Donaldson CAPITAL MANAGEMENT

SUMMER 2023

RISINGDIVIDEND REPORT

Highlights from the Investment Policy Committee

1 Dividend stocks performed well in 2022, losing only -5.4%, on average, versus the S&P 500 down -19.6%. That has flipped in 2023; just seven large growth stocks accounted for 13% of the market's entire return. Without those seven stocks, the S&P 500 would be up by only 1.2%.

2 While it may be tempting to switch to what is 'working' in 2023, history suggests that's not a good idea. Constantly switching between strategies and timing the market has hurt investors. From 1990-2019, the US stock market returned 10% per year; the average stock investor, however, earned just 5% per year. Bond investors did even worse—only earning 0.4% per year compared with U.S. bonds returning 5.9% per year.

3 While dividend-paying stocks have underperformed in 2023, history suggests they remain a good long-term investment. Ned Davis' research shows that companies that grow or initiate a dividend have outperformed four other categories—including the equal-weighted S&P 500—by a wide margin.

4 While they may not seem to have a significant impact from year to year, dividends add up over time. A $1,000 investment made in the S&P 500 back in 1928 with reinvesting dividends would now be worth $863,129. Without reinvested dividends, the same investment would be worth a mere $24,795.

Help! Give Me Your Best Advice.

All of us at DCM are grateful for the opportunity to work with our clients. But our advice isn't always just about business. One of the best parts of being an advisor is getting to be a part of your life and witnessing the fun and joy that financial stability brings. Many of you speak enthusiastically of your travels and recreational passions. Maybe you've discovered a new talent in retirement, or simply enjoy spending time with your family. We enjoy hearing about your days, whatever they may bring. And we love it even more when you invite us along for the journey.

Recently, a friend and client invited me to his local club for a round in his Member-Guest golf tournament, known for being ultra-competitive. We began the tournament in good form and cruised through a few matches, but in our third match, my partner developed the shanks, one of the most frustrating habits a golfer can have.

Irritated with his play, he looked at me and yelled, "Help! Give me your best advice." At the time, my best advice was to quit and take up racquetball, but we had a game to get through. Instead, we changed his mindset, focused on living in the fairway, and made it through with minimal scars. We had a lot of fun that day and even won a little prize at the end.

Each of our clients has unique aspirations, interests, and needs. That is why we take the time to get to know you personally and understand your values. Money is more than just numbers on a spreadsheet. It is a tool that enables you to express those values and live the life you want and deserve. If you are looking for more financial stability so you can get back to enjoying life's precious moments, give us a call. We promise you our very best advice.

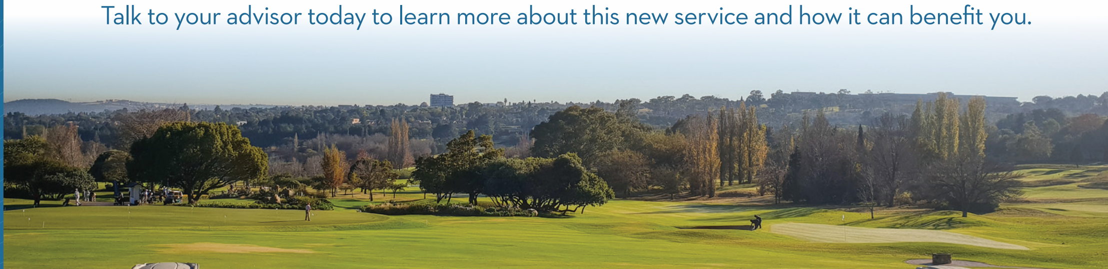
Jason Hall, ChFC®
Lead Investment Advisor

And in the meantime, keep it in the short grass.

Jason Hall

A New Way to Manage All Your Investments in One Place

We are excited to announce that we have expanded our services to include managing your held-away assets. Thanks to a new technology partner, we can now aggregate and monitor assets not under our direct management, such as employer-sponsored retirement plans. Talk to your advisor today to learn more about this new service and how it can benefit you.



