Berkshire DIVIDEND STRATEGY

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First Quarter 2017 Commentary

Quarterly Perspective

U.S equities came out of the gate with strong momentum and delivered an impressive quarter overall. The S&P 500 registered a total return just over 6.07%.

The quarter, while impressive, took on two distinct phases. The year started with high hopes for the new president's pro-growth, business-friendly agenda. The prospect for tax reform, infrastructure spending, and reduced regulations lifted the broad market to all-time highs. Commodity, energy, industrial, and financial shares paced the advance. The prospect of higher growth made many think the Fed would need to raise rates aggressively to make sure the economy did not overheat. Accordingly, Treasury yields went sharply higher and the dollar continued to strengthen. Utilities and other bond proxies lagged. Corporate earnings growth, moribund for the last two years, came in much better than expected (see below) to support the advance. The Federal Reserve continued to try to finesse market sentiment by talking about the need to raise rates and inspire confidence in the economy – without sounding overly aggressive for fear of undermining the economy's emerging strength.

Things started to take on a markedly different tone when the Fed made their actual rate announcement. The Fed did raise rates by a quarter point – pretty much what the market expected. But the comments that accompanied the hike indicated a less-than-rosy outlook. Fed Chair Janet Yellen announced that "the data have not noticeably strengthened." She recognized just enough softness in the economy that rate hikes would still depend on improving fundamentals – so she wasn't going to pull the punch bowl away yet. After her announcement, market leadership from the first two months changed noticeably. Bond yields fell back down, the dollar weakened, emerging markets rallied again, and bank shares fell from their highs.

But the real change in market sentiment occurred when the Republican majority failed to get its health care plan through Congress. This failure knocked the wind out of the rally, as the bill's failure raised concerns about the President's ability to advance his overall agenda of cutting taxes and regulation while raising infrastructure spending. Sectors that led the rally in the first part of the quarter quickly exchanged leadership with those that had lagged. Overall, however, equity investors across many sectors enjoyed solid appreciation.

BERKSHIRE is a fee-based, SEC registered advisory firm serving the portfolio management needs of high net worth and institutional clients. Over the past 30 years, we have successfully implemented highly focused equity, fixed income and balanced portfolios. Our guiding principle is a belief that success is achieved by combining rigorous, well crafted investment processes with an exceptional level of client service and attention to detail. Asset Management with a Difference... Diligence, Integrity and Focus.

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Berkshire Performance

Berkshire equity portfolios also enjoyed a solid advance although they did not quite keep pace with the S&P 500. Our strategy benefitted nicely from rebounding health care and consumer non-cyclical stocks. Hopes for an uptick in global growth also added lift to our selections in the industrial space. After a huge run in 2016, our largest capital commitment – financials – posted good operating and price performance in the quarter but came off highs as the aforementioned leadership switch occurred.

Market observers should take note of a pronounced divergence in the performance of 'value' stocks vs. 'growth' stocks and the potential dangers of trying to chase these style shifts between index funds, a popular practice these days. In 2015, growth's wide margin over value was largely because a few emerging tech stocks had outsized runs in the last few months of the year. In 2016, value outperformed growth, but almost all outperformance came from the energy and financial sectors in the last two months of the year – a move that took many by surprise.

So far this year, growth has outperformed value by a wide margin. Concern about the economy is putting a premium on earnings growth, making legitimate growth companies more valuable. But once again, growth's advantage over value has been concentrated in a narrow list of stocks. For example, shares of Apple (AAPL), which were up sharply in 2016, contributed over 15% of the S&P's 6.07% advance. We've always talked about how difficult it is to time the market, but perhaps it's even more difficult to call these turns. Investors who base decisions on past performance are likely to get whipsawed.

Our core approach is largely agnostic to these static measures of stocks. Instead, we focus on individual companies we believe can compound cash flow over our investors' time horizon. Short term results may be uneven relative to a given index, but over time we believe our approach produces steadier and more predictable results.

The Burning Question: Has the Market Gotten Overvalued?

Given some angst about the market's recent advance, many are asking if we are due for a major correction. In our fundamental view, we don't see widespread excesses, bubbles, recessions or irrational valuations likely to cause a major (15-20% or more) correction. Economic fundamentals are improving and U.S stocks recently enjoyed one of their best earnings seasons, eclipsing most analysts' forecasts by a wide margin.

Economically sensitive sectors like energy and industrials, which slumped in 2015, have showed solid earnings rebound. Many new areas of growth – tech, health care, industrials – are emerging. Europe and Asia are showing signs of legitimate growth.

Many are worried the Fed may raise rates too aggressively. But if rates do rise, the economy and earnings will likely also be growing rapidly, benefiting many stocks in our portfolio. High yield, slow growth sectors, which we feel are expensive, may not see a commensurate surge in growth, and will likely lag. We believe the dangers of buying stocks largely based on yield will quickly become apparent.

About Valuation:

While many U.S. indexes have reached all-time highs, valuations still remain well below their peak. The market's price/earnings ratio lies just slightly ahead of its long run average.

