Berkshire
DIVIDEND STRATEGY

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Practice Management Insights

"It's Over For…"

- "Low carb diets will ruin cereal consumption. General Mills will never grow again."
- "American tastes have decidedly switched away from beer to cocktails and wine. Beer is in secular decline so buy faster growth companies focused on spirits."
- "Free software is here to stay. The Windows paradigm is over."
- "GE is a structurally broken story."
- "The glory days of networking are over. The market has moved past companies like Cisco."

These were all common echoes made by many investors about stocks we've owned over the years.

What is the common thread in these examples? 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 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 usually develops, until the market just seems to give up on the company.

Biased Toward Growth?

Investors (particularly retail clients) tend to be hard wired to think: "Earnings growth is strong. Company news is good. The stock has been going up. Let's buy!" On the surface, this is intuitively simple. Yet fewer investors have the mindset to craft a deeper, value based thesis: "Growth is sluggish. The company has problems, but these problems are well known, and overly discounted relative to its true value. Let's buy!"

For sake of visualization, imagine a well-seasoned golfer who routinely shoots 10 over par (a respectable score by most recreational standards). What if, for a couple rounds, he goes out to the course and shoots 14 over par. Did he instantly become a 40% worse golfer? Probably not. And what if you could somehow magically invest in this golfer's game? If everyone seeking to invest in him was only looking at recent rounds, the "stock" of his game would drop to that of a 14 handicap. But you know better. You know his game will return to form and his results will improve. But perhaps more importantly, you are paying the price of a 14 handicap golfer but you could get the results of a 10 handicap (when he becomes back to his old self). That's value investing.

And so it was with many stocks we've owned over the years: General Mills, GE, Microsoft and Cisco. In each case the market felt these companies somehow lost their luster and obsessed over short term growth and ignored valuation. They had some bad "rounds". But great companies are not static entities with finite end dates. They evolve, adapt and make the necessary adjustments to regain favor.

Best Regards,
Gerry

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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.

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