Donaldson CAPITAL MANAGEMENT

WINTER 2023

RISINGDIVIDEND REPORT

Highlights from the Investment Policy Committee

1. To fight the highest inflation since the 1970s, the U.S. Federal Reserve raised interest rates significantly in 2022. Stocks entered the first bear market since 2020; U.S. Treasuries had their worst year since 1928.

2. Our investment team estimated the likelihood of four economic outcomes occurring in 2023: (1) continued economic growth keeping inflation high, (2) high inflation and recession, (3) low inflation with a recession, and (4) low inflation and economic growth — the Goldilocks scenario.

3. A recession is widely predicted. However, the severity of a potential recession is most important. If we have a recession in 2023, we anticipate it will be mild. Consumers are in excellent financial shape, unemployment remains historically low, and banks are much healthier than they were heading into the 2008 recession.

4. We remain tilted toward high-quality businesses in our strategies. Those should insulate against what is likely to be a volatile environment in 2023. But investors often overreact in good and bad markets. When things look their worst, that is the best time to invest in what everyone else has thrown out. With that in mind, we're open to adding lagging stocks that appear to offer long-term value.

Read the IPC Letter on page 3

A Smoother Ride

There's no disputing 2022 was a challenging year for market participants. The unanswered questions surrounding high inflation, rising interest rates, and the possibility of a recession have led to a great deal of uncertainty and erratic movement in market prices.

In 2022, 87% of the trading days saw more than 1% intraday movement. For perspective, over the last 30 years, only 2002 and 2008 have posted more volatility.

Joe Zabratanski
Chief Investment Officer & Senior Investment Advisor

One bright spot in an otherwise challenging year was our Cornerstone strategy. Cornerstone is an all-weather strategy designed to provide a "smoother ride" through market turbulence. It's built to thrive in good years – up nearly 27.9% in 2021 – and, importantly, protect our investors in down years.

The S&P 500 posted a return of -18.1% compared to Cornerstone at -5.34%. The strength of our strategy also earned it a five-star overall rating from leading independent investment research firm Morningstar in 2021, placing it in the top 10% of analyzed funds.

While we never welcome a down market, we understand they're inevitable. Our key to success through the years is that we've remained steadfast in our prioritized objectives: security, income, and growth.

We invest in companies with strong business models, smart decision-makers leading the organization, and rock-solid balance sheets providing needed **security**.

The consistent **income** generated by every company in the portfolio offers our investors an opportunity to benefit every year – via their generous dividends – no matter the market environment.

Growth in both the dividend and market value is essential. When purchased at the right price, the annual dividend increases lead to growth in the portfolio market value.

We can't be sure when the markets will stabilize, but we can enjoy a smoother ride to that eventual destination.

Joe Zabratanski

*Performance listed is net of fees. Investing involves the risk of loss and investors should be prepared to bear potential losses. Past performance is not indicative of future results.

Overall Morningstar Rating™ out of 466 funds in the Large Value Morningstar category as of 9/30/2022.

See full disclosure on back.

charles SCHWAB

TD Ameritrade/Schwab Merger Update

What to Expect in 2023

Charles Schwab and TD Ameritrade (TDA) have been actively working on transition plans since the merger deal was announced in October 2019. Over the last year, our staff has been getting acquainted with the Schwab leadership team, service team, and the transition plan.

Most importantly, we now know client accounts will shift from TD Ameritrade to Schwab on Labor Day weekend, pending regulatory approval. With this transition, you should expect to receive communications directly from Schwab. Below is a timeline of the communications you will receive.

We are committed to making this a smooth transition for you and excited about our partnership with Schwab. As we near the conversion date, we will keep you updated with details and next steps.

Jessica Klostermann
Director of Client Services

Summer → Labor Day Weekend → Schwab Conversion

Before Conversion	After Conversion
Schwab account transition notice	Account verification letter
Regulatory mailings	Residual transactions
Link to set up Schwab Alliance credentials from AdvisorClient.com	Statements from TDA and Schwab
Key information letter, including new Schwab account numbers	Tax documents from both TDA and Schwab
Schwab-issued debit cards and checks	

To ensure a smooth account transition, please log in to TD Ameritrade's AdvisorClient.com and confirm that the following items are correct:

- Physical addresses
- Mailing addresses
- Email addresses
- Phone numbers

Goldilocks and the Three Bear Markets

First she tasted the porridge of the Great Big Bear, and that was too hot for her. Next she tasted the porridge of the Middle-sized Bear, but that was too cold for her. And then she went to the porridge of the Little Wee Bear, and tasted it, and that was neither too hot nor too cold, but just right, and she liked it so well that she ate it all up, every bit! -The Story of the Three Bears, Flora Annie Steel (1922)

In 2022, the post-pandemic inflation turned out to be not as "transitory" as the Federal Reserve believed. To fight it, the Fed aggressively raised the federal funds rate from 0% to 4.5%—its highest level in 15 years.[1]

It was the most shocking reversal in monetary policy since Paul Volcker hiked the federal funds rate to 20% in the late 1970s—the last time inflation exceeded 7%.