Preparing For Moving Day

Since Charles Schwab acquired TD Ameritrade (TDA) in 2020, our DCM staff has been working diligently with our longtime custodian to facilitate a smooth transition to Schwab.

In most cases, you will have very little to do. DCM and Schwab will handle most of the transition details for you. You can access more information about Schwab and the transition by logging on to TDA's AdvisorClient.com and navigating to the Schwab Transition Center displayed when you first log in.

For clients with TD Ameritrade as their custodian, below is a timeline of when you will receive important information, account details, and documents from Schwab leading up to the conversion date on September 5.

Early August

A Key Information Packet will be sent to you by mail on or about August 1. This packet will provide you with information about your new eight-digit Schwab account number, outline important details about the transition, and prompt you to create a Schwab Alliance Login ID and password, which you will need to access your account information after the transition. Please take the time to go ahead and set up your Schwab Alliance Login ID.

If you already have a Schwab account, you will not need to complete this step and can continue to use your previous Schwab Alliance login.

Mid-August

There will be no disruption to your ability to trade or complete bank transfers. We will continue to have access to complete those tasks though the close of business on Friday, September 1.

However, some administrative functions, such as updating email, phone, mailing addresses, and beneficiaries, will be suspended 14 days prior to the transition.

If you use them, you will receive new Schwab debit cards and checks about one week before conversion.

Go Live Day - September 5

You will have full access to your accounts within Schwab Alliance starting at 5:30 a.m. EST. An Account Verification letter or email will be sent confirming that your account has officially been moved from TDA to Schwab.

If you were issued new checks and/or a debit card, you may begin using them. If you have existing TDA checks and/or a debit card and would like DCM to securely dispose of them for you, please contact your DCM Advisor.

Commonly Asked Questions

Will this change my relationship with DCM?
Absolutely not. We are not going anywhere. Moving custody to Schwab will not alter your relationship with DCM in any way. Your advisor and DCM's role regarding your account(s) will not change.

What if I choose not to move my account(s) to Schwab?
If you opt not to move your account(s) to Schwab, you will need to transfer to another custodian no later than August 25. Please note that keeping your accounts at TDA is not an option. The new broker-dealer will initiate the transfer by Automated Customer Account Transfer (ACAT). You will not be assessed any transfer fees.

Will my FDIC insurance coverage change when I move to Schwab?
Once your account(s) moves to Schwab, you will have access to up to five program banks, each offering up to $250,000 in FDIC insurance and up to a total of $1,250,000 in coverage, per depositor, for each account ownership category.

Will I need to reestablish direct deposits to my Schwab account?
If these deposits were initiated by DCM through TD Ameritrade, you will not need to reestablish. However, if you have direct deposits set up to your TD Ameritrade account, you'll need to update instructions directly with the third party and provide your new Schwab account and routing numbers.

Stay on the Bus

"The best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan and a behavioral discipline that are likely to get you where you want to go." -Benjamin Graham

Imagine you're at a bus stop, waiting for a bus to take you to your destination. After five minutes, you notice that a bus has just arrived at another stop down the road. A few minutes later, you see a second bus come to that stop. And then another.

So, you decide to move your bags there and wait for the next bus. After waiting at that stop, a bus finally arrives at your original stop. If you had been patient, you would have been making steady progress toward your destination instead of trying to speed up the process by guessing which stop the bus would be at next.

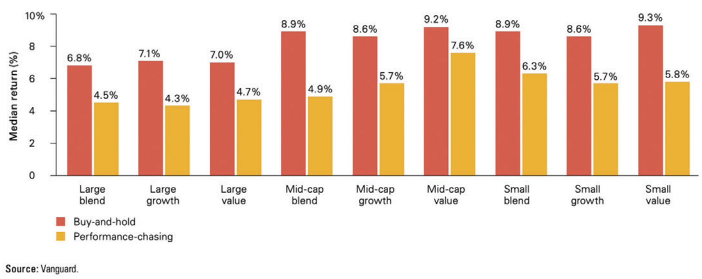
Every time you switch bus stops, you're resetting your chances of catching a bus. **Constantly hopping from one stop to another decreases your likelihood of catching any bus.** We believe investing in rising dividend stocks is the right bus to get on and stay on to reach your financial destination.

