to approve his investment suggestions; that was his job. A recent challenge—that no one expects—was a health issue. But having kept reasonably fit over the years, I was able to meet that head-on with no worries on the financial end. And another issue: my brother reminds me that we are blessed to have our children live in St. Louis and close by. So we don't have the struggles of travel just to see family.

3. What is/are your favorite book(s) and why?

Principally I like reading history, and within that realm, I like American history and military history. A great book I read recently was Frozen Hours by Jeff Shaara. Anything by Shaara is good. This current book is about the Korean War battle of Chosin Reservoir. I felt like I was freezing my bottom in the minus 30-degree weather along with the soldiers of the First Marine Division. Just the Introduction was a masterful summary of the historical prelude to the Korean War. I've also glommed onto some of the books from my wife's book club. These have been a wide variety to shake me loose from the shackles of history and war.

4. What advice would you give someone getting close to retirement?

Develop hobbies and interests (outside of one's career) to stimulate you and give your life meaning beyond work. That part of your life is over. I'd see retired doctors come to the hospital to have lunch in the doctor's lounge. Their life had been their career, and once retired, they were like lost puppies.

North Star

A Letter from the DCM Investment Policy Committee

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

Nathan Winklepleck, *Author* | Preston May, Sarah Moore, Kyle Markle, Joe Zabratanski, *Contributing Editors*

ON FRIDAY, AUGUST 3rd, 1492, a fleet of three ships crewed by 90 men set sail from Palos de la Frontera, Spain. They were on a mission to find a new world.

None of them knew how big the ocean was; no man had ever gone before them to show the way. There were no modern tools to guide them. They had no maps, only a vast open ocean. And the stars. There are 9,096 visible stars in the sky. As the Earth rotates, those stars all move in the night sky. All except one.

The star Polaris lies in a near-direct line with the Earth's axis right above the North Pole. While every other star in the sky moves, the North Star does not. It is a constant; it can sometimes be the only constant for sailors. When all else failed, Christopher Columbus and his crew had the North Star to guide them.

The Financial 'Seas'

Navigating the 2021 investment environment may feel a bit like embarking on discovering a new world. There is no map telling you where to go, no historical precedent to guide you. Interest rates have been close to 0% for years; how do you generate income for retirement? The government has never stimulated the economy to this degree; will that lead to inflation? Politics are as divisive as ever; will the social unrest continue in the next few years?

These are the endless waves crashing around you. Like Columbus, you need a 'North Star' to guide your investments where you want to go.

What Are the Characteristics of a Good North Star?

Your investment North Star should have these four characteristics.

1. It should be **measurable**. You can't know whether you're getting anywhere if you can't measure where you are.
2. Your North Star gives you **direction**, keeping you on track.
3. A North Star must be **stable**; it is constant, never changing.
4. Finally, it must be **compelling** to you. You must believe it is taking you in the right direction even when setbacks happen (and they will).

Let's work our way through some North Star candidates.

Candidate #1: Market Value

My focus is to increase the market value of my portfolio. I must be going in the right direction if my accounts are growing. If not, I should make changes.

HOW DOES MARKET VALUE STAND UP AS A NORTH STAR? It is the most **measurable** of any candidate on our list. You can find an updated dollar amount online 24 hours a day, 365 days a year.

The total value of your portfolio is **compelling**. We measure everything in our financial lives by market value. When those numbers increase, we get a surge of positive feelings. When they decrease, we feel upset, disappointed, even fearful.

Market value passes our first two criteria; unfortunately, it fails the final two.

Stocks have declined by 40% or more once every 25 years or so.[1] Market value is **unstable**; if that is where you're looking, you better pack extra Dramamine.

The most dangerous part about market value is how deceptive its **direction** can be. From February to March 2020, the Dow Jones Industrial Average fell by nearly 37%.[2] If prices were your North Star, they would be telling you to sell your stocks and change directions. The time your portfolio's market value was at the bottom was the best time to buy, not sell.

HOW CAN I GROW MY PORTFOLIO WITHOUT MARKET VALUE TO GUIDE ME? What if the goal of your investment strategy is to grow the value of your account? How will that happen if you aren't paying attention to it?

