Donaldson
CAPITAL MANAGEMENT

WINTER 2022

RISINGDIVIDEND
R E P O R T

Highlights from the Investment Policy Committee

1. 2021 was another big year for the stock market; the S&P 500 was up over 20%.

2. Inflation made a lot of headlines last year. While some price increases are here to stay, we expect the rate of inflation to slow from November 2021's 6.8% pace down closer to pre-pandemic levels.

3. The Fed is likely to increase short-term interest rates in 2022 to help fight inflationary pressures.

4. Volatility may increase in 2022 as the market digests Fed rate hikes, midterm elections, geopolitics, and the impact of new COVID-19 variants.

5. While volatility may increase in 2022, the "risk" of investing has nothing to do with volatility; it has everything to do with meeting your financial goals.

Read the IPC letter on page 3

Why a Board?

Randy Alsman
Senior Investment Advisor

Donaldson Capital Management has had a board from our firm's very beginning.

At first, when DCM was small, it was an informal advisory board. But as we grew, so did the board – adding members and evolving its role. Today, our managing board of 8 boasts various sub-committees and meets quarterly. Critical to the board are its 3 independent, non-employee members who share their experience and talent to make DCM better.

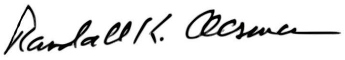
In our experience, having a board of any kind is uncommon among advisory firms like DCM. We don't understand why, since the value of a board applies to firms both small and large. Our board holds our feet to the fire on strategy, service, people development, and financial sustainability. That is, the board is your champion, helping us to always do our very best for you.

Our board stands back from, yet stays informed on, key measures of performance that can keep the focus on you, our clients. It can also spot new opportunities, allowing the firm to keep pace with your evolving needs. The new investment strategy, Sequoia, is one recent example.

Our board has clear objectives. We believe that DCM's most important responsibility – providing you with the best service and financial advice – is possible only through attracting and developing the best people. To that end, our board views oversight of human resource development as its top priority. Continual development supports consistently excellent service. Excellence in execution of our services and financial soundness are tracked via the board's dashboard of critical metrics. And rounding out the top 4 responsibilities is ensuring that management has a sound, long-term strategy for the firm.

Finally, the board realizes it can only do its job well if it takes its own performance seriously. Therefore, our board has rules of governance requiring the board to evaluate its own performance and continually improve.

We hope you agree that having a board shows our commitment to always giving you our very best efforts, both now and long into the future.



DCM Welcomes Sharon Reed Walker to the Board of Directors

I AM PLEASED TO JOIN THE DCM BOARD AND LOOK FORWARD TO THE OPPORTUNITY TO SUPPORT THE ORGANIZATION'S CONTINUED PURSUIT OF EXCELLENCE AND GROWTH. I bring a broad range of experiences to DCM. During my 35 years of corporate life, I had an opportunity to work on many challenging projects, both domestic and international. While my core background is Finance, I have spent an equivalent amount of time in Strategy and Mergers & Acquisitions.

Post corporate life, I have been consulting for privately owned companies. It has been exhilarating to bring corporate skills to this group. There are several clients that I have now worked with for more than five years. Among other projects, I have designed financial reporting systems which helped them understand the drivers of profitability. I am always pleased to see these maintained and enjoy celebrating the resulting growth of their business.

I have now lived in Evansville for 25 years and consider it home. I have been involved with many nonprofit organizations over the years, especially as many were experiencing growth opportunities or challenges. I take a lot of pride in this work. I consider it an obligation to actively support entities and institutions that are important to our community.

My most significant commitment to the community of Evansville has been with Deaconess Health System. I have been on the Deaconess Health System Board of Directors for eight years. I serve as Treasurer and Chair of the Finance Committee and was recently elected Vice Chairwoman of Deaconess Hospital. During my time on the board, the health system has enjoyed meaningful growth throughout the region. This board experience has helped me understand governance and the role it plays for an organization.

I believe that all Americans should understand how to manage and grow their wealth. In the late 1970s, I was part of a group of 10 young professional women who created an investment club. Of the 10, only two of us had finance degrees. We were pleased to find a young female broker to work with our group. It was a comfortable environment for us to understand the drivers of the market. As a result, we all became more savvy participants in the pursuit of wealth creation. Since then, I have spent a lot of my time working with individuals, churches, and anyone who will listen about taking more control over their financial life.