But what is the market really worth? Many people freely toss out random, subjective opinions. But serious analysts have utilized a discounted cash flow model ("DCF") for decades. A one dimensional price to earnings ratio is a static myopic summary of a dynamic and robust market. A DCF gets to the core of what defines value: cash flow (or earnings or dividends), growth of these cash flows, interest rates, and the risk of these cash flows.

A DCF incorporates value across all the dimensions a rational investor would consider when making an acquisition. It's much more systematic and suitable than picking a P/E out of the sky. Utilizing inputs that are reasonable and conservative, we believe that stocks are selling at what we would call 'fair value' – which means their returns going forward could be in line with long-term averages. In the short term, temporary dislocations above and/or below fair value are possible, as the market reacts to immediate events. But in the long run, DCF provides a solid framework to ensure we managers find undervalued securities, and to help us avoid overpaying for stocks.

“Anyone can predict rain. We build arks.”

We are continually asked, “is this a good time to buy stocks?” Owning dividend growth stocks is like building an ark for a rainy day that we know will come someday. This is especially true relative to other, higher risk, equity strategies. So instead of doing nothing, we encourage investors to start building!

The benefits of dividend growth may at times appear plodding, but over time they can be quite substantial. Example: a portfolio with a starting value of $1,000,000 that currently generates $31,000 in dividend income. If those dividends compound near their historical average of 8%, in five years the annual dividend could grow to $42,000 – a healthy increase to help battle inflation. Perhaps even more comforting, the cumulative amount of dividends collected over the total five year period could be over $180,000 – about 18% of the initial investment. That’s a substantial cushion from a breakeven perspective.

We don’t want to sound flippant about the threat of stock prices going down, but we don’t believe in trying to “time the market” or searching for an imaginary “perfect” time to buy. Thank you for your continued participation in our strategy.

Ken Krogulski, President and CEO of Berkshire Named to Board of Cumberland Pharmaceuticals.

Cumberland Pharmaceuticals Inc. (NASDAQ:CPIX) is pleased to announce the addition of Kenneth J. Krogulski, CFA to its Board of Directors. He is the President and Chief Executive Officer of Berkshire Asset Management LLC.

“Ken adds a new perspective to our Board, given his role and experience as an investor and portfolio manager,” said A.J. Kazimi, Chief Executive Officer of Cumberland Pharmaceuticals. “We look forward to working with him as we seek to elevate Cumberland’s public company profile”.

Mr. Krogulski’s appointment to Cumberland’s Board as an independent director will be effective January 18, 2017. Cumberland’s Board of Directors also includes Joey Jacobs, Chairman and CEO of Acadia Healthcare, Dr. Gordon Bernard, Associate Vice-Chancellor for Research at the Vanderbilt Medical Center, Jamie Jones, former Managing Partner of KPMG LLP’s Middle Tennessee operations, Thomas Lawrence, Chairman of Aetos Technologies, Jon Griggs, Former Vice President at Warner-Lambert Company and Caroline Young, former President of the Nashville Healthcare Council, who also all serve as independent directors.

SOURCE: Cumberland Pharmaceuticals Inc.

Disclosure
Berkshire Asset Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®). Berkshire Asset Management is a fee-based, SEC registered advisory firm serving the portfolio management needs of institutional and high-net worth clients. The Dividend Growth Composite contains portfolios invested in Berkshire’s Dividend Growth Strategy with an equity allocation target of 90% - 100%. The Dividend Growth Strategy’s primary objective is to generate a growing stream of equity income by investing in a diversified portfolio of equities with stable, high, and growing dividends. The benchmark is the S&P 500 Index. The index returns are provided to represent the investment environment existing during the time periods shown. For comparison purposes, the index is fully invested, does not include any trading costs, management fees, or other costs, and the reinvestment of dividends and other distributions is assumed. An investor cannot invest directly in an index. Gross returns are presented before management and other fees but after all trading expenses. Net returns are calculated by deducting actual management fees from gross returns. Returns reflect the reinvestment of dividends and other earnings. Valuations are computed and performance is reported in U.S. dollars. To receive a complete list of composite descriptions and/or a compliant presentation, contact Jason Reilly, CFP® Tel: 570-825-2600 or info@berkshiream.com. Past performance does not guarantee future results.

Definitions: The S & P 500 Index is a market capitalization weighted index of the largest 500 U.S. stocks. It is a market-value weighted index (stock price times # of shares outstanding), with each stock’s weight in the index proportionate to its market value. The index is designed to measure changes in the economy and is representative of most major industries. You cannot invest directly in an index. Beta is a measure of volatility vs. an index. Current yield is the mean estimated annual dividend amount based on current calendar year, divided by the current stock price. Dividend Payout ratio is the fraction of net income a firm pays to its shareholders in dividends, in percentage. Forward Price Earnings Ratio (P/E) is the ratio of the price of a stock and the company’s projected earnings per share.

Risks: Past performance does not guarantee future results. All investing carries risk including risk of principal or income loss. Dividends are subject to change, are not guaranteed, and may be cut. Investing based on dividends alone may not be favorable as it does not include all material risks. There is no guarantee any stated (or implied) portfolio or performance objective mentioned by Berkshire can be met. Berkshire’s equity style may focus its investments in certain sectors or industries, thereby increasing potential volatility relative to other strategies or indices.