The Danger of Chasing Performance

"Waiting helps you as an investor and a lot of people just can't stand to wait. If you didn't get the deferred-gratification gene, you've got to work very hard to overcome that." -Charlie Munger

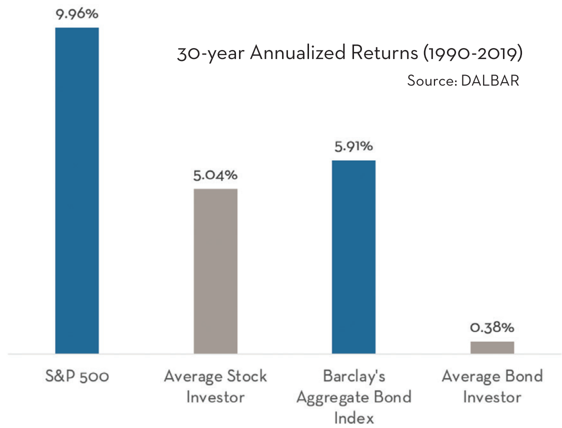
Most investors continuously jump from one investment to another based on past performance, like chasing buses. **By constantly switching investments, you risk missing out when the market finally favors the types of stocks you are invested in.**

Studies show that staying the course, rather than chasing short-term winners, is a more prudent approach for long-term financial success. From 2004-2013, Vanguard studied 3,568 mutual funds in nine different investment categories. They found that an investor who chased performance would have underperformed the average fund in each category by between 1.5% and 4% per year.[1]



And since this study was only within different investment categories, it likely understates the negative impact of performance chasing. Most investors not only chase hot-performing strategies within a particular category but across multiple categories as well. For example, after a few years of under-performance, investors may move away from the Large Value category altogether into the Large Growth category.

Research firm DALBAR publishes a study of how investors perform against common benchmarks. They find that investors consistently make bad decisions that sabotage their future returns. The chart below shows their 2020 study on actual investor returns compared with the U.S. stock and bond markets.



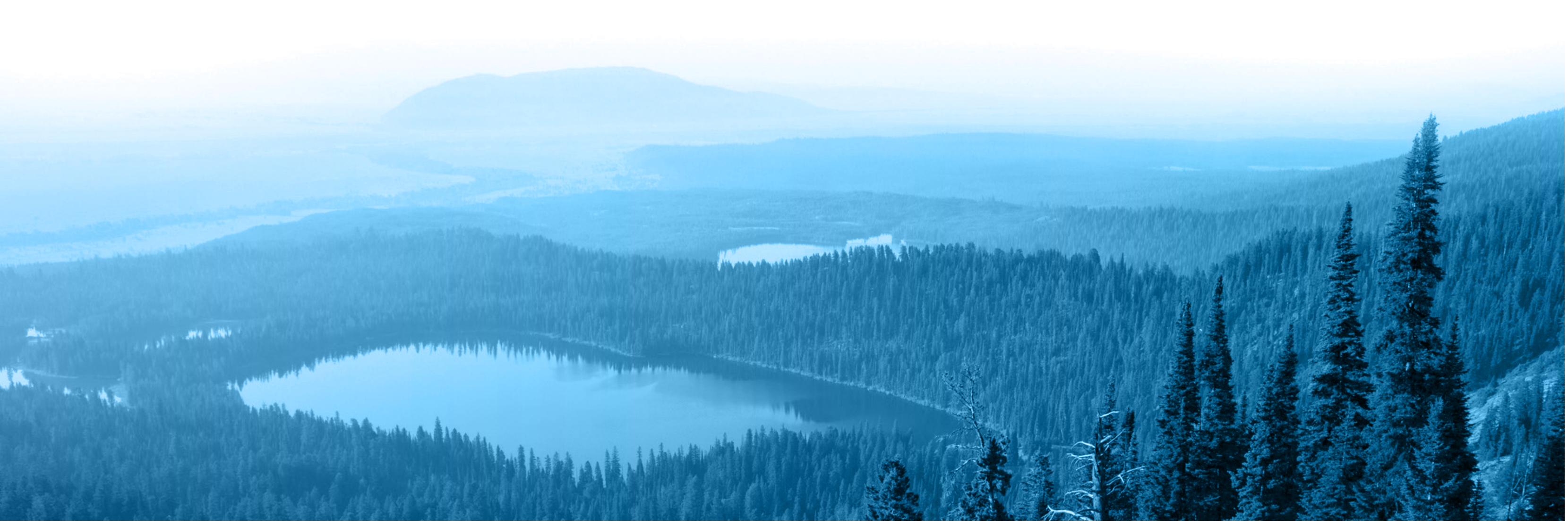
From 1990-2019, the average stock investor earned just 5.0% per year compared to 10.0% per year for the S&P 500. Bond investors also didn't fare too well–earning a meager 0.4% per year compared with Barclay's U.S. bond index returning 5.9% per year.[2] **Chasing the latest hot-performing stock strategy is one of the main reasons why the average investor performs so poorly.** And it costs stock and bond investors about 5% per year in lost investment returns.