Suppose you are going deep sea fishing tomorrow. Your goal is to catch at least ten fish. How are you going to do that? You can hire a guide, wake up early, take your motion sickness medicine, and fish with the right bait. All those things will put you in a position to catch fish. Yet, the result is still out of your control.

You can't force the fish to bite, nor can you force your account to go up. You don't fill the livewell by looking at it; you fill it by putting bait on your hook and casting it into the water. In the same way, **you don't increase your portfolio's market value by staring at it all day.** That's wasted time, at best, and more likely than not to point you in the wrong direction.

[1] Guggenheim Investments (2021). Putting Market Pullbacks in Perspective. [2] From 2/12/2020 to 3/23/2020. DIA Interactive Stock Chart. Yahoo Finance. Accessed 29 Mar. 2021.

If looking at market value isn't the best way to direct your portfolio, what is? Focus on the things that drive stock prices in the first place. Here is where we can start to find the best candidates for our North Star.

Candidate #2: Earnings

My focus is to increase the earnings per share of the stocks I own each year. I must be going in the right direction if earnings are growing. If not, I should make changes.

A share of stock is a small piece of ownership in a business. The primary purpose of a company is to earn a profit. So, it makes sense that we should focus on growing the total earnings of our portfolio year after year. How does this stack up as a North Star?

Earnings are **measurable**. All public companies report earnings according to Generally Accepted Accounting Principles. Those figures are available on any financial website.

Earnings are also **compelling**. Without profits, a company would not be able to pay dividends or reinvest in new growth projects. Growing earnings also generally lead to increasing stock prices. Focusing on growing the portfolio's earnings is an improvement over looking at market value, but there are still some issues.

Earnings lack **stability**. In recessions, they decline almost as much as stock prices. During the COVID-19 recession, earnings for the S&P 500 dropped over 30% from top to bottom.[3] That's not quite as far as prices fell, but it's close.

Earnings can also fail to provide **direction**. The most obvious failure is through accounting fraud. The most infamous example is Enron (2001), but there have been many other examples. In early 2020, Luckin Coffee (LKNCY) dropped 97% after regulators disclosed a massive accounting scandal. Earnings can also be 'managed' to hit Wall Street's expectations.

Earnings are a useful metric. We look at them regularly to assess how our companies are doing. But, they are more appropriate as an additional tool in the toolbox. Our true North Star needs to be stronger than that.

Candidate #3: Dividend Income

My focus is to build a portfolio that pays as much dividend income as possible. If dividends keep getting paid, I do not need my stock prices to go up. I'll just live on the income year after year.

A popular strategy in today's low interest rate environment is to buy stocks with the highest dividend yields. How does maximizing dividend income stack up as a North Star?

Dividend income is **measurable**. You can find dividend payments on your account statement as the checks come in each month.

Dividend income is also quite **compelling**. A $1 dividend is a lot more tangible than a $1 price increase.

And, while dividends do not provide perfect **stability**, they provide a more constant 'horizon' on which to focus. In 2020, companies in the S&P 500 decreased their dividends by less than 4%. That is more stable than the 30% decline in earnings and the 40% decline in stock prices.

Dividends also provide better **direction** than earnings. Cash dividends are a lot more difficult to fake; either you have the money or don't. The Board of Directors authorizes dividend payments. They take a long-term view of the company's financials and pay out only what they don't think they will need. Still, companies can create the illusion of dividends in two ways:

1. **They could pay out more dividends than they earn.** A company that pays out more than 100% of its earnings is, in effect, borrowing money from future years to pay dividends now. Not only is this unsustainable, but it prevents them from reinvesting into the long-term health of their business.

2. **They can work some financial wizardry.** Companies that don't have enough earnings to cover their dividends in a given year can either (1) pay out of their built-up reserves (their 'emergency fund'), (2) sell assets, (3) borrow money or (4) sell the stock, which dilutes their existing shareholders; in essence, they take from the left hand to give to the right.

Focusing on maximizing dividend income is better than focusing on price. Still, there is one thing missing to make dividends a true North Star: future growth.

Candidate #4: Maximize Dividends in 10 Years

My focus is to earn as much dividend income as possible ten years from now. Not only will this result in my income going up over time, but my stock prices will (eventually) follow.

Looking at future dividends shifts our mindset from maximizing income today to maximizing it over a lifetime. In most cases, this is at least a decade or longer.