As you can probably discern by now, I have a strong bias toward action!

I look forward to working with the DCM leadership team as we move forward.

The Fed 101

The Fed, or more formally, the US Federal Reserve System, is becoming a household name. There is significant speculation within the financial media about what the Fed plans to do with interest rates. Given this, you could have plenty of questions about the Fed and its role, but the most important is how the Fed's decisions impact you.

What is the Fed anyway? The Fed is the central bank of the United States, charged by Congress with the dual mandates of achieving maximum employment and stable prices. This is accomplished primarily by influencing borrowing and controlling inflation. One tool used, the federal funds rate, is the interest rate that banks lend to each other overnight. This benchmark rate is the foundation of interest rates across the nation. If the Fed were to raise this rate, in theory, they're trying to slow the economy to help control inflation.

The Fed also trades bonds in the open market. When the Fed is actively buying bonds, it's called quantitative easing. This buying tends to lower interest rates and spur economic growth. Recently, the Fed has been tapering bond purchases. This means they'll be purchasing fewer bonds in the open market. With the absence of the Fed's bond purchases, bond demand is reduced, and interest rates could rise.

If interest rates rise, demand for goods and services purchased with borrowed money should decrease. The result is more balanced supply and demand, stabilization in prices, and controlled inflation. In a higher interest rate world, it will be important to monitor your outstanding debt with floating interest rates and take the interest cost into account when making large purchases with debt. It is important to remember that the Fed does not control the economy or your spending. And the companies DCM invests in have long track records of producing profits and raising dividends in all Fed policy climates.

Risk vs. Volatility

A Letter from the DCM Investment Policy Committee

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

You're relaxing in your seat, cruising along at 36,000 feet. That familiar "bing" sounds as the seat belt light comes on. "We're coming up on some bumpy air," the pilot says, "Please buckle your seatbelts." A few minutes later, the plane starts to shake.

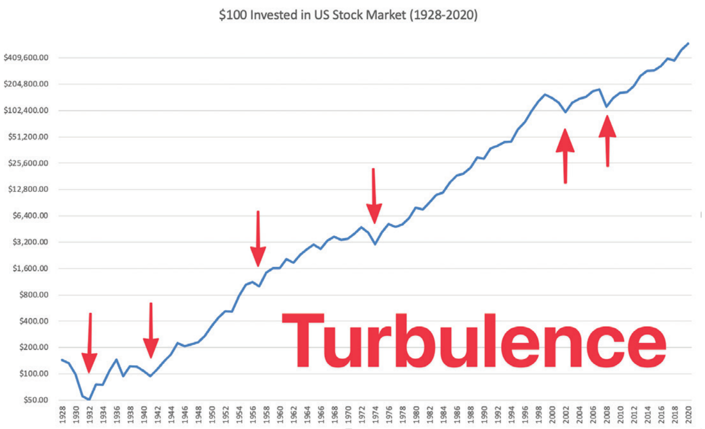
If you've ever flown, you know turbulence is normal, but still scary.

Millions of people fear flying, yet the data suggest flying is the fastest and safest way to travel long distances. Based on travel data from 2012-2016, you could expect to safely fly once a day for 22,000 years.[1]

Driving is statistically more dangerous, yet flying feels riskier. Post-9/11, the fear of flying led more people to drive, tragically resulting in over 700 more deaths from October through December of 2001 than during the same period the year before.[2]

Investing in stocks can sometimes feel like flying. They get you to a financial destination faster and, especially on longer trips, can be safer. Yet, the drops can be breathtaking. From 1928 to 2020, almost every year had a decline of at least 5% or more. More than half had at least one 10% correction with 1 in every 4 reaching a 20% or greater loss. A 40% or more decline – like we saw in 2008-09 – has happened once every twenty years.[3]

The fear of falling markets leads most people to under-invest in stocks and over-invest in safer assets, like cash and bonds. Market turbulence is never fun to go through, but – over the long run – it's been worth the cost. The chart below shows the growth of $100 invested in US stocks in 1928.