The last 18 months have been the perfect environment for investors to get whipsawed in the future if they pay too much attention to short-term investment returns.

The Tale of Two Years

In 2022, dividend stocks were the best place to invest. While the overall market declined by -19.6% and the growth-oriented Nasdaq declined by -33.5%, [3] the average dividend payer declined by just -5.4%, on average.[4] The difference between the dividend and the growth investors was a staggering 28%.

[1] They defined "performance chasing" as buying only the best-performing funds over the previous three years. Quantifying the Impact of Chasing Fund Performance. Accessed June 26, 2023. https://www.vanguard.ca/documents/quantifying-the-impact-en.pdf› [2] Source: DALBAR, investment returns ended December 31, 2019. [3] 2022 NASDAQ Return. DQYDJ. Published December 31, 2022. Accessed June 27, 2023. [4] Source: DCM research.

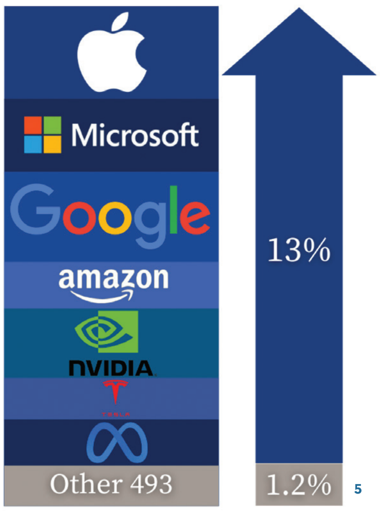


The script has completely flipped in 2023. Only a handful of large growth companies have driven all the market returns. The biggest companies in the S&P 500 index are currently Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla, and Meta. **Of these, none have a dividend yield higher than 1% and four of the seven don't pay a dividend at all.**

Last year, those stocks lost an average of 46.2%. **This year, those stocks have made a roaring comeback — increasing an average of 87.7%.**

Not only that, but they comprise a high percentage of the S&P 500. Since the S&P 500 index is market cap weighted, the largest companies make up the highest weightings and have a much higher impact on the index's performance.

As the chart below shows, just seven stocks have contributed 13% to the S&P 500's returns for 2023; **without them, the index would only be up 1.2%.**



Contribution to S&P 500's return in 2023.[5]

This high concentration could be a blessing or a curse. If those stocks continue to perform well, they will drag up the S&P 500 index. They could pull the entire market down for years to come if they perform poorly.