The point is not to ignore today's dividend; it is a valuable and essential part of the analysis. The current dividend still acts as a yardstick to **measure** our progress, provides **stability** during difficult times, and is a **compelling** cash flow source.

The main advantage of looking at dividend income in 10 years vs. current dividend income is the **direction** that it provides. If we steer our financial ship towards the stocks that are likely to maximize our income in 2030, we focus our attention on what is most likely to drive long-term price increases.

Case Study: Home Depot (HD)

Let's take a look at an example: Home Depot (HD). What is its 10-year dividend outlook?

The simplest way to forecast dividend growth would be to look in the past and project that forward. Over the last ten years, Home Depot has increased its dividend from $1.04 to $6 per share - **a 19.2% annual growth rate**. That's a good starting point, but can lead to either overly optimistic or pessimistic assumptions. In this case, we think it unlikely that Home Depot can maintain that pace.

To fine-tune the forecast, let's take a brief look at the underlying drivers of dividend growth and what they might be in the future:

- Home Depot sold $125 billion in merchandise in 2020. Sales growth has averaged around 7.3% per year over the last decade.[4] Let's assume this pace slows a bit each year to around 3.7% in 2030. If that's the case, **Home Depot's sales would be under $207 billion**.
- Now, how much of that $207 billion could they convert to

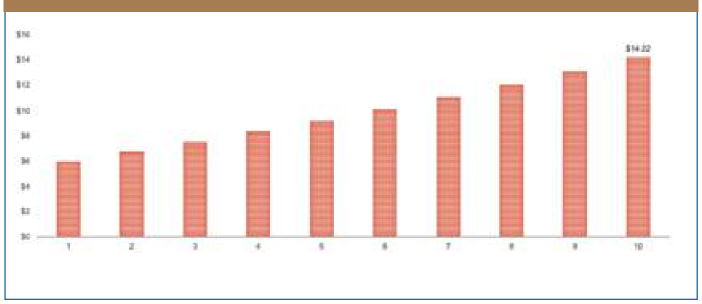
[3] S&P 500 Earnings. https://www.multpl.com/s-p-500-earnings. Accessed 29 Mar. 2021.
[4] DCM calculations. Source: Morningstar.

profits? Home Depot's margins had expanded from 9.5% in 2012 to 14.3% last year.[5] Margins are more likely to decline than keep rising, so we'll assume they come down to around 12.6%. That would mean **operating cash flows of over $26 billion** in 2030.

- Home Depot could pay the entire $26 billion as a dividend, but they need some money to reinvest into their business. Historically, they have reinvested about 17% of cash flows.[6] So, let's say **$4.5 billion** goes towards opening new stores or other worthy growth projects.
- The remaining $21.5 billion is free to pay dividends and repurchase shares. Home Depot is currently paying out 34% of its cash flow as a dividend.[7] We expect that to creep higher over the next decade to around 43%. That would mean about **$11.3 billion paid out as dividends** in 2030.
- Home Depot has been buying back its stock. If they continue, we would expect the share count will decline from around 1.1 million shares today to approximately 0.8 million in 2030. In other words, **current shareholders will own about 30% more of the business** than they hold today.

Using our 2030 estimates of $11.3 billion in total dividends and 800,000 shares outstanding, we anticipate Home Depot's dividend in 2030 to be $14.22 per share. That would be a **10.1% annual increase** from today.

DCM'S Home Depot (HD) Dividend Forecast



Compared to its current price, **Home Depot's 10-year dividend yield would be about 5.5%**. Through that lens, we would consider the stock quite attractive relative to even higher-yielding stocks. Compared with the 10-year US Treasury at 1.75%, it's very attractive.

So far, we've only touched on Home Depot's dividend income. Let's see what might happen to their stock price.

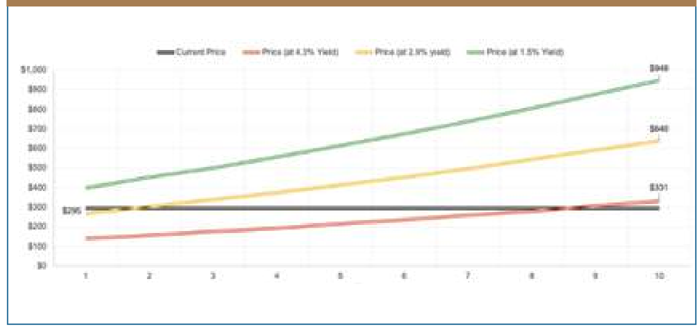
What About Stock Price?

