Donaldson
CAPITAL MANAGEMENT

SPRING 2022

RISINGDIVIDEND REPORT

Highlights from the Investment Policy Committee

1. Three significant changes have caused volatility in the beginning of 2022 – inflation, Fed policy, and slower economic growth.
2. Inflation is likely to peak in 2022 and come back down over the next few years.
3. With unemployment rates down, the Fed is focused on fighting inflation.
4. Based on our current data, there's a 75% chance the US economy continues to grow, leaving a 25% chance of a recession over the next year.
5. While in an inflationary, slower-growth economic environment, stocks are one of the best places to protect yourself. Dividend stocks can help protect your portfolio, specifically domestic, essential, energy-immune stocks with pricing power.

Read the IPC letter on page 3

A Note from Beth Dietsch

At DCM, we love nicknames. Greg Donaldson began handing them out twenty-five years ago. He still calls me "Sassy." That moniker was earned – and appropriate. I like to think it came from being objectively honest and realistic with my colleagues and clients. They deserve nothing less.

Over the last ten years, the stock market has rewarded our clients handsomely. But, owning stocks can, at times, be harrowing. Like now. Inflation and Russia invading Ukraine have played havoc with the market, tossing the market like a sailboat on a stormy sea. In the twenty years I've been with DCM, I've watched our Investment Committee keep our clients invested in boats in which we could confidently spend the night five miles offshore. Together, we've made it through the Tech Bubble, 9/11, the 2008-09 Credit Crisis, the COVID-19 pandemic, and more. The current state of affairs will keep markets rocky. That won't be fun. How the stock market has behaved so far this year is, however, normal. We can't be invested in stocks and expect our portfolios to grow without some bumps.

Beth Dietsch
Lead Investment Advisor

Realistically, none of us can predict when the market will return to good times. Just as realistically, I know my clients are invested in companies that our research indicates are built to grow. They have proven that time and again.

Beth Dietsch

Avoid Scams During Times of Crisis

How to Give to the People of Ukraine

Many people are looking for ways to support the people of Ukraine. However, a major crisis like this can be abused by fraudsters who pretend to raise money for charitable purposes. For this reason, it's important not to get caught up in the urgency of the Ukraine situation. Here's how to ensure your donation benefits the right people.

1. **Be cautious about emails.** Scammers are skilled at mimicking legitimate charities. A click on a fraudulent link could give them access to your personal information.
2. **Never donate with cash, debit card, gift cards, or wires.** According to the Federal Trade Commission (FTC), the safest method of donation is credit card.[1] Credit cards provide a paper trail for an added layer of protection if you need to dispute a charge. If you would like funds or stock sent from your DCM account, we will be happy to help verify the charity you are supporting.
3. **Determine the organization you are interested in supporting.** If you want to donate to a lesser-known Ukrainian charity, make sure to go directly to the organization's website to donate with more peace of mind.
4. **Conduct due diligence.** To ensure you're donating to a legitimate organization, use the following watchdog sites to verify the organization: CharityWatch, CharityNavigator, and the Wise Giving Alliance. Charities that receive A ratings are the safest to support.
5. **If you want your donation to be a charitable contribution** from a qualified account, we are happy to verify whether your charitable contribution to the organization qualifies as tax deductible. Remember: donations to individuals are not tax deductible, according to the FTC. [1]

World Central Kitchen (WCK) is a charity that feeds people in humanitarian, climate, and community crises. WCK has established food stations at Ukraine borders. Within hours of Russia's invasion, they were offering hot meals at a food station at a pedestrian border crossing in Poland. Since the first day of the conflict, stations have been established at seven other crossings, and the charity is helping restaurants prepare meals in five Ukrainian cities.