Turbulence to Come in 2022?

At the time of this writing, US stocks finished the year up over 28%.[4] We've been cruising along at 38,000 feet with only a few bumps.

Will stocks continue to fly high or will we experience turbulence in 2022? There are a few major issues the market is digesting as we enter the new year; each could lead to increased turbulence. Let's take a look at each.

Midterm Elections

Elections are coming up in November 2022. Elections consume headlines, but political parties haven't made much of a difference to markets over the long run. From 1853 to 2015, the average returns of stocks have been the same under both Democrats and Republicans.[5]

A Princeton study found that neither fiscal nor monetary policy had an impact on economic growth after adjusting for external events.[6] **We, the US people, drive our economy forward; it is not the few hundred elected officials in Washington.** Go out and vote, but don't let elections rattle your investment portfolio. There are much more important things to focus on over the long term.

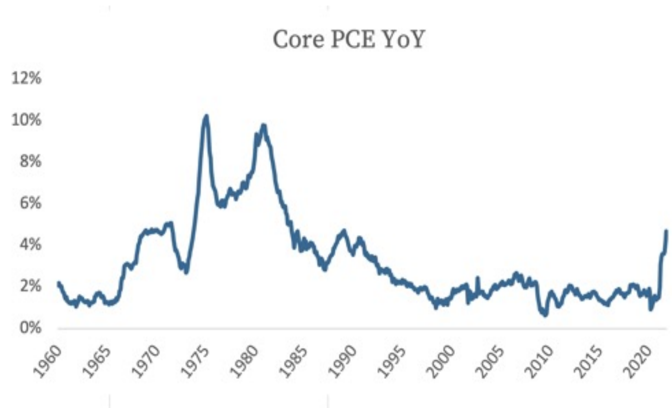
Earnings

One of those is earnings, which continue to impress. 2021 corporate earnings per share are up over 50% year-over-year. That's coming off of a low number in 2020, so we don't expect 50% growth in 2022. However, high demand from consumers should continue to support profit growth. We've seen wage pressure throughout the US economy, which has contributed to concerns about inflation.

Inflation

You've likely seen lots of headlines about inflation being at multi-decade highs. You've also felt that in your bank accounts. Prices are higher at the gas station, the grocery store, and the used car lot.

[1] https://flyfright.com/statistics/ [2] Studies at Cornell and the University of Michigan, https://www.pbs.org/wgbh/nova/planecrash/risky.html. [3] The Biggest Stock Market Reversal in History. https://awealthofcommonsense.com/2020/11/the-biggest-stock-market-reversal-in-history/. Accessed 24 Dec. 2021. [4] 2021 S&P 500 Return." DQYDJ, 31 Dec. 2021, https://dqydj.com/2021-sp-500-return/. [5] Sources: Global Financial Data, 1853-1926; Morningstar, Inc. and Ibbotson Associates thereafter through 2015. [6] Blinder, Alan S. and Mark W. Watson. "Presidents and the U.S. Economy: An Econometric Exploration." Princeton University, July 2.



November 2021's 6.8% inflation reading was eye-opening, but the biggest question is what will happen to prices going forward. Some of the price increases we have seen so far are likely permanent, but we think the rate of future inflation will slow. In other words, we don't expect 6.8% inflation to continue.

Why? For one thing, prices fell in 2020 as the economic shutdown reduced demand. Comparing prices to 2020 – especially Q2 and Q3 – would show some dramatic increases. Not only that, but we've had a perfect storm of inflationary forces: high consumer demand, labor shortages, global COVID-related disruptions, and massive government stimulus. That's a recipe for short-term inflation.

In the long-term, these four pressures will decrease. Longer-term, technological developments and our country's aging population will hold prices down.

In both the long and the short term, the US Federal Reserve (the "Fed") will hold prices down. Their mandate calls for that.

Monetary Policy

In December 2021, Jerome Powell announced the Fed is expecting three interest rate hikes in 2022. This signals that central bankers are taking inflation seriously; they will help keep the economy from getting too hot.