Neither the stock nor bond market cared much for the Fed's abrupt change in policy. The S&P 500 index fell into a bear market and finished the year down 18.1%. Bond investors, however, faced the biggest shock. The "risk-free" 10-year U.S. Treasury bond fell 15.2% in 2022 — its worst single-year performance since 1928.[3]

Even as inflation flared up in 2021, the Fed held interest rates at 0% and continued buying bonds to support the economy. Now, the question is will they make a second mistake by raising rates too far, too fast?

In December, our Investment Policy Committee estimated our odds for the U.S. economy to end up in each of the four possible economic scenarios:

1. High Inflation, but with economic growth (10% probability)
2. Low inflation, but with a recession (45% probability)
3. High inflation with a recession (5% probability)
4. Low inflation with economic growth (40% probability)

There are varying degrees to each scenario but, broadly speaking, we're always in one of those four potential outcomes.

Let's walk through each of those scenarios—one Goldilocks and three bears—and which stocks we expect would do well in each environment.

Scenario #1: The economy grows in 2023, but inflation remains high

Despite all the recession talk, the U.S. economy may surprise to the upside in 2023. The most feasible path to this outcome centers on two potential variables: strong consumers and China's relaxing of its zero-COVID policy.

Consumer spending makes up 70% of the U.S. economy. Shoppers are seeing bigger numbers on their pay stubs and Social Security checks. Though they may not *be* better off on an inflation-adjusted basis, these bigger numbers may help them *feel* better off. *Feeling* better off often leads to more spending, fueling economic expansion.

Second is the **relaxation of China's zero-COVID policy**. China is finally opening its economy after a long lockdown. Demand could rise for all goods and services, causing economic growth *and* inflation to surge across the global economy.

This boom economy scenario is plausible, but improbable for one major reason: *the Fed doesn't want us here.* **That's why we assigned this scenario a low 10% probability.** Any inflationary pressure will be met by an increasing effort by the Fed to slow it.

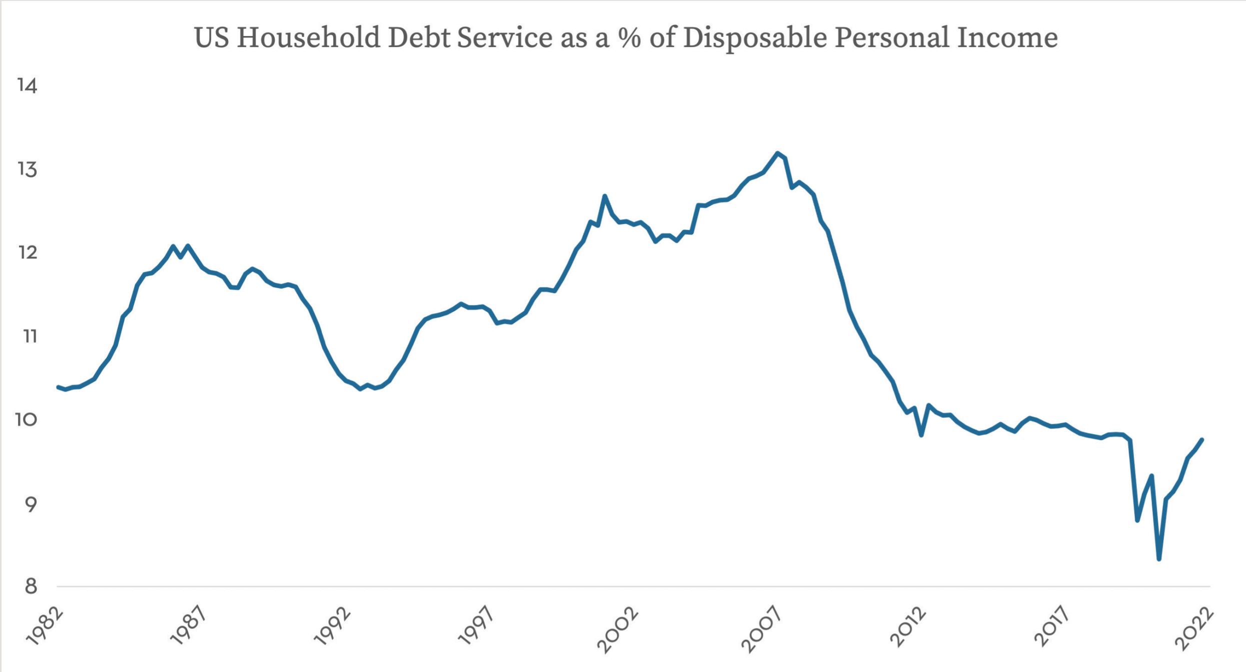
Scenario #2: The Fed's aggressive rate hikes break inflationary pressures, but lead to recession