United States Fund for UNICEF is on the ground in Ukraine, committed to reaching children and families. Assisting unaccompanied and separated children is their top priority. Protecting women and girls from gender-based violence and sexual exploitation is another. On March 3, 2022, UNICEF launched an emergency appeal to raise $276 million to scale up relief efforts across the country, also appealing for another $73 million to assist those fleeing to various surrounding countries.[2]

Doctors Without Borders USA have sent emergency and specialist medical staff to Ukraine. More are expected to arrive to support the teams already in the country. Teams are preparing for a range of scenarios, including providing surgical care, emergency medicine, and mental health support for displaced people.[3]

[1] https://www.consumer.ftc.gov/articles/before-giving-to-charity#five%20things
[2] https://www.unicefusa.org/war-ukraine
[3] https://www.doctorswithoutborders.org/what-we-do/news-stories/story/how-msf-responding-war-ukraine#p1

Getting D-E-E-P

Our thoughts and prayers are with the people of Ukraine. We can't do much to restore peace, but we can try to help you find some financial peace in these difficult times. Our job is to help you navigate your investment portfolio through this period. This note is about the impact on the markets; yet, the financial costs pale compared to the human costs.

If the 2021 stock market could be characterized as uneventful and profitable, 2022 has been the opposite. There is volatility from uncertainty in three key areas: inflation, Fed policy, and economic growth.

What is the best place to invest in this inflationary, slower-growth economic environment? There are two primary ways to influence your portfolio: the mix between stocks and bonds and the types of businesses you own.

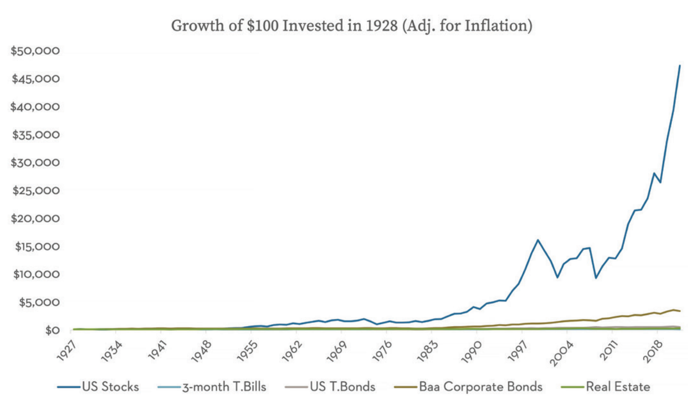
Let's start with asset mix: **what is the best mix of stocks and bonds in an inflationary environment?**

The Best Inflation Hedge

When volatility comes, it's easy to look for shelter in cash and bonds. Over shorter periods, those can be essential. But historically stocks have almost always been the best place to be for money you don't plan to need for at least five or ten years. In Stocks for the Long Run (2014), Jeremy Siegel writes:

"[O]ver long periods, the returns on equities not only surpassed those on all other financial assets, but were far safer and more predictable than bond returns when inflation was taken into account."

The chart below shows how great stocks have been. Accounting for inflation, $100 investment made in 1928 would be worth over $47,200 in 2021. For comparison, a $100 investment in US corporate bonds would be worth just over $3,300.



Note: US Stocks are represented by the S&P 500 Index.

If you're worried about inflation, the evidence suggests that stocks are one of the best places to protect yourself against that reality.

Why is that?

Businesses Adapt

Good businesses **change with the conditions.**

If Apple (AAPL) can't get enough supply of Liquid Retina screens, Tim Cook and his team won't stop until they figure out a way to get more. Likewise, if one product line becomes unprofitable, Target (TGT) will switch to another line.

Thousands of the best and brightest in the world wake up every day to figure out, **"How do we profitably bring better products (or services) to our customers?"** Those people work for you, their shareholders. Progress may not happen all at once or without interruption, but it will happen. And, when it does, stock prices will reflect that growth.

Dividends & Inflation

Dividend growth stocks, in particular, have been great hedges against inflation. According to research by Goldman Sachs, stocks with either high dividend yields or high dividend growth *both* outperform the market during periods of high inflation.[1] The most outperformance occurred when headline inflation was between 6% and 7%.

Another study by Fidelity found that the fastest dividend growers in the S&P 500 outperformed by 3% per year in the highest inflationary environments.[2]

Growth is so important in these environments because it protects your purchasing power. If you bought $1 million worth of 10-year US Treasury bonds, you would get $21,000 in interest each year. But, that doesn't consider the impact of inflation. If inflation stays at 7%, the purchasing power of that $21,000 will fall to $10,163 in ten years.