Tighter Fed policy has been a negative for stocks, but not as bad as headlines might have you think. Since 1972, stocks returned 9% per year, on average; in years where the Fed increased rates, stocks returned 7.7%. Since 1990, stocks have actually done better than average in the 12 months following a Fed rate hike. Still, monetary policy will be important. **How well the Fed balances fighting inflation and supporting employment will be a major factor in 2022.**

COVID-19

The pandemic continues to be front-of-mind as new variants emerge. We've been living with COVID for two years and do not see that changing anytime soon. However, we're unlikely to see widespread economic shutdowns again – at least in the US.

Outlook

Despite these headwinds, our outlook for stocks remains optimistic. The biggest long-term driver of markets is growth in underlying profits. The economy is doing well, which will continue to support higher sales, earnings, and dividends. And those profits are worth more in an ultra-low interest rate environment.

Other investment options are scarce, which makes stocks worth more than they otherwise would be. This ultra-low interest rate environment justifies the higher-than-average valuations for stocks. Even if the Fed raises short-term rates, long-term rates can still remain low – even decline. In our research, longer-term Treasury rates matter more to valuations than the Fed funds rate.

Still, we know volatility could be coming in 2022 – there is a lot for the market to digest. So, in this letter, we would like to help build a framework for how to think about "risk" as it relates to your investment portfolio.

What is Risk?

Risk, as the dictionary defines it, is "probability of injury or loss." Some risks – injury, disease, accidents – are **unavoidable** parts of life. Others – like driving without a seatbelt – are **avoidable** risks. There are also **calculated** risks – actions that may increase your probability of injury or loss in some ways, but reduce them in others.

Your financial situation also has some risks. Some of them – like investing 100% in one company – are **avoidable**. Others – like inflation – are **unavoidable**. The **calculated risks** are where we will spend the rest of this letter. Specifically, we're going to address the important decision of how much money to invest in three types of assets – cash, bonds, and stocks.

Volatility vs. Risk

Most academics – at least, those in the finance department – must have fallen asleep in English class; they do not define risk as "the possibility of loss or injury." They define risk by the volatility of a particular asset. In other words, an investment is riskier the more its price moves.

To illustrate the absurdity of that definition, let's assume you have two investment options:

Investment A has an expected return of 40% per year with a standard deviation of 20%. In other words, this investment would produce somewhere between 0% and 80% returns in 9 out of 10 years.

Investment B has a 1% expected return with a 0% standard deviation. In other words, it will always produce a constant return of 1% per year.

Now, which of these investments is riskier? If we're looking at volatility only, we conclude that Investment A is the riskier investment. Common sense suggests that it is lunacy.

Defining risk as volatility is the equivalent of measuring the risk of flying by the amount of turbulence you experience on the flight. We're not interested in that, we're only interested in whether or not we get to where we want to go. **The real risk in investing is not volatility, but not achieving your financial goals.**

And by that definition, we would rightly conclude that Investment A is far more likely to get you where you want to go than Investment B.

When Volatility Matters

Measuring volatility isn't all bad; there are some cases when it matters a lot. **Volatility is relevant if you expect to sell your investments at some point within that time frame.**

Let's say you have $10,000 that you must have next year for an important medical treatment. You want to earn something on that investment, but you don't want to lose it. Investment A will pay $100 in interest over the next year – a guaranteed 1% return. For Investment B, you flip a coin. If the coin is heads, you double the money; if tails, you lose 25%.

Which would you choose?

If you could flip the coin 10 times, you would be better off with Investment B. The long-term expected return of this coin-flipping strategy would be 37.5% per year. After 10 coin flips, the average result would turn $10,000 into over $240,000. Meanwhile, Investment A's guaranteed 1% return would turn $10,000 into over $11,000. Investment B is the best long-term portfolio if you can flip the coin enough times.

In your situation, however, the short-term volatility of Investment B is a problem. You only have one flip to make before you need the $10,000. Given the importance of this procedure, you cannot accept the 25% chance that the money isn't there when you need it. So, **the short-term volatility of Investment B becomes a real risk because it matches your short-term need.**

The problem is not that calculating volatility is bad; the problem is that **most volatility calculations are not aligned with financial needs.** This mismatch can have terrible long-term financial consequences.