A recession is now the expected scenario among economists,[4] but that's not the right point. **The important question is how bad the recession would be.**

What we don't want is a deep recession to threaten otherwise healthy businesses. Fortunately, the odds of a deep recession are remote because the financial system today is much healthier than that in pre-2008.

Households are in better financial condition. People have excess savings from the pandemic, unemployment rates are near all-time lows, and household debt as a percentage of disposable income remains at multi-decade lows.

[1] Federal Funds Effective Rate. Stlouisfed.org. Published 2022. Accessed December 22, 2022. https://fred.stlouisfed.org/series/FEDFUNDS [2] S&P 500 (TR) Stock. Yahoo Finance. Published 2022. Accessed December 22, 2022. [3] As measured by iShares 7-10 Year Treasury Bond ETF (IEF). Compared with historical U.S. Treasury bond data from NYU. Published 2021. Accessed December 22, 2022. https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html [4] Source: Strategas



The 2008-09 recession turned into a financial crisis because banks held too many risky loans. Post-2008 loan standards tightened and regulations now require banks to keep leverage (debt as a percentage of capital) at lower levels. Banks are much healthier today with far more equity capital relative to their total assets.[5] Banks also are required to pass Fed stress tests to help prevent another financial crisis.

A basket of leading economic indicators has declined over 3% in the last 6 months.[6] We're optimistic that a recession won't be deep, but we do expect a slowdown in 2023. **We assign a 45% probability to a recession.**

In a mild recession, investors flock to quality companies with bulletproof balance sheets. In the bond market, U.S. Treasuries do well as the Fed stops raising rates as inflationary pressure subsides. Of the four scenarios we cited earlier, we expect this scenario has the highest probability of playing out. We will stay tilted toward high-quality businesses selling essential goods and services.

Scenario #3: A double whammy of recession *and* high inflation – called "stagflation"

A recession usually reduces demand and lowers inflationary pressure, which is why stagflation is rare. The only way to get both high inflation *and* a recession is if demand falls, but supply falls faster.

[5] Source: FRED
[6] Source: Conference Board Leading Economic Indicators

The path to stagflation often includes a combination of external supply shocks. An obvious example would be additional disruptions in oil and food supply stemming from an escalation in sanctions from the Ukraine-Russia war. A deeper recession would hit Europe if that happens, which has negative ramifications for the entire global economy.

The second potential supply shock could be a major wave of reshoring supply chains away from China. Replacing low-cost Chinese labor with the higher labor costs in other countries may cause an inflationary jolt.

If inflation remains high, the Fed has no choice but to continue raising rates until inflation breaks. In this difficult scenario, we may see a recession, high inflation, and continued rate hikes from the Fed.

Yet, the probability of stagflation remains low. Inflationary pressures appear to be abating and should fall further with a recession. **We assign this scenario a 5% chance of playing out.**

This environment would be difficult for bonds and stocks. Higher inflation would likely lead to higher interest rates and lower bond prices. Inflationary pressure hurts corporate profit margins, driving earnings lower. Also, history shows us higher inflation lowers price-to-earnings multiples, which is the price investors are willing to pay for a dollar of a company's earnings.