That's why it's crucial to own stocks. Even though they can be more volatile in the short run, stocks have something that fixed-income securities do not: **growth.**

[1] Source: Wall Street Journal's The Daily Shot, March 10, 2022.
[2] Inflation and Dividend-Paying Stocks. Fidelity. https://www.fidelity.com/learning-center/trading-investing/inflation-and-dividend-stocks. Accessed 22 Mar. 2022.

A stock with a 2.1% dividend yield growing at 10% per year will generate $54,468 per year in ten years. Even adjusting for a 7% inflation rate, the purchasing power of that income stream would be $26,361 in a decade.

If you need your income to grow faster than inflation, stocks are far better than bonds. But even within stocks as an asset class, certain types of stocks do better than others when inflation picks up.

Getting D-E-E-P

Stocks, particularly dividend stocks, can help protect your portfolio against rising inflation. But *within* that universe, some businesses are likely to do better than others.

Since early 2021, we've been positioning DCM portfolios towards what we call "D-E-E-P" businesses: **domestic, essential, energy-immune** with **pricing power.** Not every company can fulfill all four, but companies with at least some of these characteristics should hold up well in this slow growth, inflationary environment.

In the remainder of this letter, we'll walk you through each of those characteristics.

"D" for Domestic

We've long been tilted more towards the US; that has intensified in recent quarters as global supply issues have surfaced.

Europe is far more dependent on Russian energy exports than the US. Consumers in Europe, particularly Germany, will have less discretionary income to spend. Less demand from overseas could put pressure on US businesses with a lot of foreign sales, particularly discretionary sales. (More on that in a minute.)

Russia and Ukraine are in a recession already; many countries in Europe are likely to join them. Investors will continue to prize US-centric businesses because our economy continues to be stronger than most. So, we stay focused on businesses with mostly US sales.

Domestic sales are important, but so is domestic growth. Many companies who rely primarily on other countries for growth, particularly China, could suffer. Starbucks (SBUX), for example, has saturated the US market. They have long been one of the more aggressive companies expanding outside of the US. If relations between the US and China continue to be strained, that growth may not materialize.

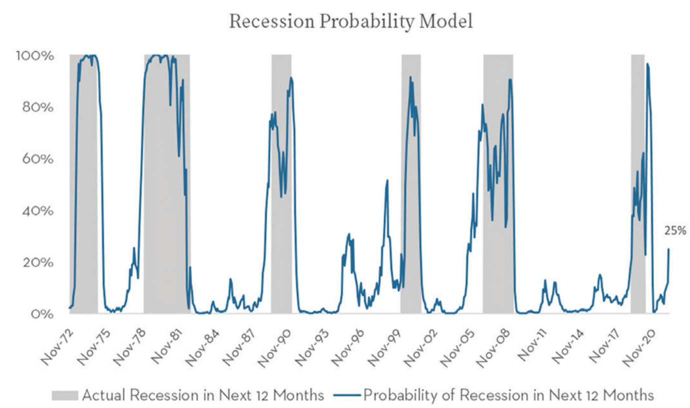
And, finally, geopolitical issues in Russia and China have exacerbated an already challenging shipping environment. We're looking for companies that are not as reliant on supply chains outside of the US. Some businesses do not have physical supply chains at all. For example, insurance companies primarily deal in direct relationships and electronic contracts; they have no physical supply chain to be disrupted.

It's impossible to avoid all supply chain issues; many businesses are impacted either directly or indirectly. But we're looking to avoid issues that could get worse over time.

"E" for Essential

Economic growth outside the US is almost certainly going to slow in 2022. What impact will that have on the US? Is our economy going to go into a recession?[3]

Our economic recession model uses several data points to measure the likelihood. At the time of writing, our model suggested that is still not likely. Based on our current data, we forecast there is approximately a 25% chance of a recession over the next 12 months. Or, if you prefer, there's a 75% chance the US economy continues to grow through early next year.



The main reason for optimism is consumers – which make up 70% of the US economy. Wages are strong, cash is plentiful, and jobs are easy to find. The consumer continues to be in good shape – both from an income and an asset perspective. That should support continued economic growth in 2022.