Dividend Stocks in 2022; Non-Dividend Payers in 2023

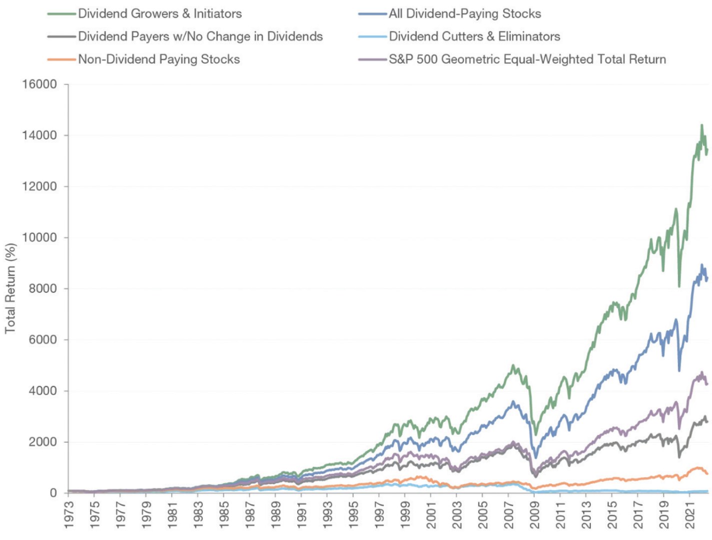
As great as it was to be a dividend investor last year, it's not performed as well this year. So far in 2023, **the average non-dividend paying stock is up 18.2% compared with the average dividend payer up just 2.3%–a gap of over 15%.**[6]

There may be light at the end of the tunnel for the patient investor. As brutal as 1999 was for dividend investors, those who remained patient did exceptionally well in the years that followed. Dividend stocks outperformed in four of the next five years–beating the S&P 500 by nearly 20% in 2000, over 20% in 2001, and over 10% in 2002.[7]

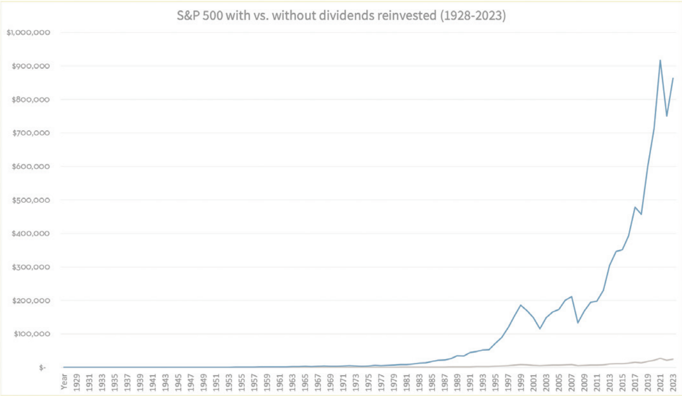
We don't think this is another technology bubble, but we do feel confident that–despite the short-term underperformance–dividend stocks remain an excellent "bus" to be on.

Dividends for the Long Run

Ned Davis Research studied stock returns going back to 1973. They divided stocks into five categories: dividend payers, dividend growers and initiators, non-dividend payers, dividend non-growers, and dividend cutters. According to their research, **stocks that grow their dividends have outperformed all other categories over the long term:**



While gains in stock prices get all the headlines, dividends–not stock price increases–drive stock returns in the long run. Dividends have accounted for nearly 100% of the market's total returns if we consider the impact of *reinvested dividends.*



Source: DCM Research

A $1,000 investment in the S&P 500 made in 1930 with dividends reinvested would have grown to $863,129 by the end of June 2021. The same investment without reinvesting dividends? $24,795.[8]

Dividends in the Bad Times

While dividends are essential to returns, they fade into the background when times are good, and stock prices rise by double digits. Not only does the dividend amount pale compared to significant price increases, but the dividend stocks tend to underperform when the entire market increases.