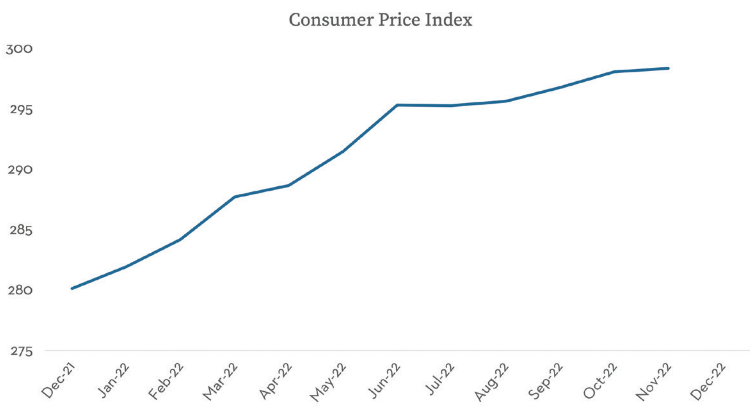
Higher rates will hurt longer-term bonds while a recession typically means investors rotate from higher-risk corporate bonds to Treasuries. So, in this environment, the best-performing assets should be short-term U.S. Treasuries, cash, and inflation-hedging sectors like Energy.

Scenario #4: Inflation falls without a severe recession

It is possible stocks and bonds can make a strong recovery in 2023. A "softish landing" for the economy combined with lower inflation sets the stage for a market rally.

Evidence shows slowing inflationary pressure is well underway. The latest inflation data showed 7.1% year over year in November. (December's inflation report may be released by the time you read this.)

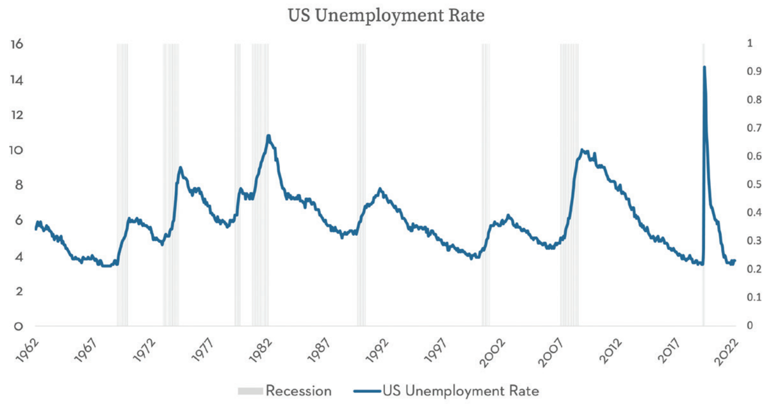
Year-over-year inflation will fall below 3% by Summer 2023 if the 6-month inflation rate continues.[7] Year-over-year inflation remains high, but the month-over-month pace has slowed. Inflation increased 1.02% in the five months from June to November, which is 0.2% per month.



The Fed is worried about the labor market, but there is evidence that job demand is falling. Employment openings peaked in March 2022, suggesting less demand for workers and slowing wage pressure.

If inflation continues to slow, the Fed could pause rate hikes sooner than expected. Meanwhile, the strength of the U.S. consumer may limit the economy to a slowdown, not a recession.

The unemployment rate and initial claims for unemployment both show a strong labor market. Both support the economy.



A recession is the most likely scenario, but it's not a foregone conclusion. Despite weakness in economic data, we've never had a recession during a strong labor market. **We assign a 40% chance to the Goldilocks scenario.**

If the Goldilocks scenario occurs, expect to see a reversal in 2022's poor performance. Stocks that have sold off on recessionary fears should rebound. Meanwhile, higher-multiple growth stocks will likely bounce on lower interest rates and less pressure from the Fed. The bruised consumer discretionary, technology, and communication sectors should rebound. Meanwhile, lower-quality bonds would likely outperform risk-free Treasuries.

What Changes?

How do these forecasts affect your portfolios as we enter 2023?

High-quality, dividend-growth stocks did well in 2022. We expect continued outperformance for dividend payers in 2023. Our current strategy is to stay guarded against continued downside pressure with D-E-E-P-E-R stocks–*D*omestic, *E*ssential, *E*nergy-immune, *P*ricing Power, *E*lite Balance Sheets, and *R*ate-insensitive.[8] Those should insulate against what is likely to be a volatile environment in 2023.

Recessions often destroy businesses struggling for survival. When a company fails, it frees up resources–employees, capital, factories, buildings, etc.–to more productive uses, which fuels future economic growth.

Investors often overreact in good and bad markets. Peak pessimism is when things look their worst; paradoxically, that is the best time to invest in what everyone else has thrown out. If a mild recession clears out inflation and 'zombie companies,' the year ahead may establish the economic foundation for the next bull market. With that in mind, we're looking for companies that fit our D-E-E-P-E-R criteria and offer long-term value, even if they have some short-term concerns. Those companies should do well, no matter what awaits us in 2023 and beyond.