If you owned a farm that went from generating $10,000 in profits to $20,000, what do you think would happen to that farm's value? You might expect that the value would double (or something close to it) as well.

Home Depot is like a 'farm' that is growing its payout year after year. If you collect $10,000 in dividends from them today, which increases to $23,700, what do you think will happen to the market value?

We can't know for sure, but we can create some possible outcomes. The chart in the next column uses our dividend estimates above, combined with Home Depot's historical dividend yields. We've constructed a 'worst case' scenario (red line), a 'best case' (green line), and an 'average' scenario (yellow line). The grey line shows where Home Depot is currently trading.[8]

Home Depot Price Forecast



Let's start with the 'worst case' scenario. If Home Depot were to grow its dividend to $14.22 with the exact yield it had in 2009 (4.3%), the stock price would be **$331**. If you own the stock the entire decade, our forecast suggests you would also collect about $98 per share in dividend income. Thus, **our pessimistic total return[9] would be about 3.8% per year**.

Moving away from our worst-case scenario, we'll use Home Depot's long-term average dividend yield of 2.9%. If the dividend were $14.22, the stock price would go up to $490. Decade-long owners of Home Depot would earn about **7.1% per year**.

Finally, in an optimistic scenario, Home Depot's price would increase so that the dividend yield in 10 years was 1.5%. **The total return under this scenario would be 13.5% per year**.

Closing

What does 2021 have in store? If 2020 is any indication, no one has any idea. Fortunately, it's not important to predict the details. Over the long run, it won't make much of a difference whether this year's inflation was 2% or 5%. Your 2030 self won't care about this month's Fed meeting. Your 2030 self might care about politics, but what happened in 2021 will be a distant memory. What will matter is that 2021 was the year when you stopped paying attention to the crashing waves. And, in doing so, you found a North Star to steer your portfolio even in the worst storms.

[5] Using cash flow from operations divided by 12-month sales. Source: Morningstar. [6] Looking at capital expenditures divided by Cash Flow from Operations. Source: Morningstar. [7] Data source: Morningstar [8] At the time of writing, Home Depot's stock price was at $295 per share. Source: Morningstar. [9] Total return includes both price gains (or losses) and dividend payments.

Thank You for Supporting DCM's Habitat House

WE ARE PLEASED TO ANNOUNCE THAT DONALDSON CAPITAL MANAGEMENT (DCM), DCM CLIENTS, AND DCM TEAM MEMBERS JOINED TOGETHER AND RAISED A TOTAL OF $97,284 TO FUND THE DCM HABITAT HOUSE. This house was built for a deserving family aspiring for an improved life. Members of the DCM team gathered, and the home was dedicated on January 30th, 2021, to the Mitchell family.

We would like to extend our sincerest gratitude to all of you who contributed to the Habitat for Humanity house in honor of our 25th Anniversary in 2020. We don't take your contributions lightly. Thanks to you, there is a family making this house a home.

New homeowner Kaynah & family join DCM team members at the home dedication.

Your 2020 Tax Update

THIS TAX SEASON IS UPON US. The pandemic continues to cause changes and delays to the traditional federal and state tax filing dates. For 2020, the deadline for filing and paying your Federal return has been moved to May 17, 2021. At the time of this publication, most states have also delayed the date for filing to align with the Federal rules. If you pay quarterly estimated taxes, your first quarter payment is still due on April 15, 2021. It is certainly possible that more changes will follow in the days and weeks to come. Please work closely with your tax preparer to ensure timely filing and payment of your obligations.

- Contributions to a traditional IRA or a Roth IRA are now due by **May 17, 2021.**
- If you need more time to file your return, you can file an extension request. You must do so no later than the due date of your return and then file your return by **October 15, 2021.**
- An extension of time to file your return does not grant you any extension of time to pay your taxes.
- You should estimate and pay any taxes owed by the due date to avoid late payment penalties.

