



Berkshire

DIVIDEND STRATEGY

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"Casual Friday" Commentary

Casual Friday: Portfolio Change + "It's Over For..." – July 24, 2020

Good Morning,

Berkshire Portfolio Change: Trim Microsoft (MSFT)

- Risk management of portfolio/position size – The stock hit 6% of the portfolio
- Approaching our intrinsic value expectations
- Creates source of capital for "names on the bench" that look particularly attractive now

Berkshire clients could see more upcoming moves in the weeks ahead. First priority? In the rare cases where a company has suspended, reduced or at risk for reducing its dividend, we plan on a swifter exit of those positions. COVID crisis has created dislocations in the market - We believe there are plenty of solid opportunities for available capital.

Is Value Making a Comeback?

Definitely Maybe! The last few trading days we've seen value start to outperform in a "noticeable" way. We've had days where value outperformed growth by a full percentage point. And some noticeable growth bellwethers had meaningful price declines even after posting good earnings - But expectations have just gotten too high in many tech / growth names. Obviously, we are not declaring a value victory of any sorts, but this could be a start to a new trend. (source: Bloomberg)

It's Over For...

"The only reason for time is so that everything doesn't happen at once." - Albert Einstein

The Value / Growth dynamic reminds us of many instances we've seen in the past... Today, advisors and retail investors state: "why buy any of these lousy value stocks when growth has performed so well?"

This is no different than common refrains we've heard about some Berkshire stocks over the years:

- "Free software is here to stay. The Windows paradigm is over."
- "The glory days of networking are over. The market has moved past companies like Cisco."
- "Low carb diets will ruin cereal consumption. General Mills will never grow again."
- "Post Dodd Frank the banks may never grow again."

And recently we've even heard some rumblings that its "over for dividend stocks!"

The common thread in all of these statements?

A short-sighted obsession with near term earnings growth while overlooking longer term cash generation and valuation. In short, many investors felt it was "over" for these companies, at least from an investing standpoint. In each case, the market was focused on short term product cycles and temporary problems. Recency bias, or the tendency to

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Dividend Highlights

- Dividend growth can often provide transparent insight into a company's fundamentals and vitality.
- Dividend growth can provide an attractive stream of increasing cash flow to satisfy many financial objectives.

subconsciously overweight most recent data in drawing conclusions, plays a role. And as a consensus forms around bad news, what analyst or portfolio manager wants to make brazen predictions that could involve embarrassment and significant career risk, if incorrect? A negative price/news feedback loop sometimes develops, until the market just seems to give up on the company.

Here's a recent discussion of how/why we think value can close the gap, including the solid growth prospects for a handful of companies in our portfolio:

<https://berkmgt.com/wp-content/uploads/2020/05/Casual-Friday-The-Value-Defense-Top-10-Innovation-May-15-2020.pdf>

Contrarian Ideas Play a Role But Test Patience:

Berkshire's primary mission is to find companies with a healthy dividend yield and potential to grow the dividend in the future. Comprehensive valuation work is completed on each of the companies. There is an art and science to valuing companies, and investors who think in terms of "businesses" vs. "stocks" think deeply about the interplay of a company's current dividend, growth of dividend, stability of dividend and ultimately decide what that business is worth.

Think of our portfolio in approximately three sleeves. The first and by far the largest is the "Core Dividend" sleeve...high quality, liquid, fundamentals, solid dividend growth momentum and reasonable valuation. Clients typically know and feel good about these names. The second is the emerging dividend sleeve...we've had some success with larger companies who recently initiated dividends and some rapid growth rates are possible as the company ramps up the portfolio to its target yield. The last sleeve is for contrarian ideas. They usually represent only a few names in the portfolio., but they end up having two things in common:

- They attract all the attention from retail investors - "who would buy such a thing right now" even through the other 90% of the portfolio or so is dominated by the core/emerging dividend portion!
- Many are "fallen angel" types that may be in need of a turnaround
- They may represent one the largest total return opportunities because the stock is so heavily discounted and investors have conclude - "Its over for..."

We attempt to gain an edge as stock pickers by adopting a more "business like" view of dividend investing and a longer time horizon. We are patient and allow for our long term assessment to play. And yes sometimes companies try our patience in big ways! This thorough analysis and patience has played out well for investors over time.

Berkshire Attribution Analysis

Over a rolling 5 year period 6.30.2015 - 6.30.2020, roughly 85% of our out performance has come from Berkshire stock selection process relative to the Russell 1000 Value (Source: Bloomberg Model Portfolio):

- Berkshire Active Return/ out performance relative to benchmark: +23.00% (6.30.2015 - 6.30.2020)
 - o Berkshire Selection Effect: +19.24% (6.30.2015 - 6.30.2020)
 - o Berkshire Allocation Effect: +4.09% (6.30.2015 - 6.30.2020)
 - o Berkshire Currency Effect: -0.34% (6.30.2015 - 6.30.2020)

As Einstein said "The only reason for time is so that everything doesn't happen at once" which we believe is the opportunity for patient value investors.

(Source: Bloomberg Model Portfolio only - individual results will vary)

Ok that's enough thinking for a hot summer Friday!

Best ice cream innovations 2020: <https://www.thedailymeal.com/eat/best-new-ice-cream-flavors-summer-2018-gallery>

Great summer parties: <https://www.countryliving.com/food-drinks/g4381/summer-dinner-recipes/?slide=1>

Best Regards,
Gerry

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