Thank you for the opportunity to serve you in 2022. If you have questions about the markets in 2023, we would love to talk to you. Reach out to your advisor or anyone on the investment team; we're all here to help you however we can.

[7] Source: DCM's calculations
[8] Read our Fall 2022 letter for more on that topic. Send us a note if you'd like to request a copy.

Our View on ESG Investing

American economist Milton Friedman penned in his famous 1970 essay that the sole social responsibility of a business is to increase profits.

This prevailing view was written into law long before Friedman. The Michigan Supreme Court's 1919 decision in Dodge v. Ford Motor Co. held that "a business corporation is organized and carried on primarily for the profit of the stockholders."

Recently, however, an alternate view was developed that focused on social factors as much as profit. Known as Environmental, Social, and Governance, or ESG, this framework holds corporations accountable to additional stakeholders: customers, employees, suppliers, communities, and the environment.

ESG proponents believe corporations that "do good" will also do well – or better – for their shareholders. ESG, promoted as socially progressive, quickly became the hot new marketing slogan for funds composed exclusively of purportedly ESG-compliant companies.

However, there is no SEC list of ESG criteria. Promoters are free to label any company they want as ESG-compliant. Some companies, such as fossil fuel giant Exxon, have used ESG rhetoric to greenwash investors into believing they are eco-friendly despite increasing carbon emissions. Firms are piled into so many ESG funds that Aaron Brown, former head of financial research at AQR Capital, wrote in a 2021 Bloomberg article: "Many ESG funds are just expensive S&P 500 indexers."

NYU's Stern Center for Sustainable Business analyzed over 1,000 studies of ESG performance published between 2015 and 2020 and found only 33% of ESG investments outperformed non-ESG investments. The other 67% showed no difference, mixed, or negative results.

At DCM, we believe protecting the environment, being socially responsible, and following sound corporate governance principles are all positive qualities. However, we don't look for good or bad when investing your funds. We focus on bullish vs. bearish. We prioritize proven security, income, and growth of your invested assets. Until ESG is a regulated, standardized designation and evidence shows that ESG funds consistently outperform, we will not include ESG in our investment considerations.

Maximizing Your Cash Reserves

The top-performing asset class in 2018, with a return of 1.9%, was cash. While commodities claimed the top spot in 2022, cash came in second among asset classes. You've probably heard this phrase that has had everything to do with cash rising to the top in both 2018 and 2022: "The Fed is raising interest rates."

Comparing deposit and savings rates at financial institutions can provide greater returns in a high interest rate environment. The table below, for example, compares the value of interest rate offerings.

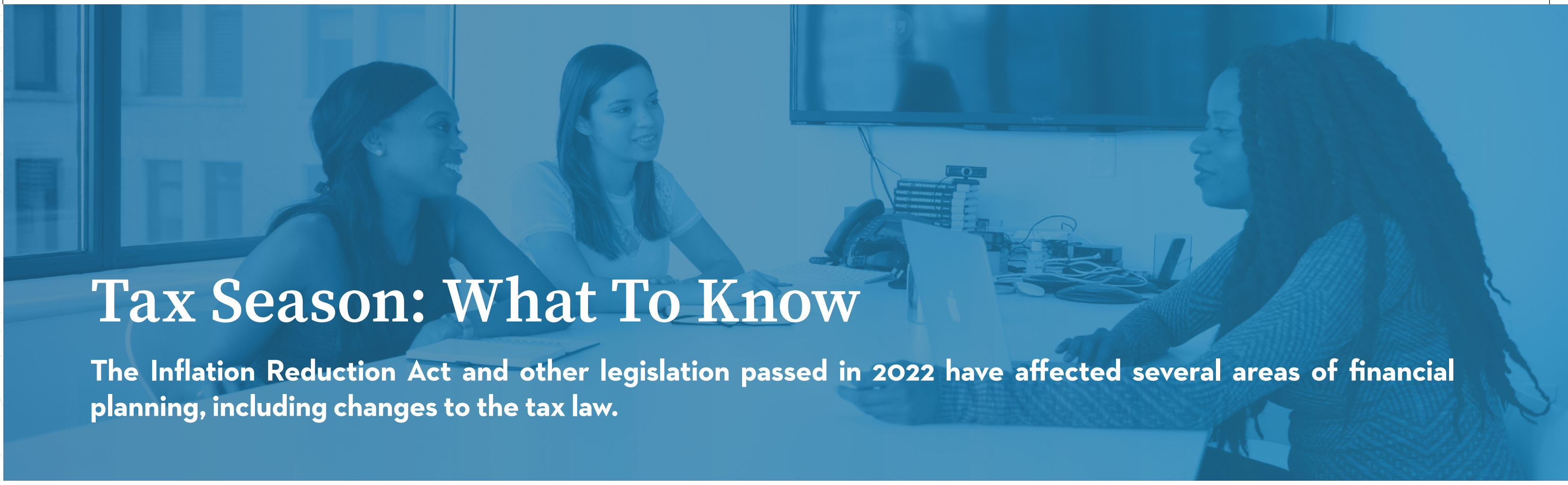
	Financial Institution 1	Financial Institution 2	Financial Institution 3	Financial Institution 4
Annual Rate	1.00%	1.25%	2.00%	3.00%
Balance	$300,000	$300,000	$300,000	$300,000
Annual Interest Earned	$3,000	$3,750	$6,000	$9,000