Even though recession odds remain low, this investing environment is a challenging one for businesses that sell discretionary products.

Higher costs – particularly from gas prices – are likely to reduce consumers' ability and willingness to spend money. Moreover, if inflation continues, discretionary spending is expected to decline. As a result, we have pivoted our portfolios towards "essential" businesses – companies that make products we need to survive.

Whether gas prices are $2 per gallon or $20 per gallon, there are still 8 billion people on Earth that need food, shelter, and clothing. That isn't possible without the companies making those things or supplying the technology. Procter & Gamble (PG) is an example of a business that sells essential items from diapers (Pampers, Luvs) to laundry detergent (Tide) to deodorant (Old Spice). **Don't forget that your stocks represent companies; those companies make things we have to have.**

"E" for Energy Immune

The direct economic impact from Russia and Ukraine's economies is small; they combine to make up around 2% of the global economy. Yet, the two countries punch above their weight in their impact on commodity prices – particularly in Europe. Russian imports make up 32% of Europe's energy supply.[4] With that reduced, Europe has seen its energy prices spike.

[3] A recession is defined as a reduction in GDP for two consecutive quarters.
[4] "Gas Market and Russian Supply – Russian Supplies to Global Energy Markets – Analysis." IEA, https://www.iea.org/reports/russian-supplies-to-global-energy-markets/gas-market-and-russian-supply-2. Accessed 24 Mar. 2022.

Higher energy prices are bad news for most businesses. They increase the cost of transporting items and put pressure on profit margins. Not only that, but less demand from consumers leads to fewer sales growth opportunities.

Yet, some businesses benefit from rising energy prices. The energy sector is the most apparent example. Higher oil prices mean producers like Chevron (CVX) and Exxon Mobil (XOM) see an immediate increase in profitability.

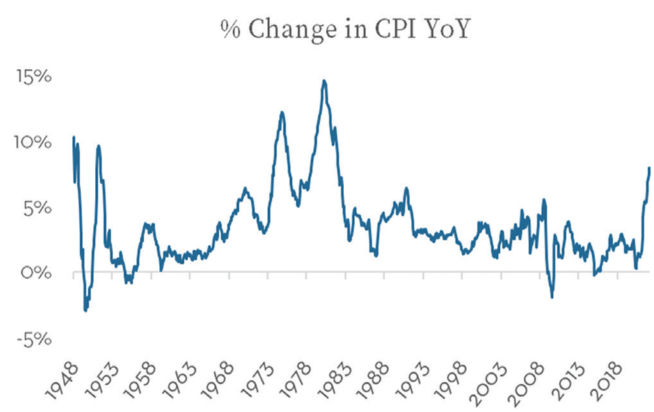
Some beneficiaries are not obvious. Take, for example, the railroads. When gas prices are on the rise, trucking costs also increase. That makes transporting goods via railroads – which is more energy-efficient – less expensive in comparison. Some railroads, like Union Pacific (UNP), also transport oil to refiners. As demand for oil increases, so does the demand to ship it via railroads.

Most businesses are impacted negatively by energy prices rising; if we can identify those that are benefited by rising prices, we can hedge against future increases.

"P" for Pricing Power

And, finally, we're looking for businesses with pricing power; these are the types of businesses that can pass on higher costs to their customers without reducing their margins.

Inflation reached 7.9% in February, the highest since January 1982.[5] You probably have noticed it yourself if you've filled up your vehicle or grocery cart in the last few weeks. Things are getting more expensive; there is no doubt about that.



In 2021, the US Federal Reserve ("The Fed") was calling for inflation to be "transitory." They expected that, once the economy reopened from the pandemic, inflation would subside.

When Russia invaded Ukraine, that changed. Fed chairman Jerome Powell admitted as much in March:

> *"The expectation going into this year was that we would basically see inflation peaking in the first quarter, then maybe leveling out. That story has already fallen apart."*

While Russia and Ukraine's impact on the global economy is low, the effect on commodity prices is more considerable. Russia is a significant supplier of energy commodities, agricultural products, and raw materials. The cascading effects of that will drive prices up across the board.