Let's go back to your $10,000 medical expense. Let's say that rather than needing it next year, you don't need it for 30 years. And the cost will increase with inflation each year – let's say, 3%. So you need to come up with $24,273 in 30 years.

Your investment options are either 2% guaranteed in a 30-year US Treasury bond or the stock market at an assumed 10% return with 17% annual volatility. (In other words, 9 out of 10 years will be between -24% and +44%.)

What should you do now?

Investment B will generate a guaranteed 2% return – meaning you'll end up with just over $18,100 – less than your $24,273 need. **Even though this asset was "risk free" in terms of volatility, it was 100% risky in terms of actually achieving your financial goal.**

The safer option in this case is to invest all $10,000 in the stock market. There is still a small chance of failure, but over 95% of simulations would result in you having what you need in 30 years.[7] (And, most likely, with quite a bit left over.)

Matching Risk to Time Horizon

Millions of investors confuse financial risks. Most of their goals are decades in the future, yet they use 12-month volatility to decide their mix of stocks and bonds.

Two leading behavioral finance researchers concluded that investors place too much emphasis on the potential loss from a single year. So they don't invest in enough stocks.[8] That can cause them to earn returns too low to adequately cover long-term retirement needs.

That is particularly true in today's low-interest rate environment. A 10-year US Treasury yields less than 1.5% – likely lower than inflation will be over the next decade. **You can lock in a 100% safe return on your principal with Treasuries, but you are virtually guaranteed to lose purchasing power.**

That's not to say Treasuries don't have value; they certainly do in some situations. If you have money you might need in the next few years, holding Treasuries, cash, or investment-grade bonds can be a great option. It prevents you from having to sell stocks in poor environments.

For longer-term goals, however, bonds can be riskier than stocks. Research shows that the riskiness of stocks and bonds depends on the period they are measured over. From 1802-2012, a 100% stock portfolio was less volatile than a 100% bond portfolio when measured over 20-year periods.[9] If you were going on a 20-year trip and wanted to put money in the safest place possible – stocks would be the choice.

Bonds continue to have a place in most investors' portfolios; however, **we continue to favor stocks going into 2022.** Even if things get choppy, remember that the "risk" of investing has nothing to do with volatility; it has everything to do with meeting your financial goals.

[7] Bernartzi and Thaler (1995). "Myopic Loss Aversion and the Equity Premium Puzzle."
[8] Bernartzi and Thaler (1995). "Myopic Loss Aversion and the Equity Premium Puzzle."
[9] Siegel, J. J. (2008). Stocks for the long run: The definitive guide to financial market returns and long-term investment strategies. New York: McGraw-Hill.

Supporting Someone Else's Future: Creating Your Own Scholarship Program

Scholarships are a wonderful way to support students by assisting with the cost of their education. Establishing scholarship programs is one of many ways DCM clients have generously used their wealth to help others. It can also offer a way to memorialize your estate, and awarded funds are potentially tax-deductible.

A scholarship program can be designed to reflect your values and objectives. The first step is to decide who you want to help. For example:

- Establish a memorial fund to honor loved ones.
- Choose a field of study you want to support.
- Assist students in underrepresented communities.
- Support students like yourself in some way.

Scholarships don't need to be for large amounts to have an impact. However, if you would like to support a specific university, it is best to ask their development department for their minimum annual gift requirement to establish an annual scholarship. Your DCM advisor can work directly with university professionals to establish a one-time scholarship or an agreement for an endowed scholarship program. When it is time to grant an award, we will work with the university to transfer funds.

Funds you donate through your scholarship donation will be tax-deductible if the program is built to meet three qualifying criteria:

1. **Funds must go toward paying direct educational costs.** Direct educational costs are defined as tuition, fees, course-required books, supplies and equipment.
2. **The student receiving the award must be in a qualified charitable class.** DCM advisors can work directly with the university to ensure the class of potential recipients meets these criteria.
3. **The selected recipient must be determined in an objective and nondiscriminatory way**. Criteria could include financial need, GPA preference, and academic major preference.

If you are interested in a scholarship program, contact your DCM advisor to help you with next steps.