Research from S&P Global finds that Dividend Aristocrats have outperformed in 52% of all months from January 1990 to June 2021; however, most happens in down markets. Dividend Aristocrats underperformed the market in 43.4% of up markets–underperforming the S&P 500 by an average of 0.36% per month.

Outperforming in bad markets is far more critical than outperforming in good markets because of the mathematics of compounding. Every 1% decline in a stock requires a greater-than-1% increase to return to even. To illustrate, the NASDAQ 100 index declined by 33.5% in 2022, which requires a 50.4% return to get back to 'even.' The Dow Jones Index, on the other hand, declined by just 8.7% - requiring 9.5% to get back to 'even.'

[5] Contribution to the S&P 500's return in 2023. [6] DCM research. [7] Strategas Research Partners. [8] Soe A. S&P 500 ® Dividend Aristocrats ® the Importance of Stable Dividend Income EXECUTIVE SUMMARY. https://www.spglobal.com/spdji/en/documents/research/research-sp500-dividend-aristocrats.pdfen/documents/research/research-sp500-dividend-aristocrats.pdf

Conclusion

2023 has been a rough year for dividend investors, but history suggests switching strategies after underperformance isn't a great idea. Dividends will eventually be in favor again.

And in the meantime, they continue to pay out income monthly, meeting your cash flow needs in retirement or allowing you to reinvest them. Patience will ultimately be rewarded.

We thank you for the opportunity to serve you.

If you have any questions or comments, please contact your advisor.

Saving for College Using a 529 Plan

Planning for future education expenses can be daunting, but understanding the tools at your disposal is the first step toward financial clarity. A 529 plan, named after Section 529 of the Internal Revenue Code, offers impressive tax advantages. Contributions to a 529 plan grow tax-free, and withdrawals for qualified education expenses are also exempt from federal taxes. This tax-free growth and withdrawal mechanism can result in substantial savings over the life of the plan. In contrast, a regular taxable account does not offer this tax-free benefit; both the investment growth and withdrawals are subject to tax, which may eat into your overall returns.

Consider this scenario: You start saving for college when your child is born, investing $200 per month each in a 529 plan and a taxable account. Assuming an annual growth rate of 6%, when your child turns 18, the 529 plan would be worth approximately $75,700. The taxable account, assuming a 15% tax rate on earnings, would only be worth about $65,000. Over 18 years, the 529 plan saves you around $10,700 solely due to its tax benefits. And the ongoing tax benefits could be far greater depending on what state you live in. Each state has its own 529 plan with specific state tax benefits, making the 529 plan option more attractive for high income earners looking to reduce their tax liability.

Despite these advantages, there are potential downsides to 529 plans, the primary of which is the penalty incurred for non-qualified withdrawals. If funds are withdrawn for non-education expenses, earnings are subject to federal income tax and a 10% penalty. A taxable account, on the other hand, provides complete flexibility in the use of funds. Additionally, a 529 plan offers a limited selection of investment options, typically a range of mutual funds. For more advanced investors looking to invest in individual stocks, ETFs, or other asset classes, a taxable account offers greater flexibility. Both 529 plans and taxable accounts have their merits and downsides, but when it comes to saving for education expenses, the 529 plan's tax advantages make it an efficient tool in most circumstances. However, individual situations may vary. It's crucial to consult with a financial advisor to determine the most appropriate strategy.

Why We Don't Use Mutual Funds

Investors have access to a multitude of options when deciding how to invest their money, including active or passive investment strategies, mutual funds, Exchange-Traded Funds (ETFs), and individual securities. DCM's primary investment strategies all use individual securities representing ownership in actual businesses. This is how we have always managed our strategies, and how you can expect them to be managed in the years ahead. But with so many options available, you might wonder why we prefer to use individual securities (stocks and bonds) despite most U.S. households choosing to invest their money in mutual funds or ETFs. Below are a few reasons why we continue to manage our strategies using individual securities.