Inflation will be stickier than we originally thought. However, don't expect a repeat of the late 1970s and early 1980s when inflation reached 10%. Barring a widespread global conflict, inflation is likely to peak in 2022 and then come down over the next few years. Treasury investors are still predicting inflation to fall back under 3% per year over the next decade.[6]

Businesses do not like inflation. Higher input costs from materials and wages put pressure on margins. Companies will try to pass these costs on, but that can be difficult. That's why we look for companies with pricing power – the ability to pass price increases on to consumers.

Some businesses may even see an increase in demand during inflationary periods. Take, for example, Costco (COST). People look to save money when prices increase. And when they do, Costco gets more people to sign up for and keep their memberships. Not only that, but Costco's scale gives them buying power, helping them keep prices low for their members. They can push through any price increases to customers while still undercutting competitors' prices, strengthening their value proposition.

Because the iPhone has become an essential item for most people today, it gives Apple (AAPL) incredible pricing power. Other phones can be found for a lot less money. But people pay more compared to the competition to have the same phone. The iPhone drives interest in other Apple products, further cementing customers in the Apple ecosystem. If Apple's costs go up, they can pass those costs to consumers.

Bottom Line

This is a challenging environment for investors. We haven't seen a combination of higher inflation and slower economic growth in a long time. Markets may be choppy for a while, but we would urge you to stick with your long-term investment plan.

And D-E-E-P companies, in particular, should do well in this environment. Still, we know that years like 2022 can be difficult to go through. If you're anxious, **call us.** We want to help you weather this market volatility and stay on track to meeting your financial goals.

Blessings,

Your Investment Policy Committee

[5]Inflation was 8.2% in January 1982. Historical Inflation Rates: 1914-2022 | US Inflation Calculator. 24 July 2008, https://www.usinflationcalculator.com/inflation/historical-inflation-rates/.
[6] 10-year breakeven inflation rate. Source: FRED

DCM Is Starting a New Season of Events

Join us at our upcoming Kentucky Derby Social on Saturday, May 7, 5-8pm at Fairway Social in Alpharetta, GA. Grab your derby hat, place your bets, and enjoy the camaraderie. Send your RSVP to Atlanta@dcmol.com.

The World Economy

In today's market, stock prices are a function of global economic activity. Nearly all companies are influenced in one way or another by economies beyond their borders. Because of this, it is critical for investors to understand the key players on the world stage and the relationships between them.

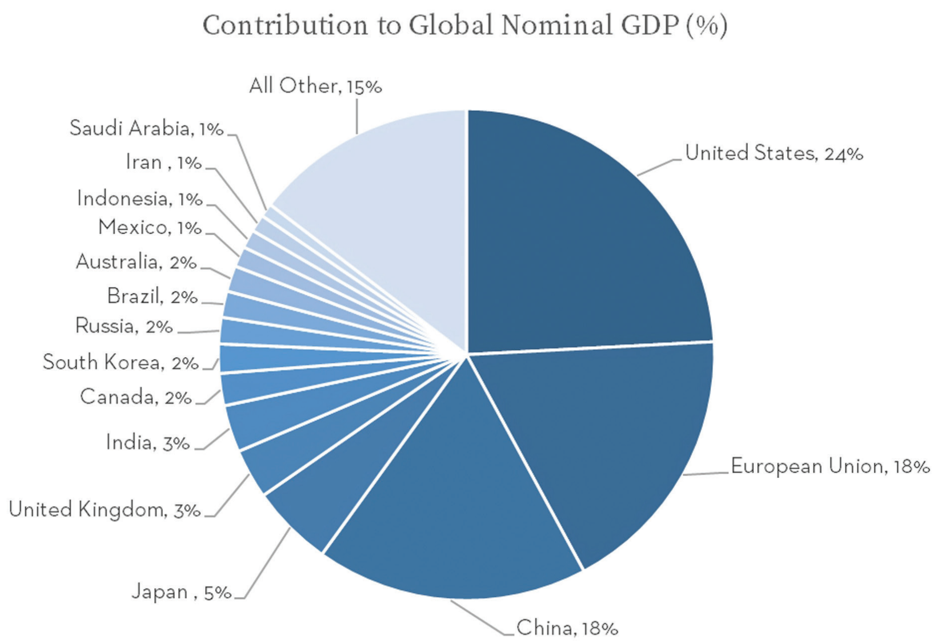
The United States, the European Union, and China are the driving forces of the global economy. Together, they account for roughly 60% of all economic output. With such heft, these entities are naturally interdependent. The US economy is largely consumer driven and depends on the EU and China as sources for consumer products and industrial inputs. In turn, the EU and China depend heavily on the US for its financial and technological prowess. China and the EU are also major trading partners for various goods and services.