CONSIDER SHARING YOUR RETURN WITH YOUR INVESTMENT ADVISOR. Having a copy of your latest tax returns will help us advise you more thoughtfully and thoroughly. Your tax returns tell a unique story about you and could enhance the job we do for you in areas like:

- Implementing tax-mitigating strategies such as Tax Loss Harvesting and Roth IRA conversions
- Suggesting charitable giving strategies or estate planning techniques
- Managing IRA Required Minimum Distributions across various qualified accounts

Once you receive your completed return, there are multiple secure ways to send it to us:

- Upload through the DCM Client Portal. Once logged in, navigate to the Documents Tab and then the Cloud Storage section. There will be an Upload Files button on the top right-hand side.
- Your Investment Advisor can send you a secure upload link via email.
- Mail us a hard copy. This is a more secure option than an email attachment.
- With your permission, your tax preparer may also be able to email us a copy securely.

If you'd like us to contact your tax preparer to obtain a copy of your return, please let your Investment Advisor know. We will take it from there.

Wealth Transfer Strategies for Children & Grandchildren

We often find that our clients have an interest in learning about ways to support their children and grandchildren while enjoying some tax benefits along the way. The great news is you have options, and the best path ultimately depends on your goals. Two of the more common strategies considered are 529 plans for education savings and Uniform Transfers to Minors (UTMA) accounts for general gifting.

If funding education is your primary goal, the 529 plan is your first stop. The main benefit of funding a 529 plan for your beneficiary is that it offers tax-deferral on investment growth, and withdrawals are tax-free for qualified education expenses. 529 plans vary from state to state, with some states offering additional tax benefits to incentivize investors. The Indiana plan is among the best, offering a 20% state tax credit on your first $5,000 of annual contributions. The 529 plan also has generous contribution rules for those looking to move assets out of a large estate.

Alternatively, a UTMA account can be a tax-efficient way to transfer assets to a minor while allowing a custodian (adult) to manage the account until the minor comes of age (21). Since the assets are irrevocably transferred to the minor, any tax consequences are often realized at considerably lower tax rates. UTMAs are most commonly used to fulfill general family transfer goals rather than save for education expenses. One reason for this is that an account owned in a child's name can affect their ability to receive financial aid in the future.

529 plans and UTMAs are two examples of strategies available to structure wealth transfer to your children or grandchildren. Contact your DCM investment advisor to discuss your family transfer goals and consider the best options for you.

Avoid Coronavirus Scams

WE CONTINUALLY MONITOR, update, and upgrade DCM systems and policies to increase security. Our systems and professionals help us stay aware of the latest fraud scams. We also want to empower you with the knowledge to maintain cybersecurity at home.

Be aware that the coronavirus pandemic has been exploited by criminals worldwide. We want you to understand what coronavirus-related fraud can look and sound like so you can better protect yourself and your family.

▲ BE ALERT & BE AWARE:

States have seen increases in identity theft via fraudulent unemployment insurance claims. If you receive notice of an unemployment claim you did not file, report the fraud to law enforcement and notify your state unemployment administrator. Most states now have hotlines and forms for reporting this type of fraud.

▲ OTHER POTENTIAL COVID-19 FRAUD:

- Telemarketing calls, text messages, social media platforms, and door-to-door visits have been used to perpetrate COVID-19 related scams. Be cautious of any unsolicited requests for personal, medical, and financial information.
- Do not give your personal or financial information to anyone claiming to offer Department of Health and Human Services grants related to COVID-19.
- Medicare will not call to offer COVID-19 related products, services, or benefit review.
- Fraudsters are offering COVID-19 tests to Medicare beneficiaries in exchange for personal details, including Medicare information. However, services are unapproved and illegitimate.
- Be aware of scammers pretending to be COVID-19 contact tracers. Legitimate contact tracers will never ask for your Medicare number or financial information, or attempt to set up a COVID-19 test for you and collect payment.
- You should never be asked for money to enhance your ranking for vaccine eligibility.

▲ PROTECT YOURSELF:

- If you receive a suspicious call, hang up immediately.
- If you suspect COVID-19 health care fraud, you can report it by calling 800-HHS-TIPS.
- If you suspect you are a victim of fraud, contact your DCM Investment Advisor.

Sources: Oid.hhs.gov, dol.gov

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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.