Control & Transparency – When investing in mutual funds, you entrust the fund manager with your investment decisions. Our approach is similar – clients give us discretion to buy and sell securities in their accounts that we believe align with their goals and objectives. However, the difference is the level of transparency involved with owning individual securities. Our clients know each day exactly what companies they own in their portfolio – and our advisors can tell them why. Meanwhile, fund companies are only required to report their holdings four times per year. Clients may also refrain from owning certain companies because of the products they make, services they provide, or because their values do not align. While we prefer to maintain accounts 'on model' and strive to own what we believe to be upstanding companies, we allow exceptions in certain instances that are not possible in mutual funds.

Potential Conflicts of Interest & Fees – Mutual fund managers may face conflicts of interest, such as prioritizing the fund company's interests or generating higher fees to the detriment of individual investors' goals or preferences. Our model is simple. We charge an annual fee that covers all the services we provide. There are no additional fund expense ratios, early redemption fees, or sales loads layered on top of the management fee.

Capital Gains Taxes – Using individual securities allows for more efficient tax management. We can better control the level of capital gains by delaying the sale of a security into the next year for tax purposes or tax-loss harvesting at year-end to offset gains realized throughout the year. Mutual funds, on the other hand, are subject to capital gains taxes when the fund manager sells securities within the fund at a profit. Even if you did not sell your shares, you may still be liable for taxes on those gains, leading to tax implications that are unpredictable or outside of your control.

What You Need to Know:

Corporate Transparency Act

Corporations or limited liability companies (LLCs) are often created to provide administrative flexibility, beneficial tax treatments, and liability protection. But, sometimes, these instruments are used for nefarious purposes. The creation of 'shell companies' can be used to facilitate criminal activities such as money laundering, terrorism, and tax evasion. The structure of these shell companies can make it difficult to determine who is pulling the strings.

To combat these illegal activities, Congress passed the Corporate Transparency Act in 2021. The Act creates a national database of private companies, which allows law enforcement to better identify companies suspected of illegal activities. This new legislation will also significantly increase the level of reporting and transparency required for all companies and their owners, regardless of the nature of their activities.

Any entity formed by filing paperwork with a Secretary of State or equivalent office will be required to provide additional information, with a few exceptions. Those exempted include:

- Large operating companies
  - Defined as having more than 20 employees, generating more than $5 million in gross revenue annually, and having a physical operating office in the U.S.
- Charities
- Entities already subject to government oversight (e.g., banks)

Non-exempt companies will be required to provide:

- Legal name and any trade names
- Street address for company's principal place of business
- State of formation
- Tax Identification Number. If an entity doesn't have a Tax Identification Number, it may have to obtain and provide a unique identifying number
- Image of an identifying document from an issuing jurisdiction (e.g., a certificate of incorporation)

In addition, reporting companies will be required to provide further information for "beneficial owners," loosely defined as anyone with at least a 25% ownership stake or who has substantial control over the company. For these individuals, the reporting company must provide:

- Full legal name
- Date of birth
- Home address
- Copy of a legal identification document (driver's license, passport, etc.)

The new law takes effect on 1/1/2024, and for entities created on or after 1/1/2024, the reporting is due within 30 days. For entities created before 1/1/2024, the reporting is due by 1/1/2025. Failure to comply with these new reporting requirements can result in civil penalties of $500 per day, criminal fines up to $10k, and imprisonment of up to two years. The time to start planning for these new reporting requirements is now. If you are involved with entities that this new legislation may impact, please let us know, and we can help develop a plan of action to keep you compliant with the new laws.

Updates to the DCM Portal

DCM's client portal has a new look. Rolled out in late June, the new interface makes navigating and viewing account holdings, balances, and investment performance easier. The new portal also allows you to switch between your associated accounts seamlessly. While these changes impact how you view your accounts, the following information remains uninterrupted:

User login (username, password)
Access to the DCM mobile app
The URL link to access the portal
Access to past documents on the portal

We are happy to walk you through these features and answer any questions you have about the new portal. Please feel free to reach out to any member of our Client Services team at 812.421.3211.

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