Because of these relationships, there is strong correlation between the fortunes of the 3 major economies. Strength in one economy often leads to strength in the others and vice versa. However, the US does enjoy a higher degree of insulation due to its consumer slant. It can take much longer for foreign pressure to bleed into the US economy.

Economies outside of the top 3 are still important in the aggregate, but typically do not carry enough weight individually to influence the direction of the global economy. Other than the US or China, no single country contributes more than 5% to global GDP. Strength or weakness within one of these economies does not necessarily translate to the global economy.

However, specific companies or industries could be impacted by the health of smaller economies. As an example, Russia and Saudi Arabia combine for roughly 3% of global GDP, but they have outsize influence on the energy industry because of their productive capacities.

In our strategies, we pay close attention to the geographic distribution of sales and supply chains for our companies. As economies take shape, we can alter our exposure by going global or staying home. We accomplish this by moving the needle on the foreign vs. domestic split of sales and/or assets within our portfolios.



Getting to Know Charles Schwab

Ciavon Hartman
Chief Operations Officer &
Chief Compliance Officer

In October 2019, the merger deal between Charles Schwab and TD Ameritrade was announced. Since then, the two firms have been actively working on transition plans. We anticipate client accounts will move from TD Ameritrade to Schwab in the second half of 2023. Rest assured, we will keep you updated as plans evolve.

In the meantime, at Donaldson, we are doing everything we can to get to know the leadership of our new custodian. We will ensure your client experience is only enhanced by this change.

We've already seen exciting benefits and resources from our new relationship with Schwab. As an example, DCM's Chief Operations Officer & Chief Compliance Officer Ciavon Hartman was accepted to an exclusive program only offered to leaders in around 30 firms each year. Schwab's Executive Leadership Program is a one-year program that leverages premier academic curricula and faculty from top graduate schools, including Michigan's Ross School of Business, Wharton, Harvard, and MIT. The program is designed to equip the best and brightest as they transition to executive leadership more successfully and manage firms more confidently and effectively.

With Ciavon's leadership, DCM has experienced internal growth and operational efficiencies that allow us to serve clients better and to enrich the work of DCM team members. We know that participation in programs like Schwab's will only help DCM create a better company for clients.

Is Your Variable Annuity Right for You?

Variable annuities can be a polarizing topic. A Google search will result in articles with a range of viewpoints, from don't ever invest in a variable annuity to a variable annuity is the answer to all financial objectives. It can be hard to separate fact from fiction.

DCM can help by providing a thorough analysis of your annuities, including breakdown of fees, features, and riders. We can also determine if there are more suitable, less expensive options and provide a side-by-side comparison to your existing annuities.

If the analysis indicates a new annuity might make sense, and you would like us to manage the new annuity, we now have that ability. Historically, as a fee-only fiduciary, we have avoided the conflicts of interest that can arise from the large commissions annuities often offer financial advisors. However, relatively new to the industry are "Advisory" annuities. These "Advisory" annuities offer low-cost, no-load alternatives that strip out many of the fees associated with traditional commission-based annuities. This allows us the opportunity to manage annuities in the same manner as we manage investment accounts, including an annual advisory fee commensurate with fees charged on other client assets under our management. Additional costs associated with these types of annuities can be as little as a $20/month administrative fee levied by the issuing company.

If you have an annuity and are interested in conducting this analysis, please contact your DCM advisor to discuss next steps. We are happy to help.

Donaldson
CAPITAL MANAGEMENT

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An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indexes are unmanaged portfolios and investors cannot invest directly in an index. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown.

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.