Healthy Things Grow

ACROSS ALL OF DCM'S INVESTMENT STRATEGIES, we emphasize the benefits of healthy growth. A company's fair value is determined by the future cash flows it is expected to generate. Thus, a company steadily growing its cash flow should see an increase in its stock price over time. This is a simple concept, but the challenge lies in finding the companies we think can grow their fundamentals faster than average. Through our research efforts, we have found three factors we believe are reliable hallmarks of healthy growth. They are: Competitive Advantage, Momentum, and Predictability.

For a company to consistently grow, it needs to have an edge on its competition. We call this factor Competitive Advantage. When evaluating companies, we look for signs that they are doing something truly unique. For example, Starbucks' image, brand recognition, and technology go unmatched by rivals. With such advantages, the company is well positioned to take business from peers, open more stores, and push new products. We can see the potential for growth exists.

Once we have established that a company has a foundation for growth, we need to see that the fundamentals are actually increasing and that the market appreciates it. We call this factor Momentum. When we see growth in the fundamentals, it verifies that a company has been able to follow through on its growth opportunities. If accompanied by a rise in the stock price, it is a sign the market believes the company is creating value over the long-term.

Last, we need to see that the company has historically had a strong correlation between fundamental growth and price appreciation. We call this factor Predictability. This ensures that the recent action is not just a fluke. Instead, the company has a long record of executing its growth strategy and being rewarded with a higher stock price. With a history like this, we have much greater confidence in the trajectory of the company.

Tax Season: What We Know

There is a lot of speculation about the 'Build Back Better Act' and what will be included in the bill, particularly regarding changes to the tax code. While we wait, here are things we know now regarding tax filing dates, deadlines, and retirement contribution limits for the 2022 tax season.

Here are some reminders to help you prepare for the upcoming 2021 deadline and navigate the 2022 tax year:

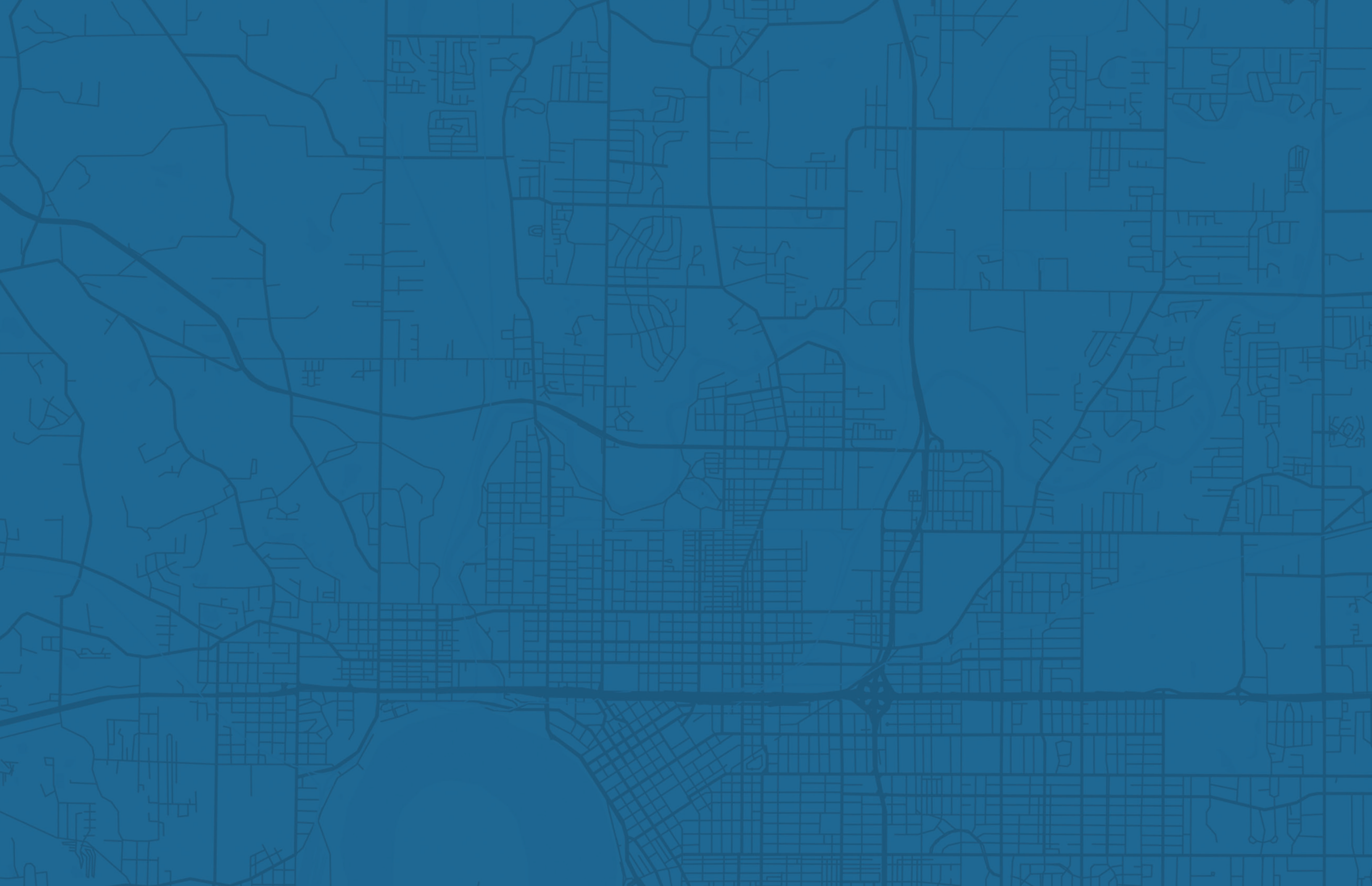
- ☐ Unless you file an extension, your 2021 tax return is due on April 15, 2022.
- ☐ You can expect to receive a Form 1099 tax document for all taxable accounts by mid-February. This tax form, issued by your account custodian, reports on earned dividend and interest income
- ☐ If you had a distribution from a retirement account in 2021, you can expect to receive a Form 1099R from the account custodian by late January.
- ☐ Don't forget you have until April 15, 2022, to make contributions to your IRA (deductible and non-deductible), Roth IRA, and HSA for 2021.
- ☐ Two CARES Act charitable giving provisions were extended through 2021:
    - ☐ Individuals can write off up to $300 ($600 for married couples filing jointly) of cash donations made to qualifying charities in 2021, regardless of whether they take the standard deduction or itemize their taxes.
    - ☐ Those who itemize can write off up to 100% of their adjusted gross income for qualifying cash contributions.
- ☐ If you make quarterly estimated tax payments, mark your 2022 calendar with the following due dates: April 15, June 15, Sept. 15, and Jan. 15, 2023.
- ☐ The standard deduction for 2022 has increased to $12,950 for single filers and $25,900 for married filing jointly, and $19,400 for head of household.
- ☐ Over age 50? You're also eligible for additional catch-up deferrals. If you're unsure what deferral amounts are right for you, reach out to your investment advisor for help.
- ☐ See the accompanying table for the 2022 Contribution Limits for Retirement Accounts:

Having a copy of your annual tax return allows us to spot issues for you and suggest planning opportunities as well as most effectively manage your taxable investment portfolios. Consider sending your advisor your annual return or giving us permission to reach out to your CPA or tax preparer to obtain a copy.

2022 Contribution Limits for Retirement Accounts:

401(k), 403(b), 457(b) elective deferrals:	$20,500
Catch-up Contributions Limit (age 50+):	$6,500
Traditional & Roth IRA Limits:	$6,000
Catch-up Contributions Limit (age 50+):	$1,000
SIMPLE IRA Employee Deferrals:	$14,000
Catch-up Contributions Limit (age 50+):	$3,000
Health Savings Account (Single):	$3,650
Health Savings Account (Family):	$7,350
Catch-up Contributions Limit (age 55+):	$1,000
Defined Benefit Plan, Benefit Limit:	$245,000
Defined Contribution Plan, Contribution Limit:	$61,000
Annual Compensation Limit for Retirement Contributions:	$305,000
Highly Compensated Employee Threshold:	$135,000
Social Security Wage Base:	$147,000

Source: http://www.irs.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.