Changing banks is not the only opportunity to maximize cash. Strategies and investments such as laddered CDs, money market funds, Treasury bills, and I bonds are all opportunities to consider. Still, the best option for cash depends on your personal needs.

One way to determine the right option for you is to work with your investment advisor to answer the following questions:

- What is the right amount of cash for me to hold?
- What is my short-term liquidity need for 3-6 months?
- What is my intermediate-term liquidity need for 6-18 months?

Once you have worked through a financial plan to answer these questions, we can create a clear path to compartmentalizing these cash options to maximize yield without jeopardizing your flexibility.



Tax Season: What To Know

The Inflation Reduction Act and other legislation passed in 2022 have affected several areas of financial planning, including changes to the tax law.

As we monitor how those changes will affect you, here are some reminders on filing dates, deadlines, and retirement contribution limits to help you prepare for the upcoming 2022 deadline and navigate the 2023 tax year:

- Unless you file an extension, your 2023 tax return is due on April 18, 2023.
- You can expect to receive a Form 1099 tax document for all taxable accounts by mid-February. This tax form reports on earned dividends and interest income and is issued by your account custodian.
- If you had a retirement account distribution in 2022, you can expect to receive a Form 1099R from the account custodian by late January.
- Don't forget, you have until April 18, 2023, to make contributions to your IRA (deductible and non-deductible), Roth IRA, and HSA for 2022.
- If you make quarterly estimated tax payments, mark your 2023 calendar with the following due dates: April 18, June 15, Sept. 15, and Jan. 15, 2024.
- The standard deduction for 2023 has increased to $13,850 for single filers, $27,700 for married filing jointly, and $20,800 for head of household.
- Employers often institute compensation changes at the beginning of the year. Review and adjust your elective deferrals to take advantage of savings opportunities.
- Filers over 50 years old are also eligible for additional catch-up deferrals. If you are unsure what deferral amounts are right for you, reach out to your investment advisor.
- 2023 Contribution Limits for Retirement Accounts:

401(k), 403(b), 457(b) Elective Deferrals:	$22,500
Catch-up Contributions Limit (age 50+):	$7,500
Traditional & Roth IRA Limits:	$6,500
Catch-up Contributions Limit (age 50+):	$1,000
SIMPLE IRA Employee Deferrals:	$15,500
Catch-up Contributions Limit (age 50+):	$3,500
Health Savings Account (Single):	$3,850
Health Savings Account (Family):	$7,750
Catch-up Contributions Limit (age 55+):	$1,000
Defined Benefit Plan, Benefit Limit:	$265,000
Defined Contribution Plan, Contribution Limit:	$66,000
Annual Compensation Limit for Retirement Contributions:	$330,000
Highly Compensated Employee Threshold:	$150,000
Social Security Wage Base:	$160,200

Source: http://www.irs.gov/

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

Adding Dividend Growth to Your Retirement Plan

The power of dividends is significant in retirees' endeavors for dependable, growing income. However, it can be just as powerful in asset accumulation for those working toward their retirement goals. In February, we launched the *Donaldson Rising Dividend Cornerstone* Collective Investment Fund. A Collective Investment Fund or "CIT" is an investment vehicle that can be hosted on any 401(k) or similar retirement plan platform. The Cornerstone CIT is a pooled investment vehicle that behaves much like a Mutual Fund or Exchange Traded Fund without the added costs. Contact us to see how our core strategy can be applied to your company's retirement plan platform.

Donaldson
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The Morningstar Rating™ for funds, or "star rating", is calculated for separate accounts with at least a three-year history. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/ 20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.