Berkshire
DIVIDEND STRATEGY

Gerard Mihalick, CFA
gmihalick@berkshiream.com
46 Public Square
Wilkes-Barre, PA 18701
570.825.2600
"Casual Friday" Commentary

Casual Friday: All Time Highs...Now What? + "Will They Or Won't They?" - *October 27th, 2017*

Berkshire Q3 Materials:
Fact Sheet (Client Ready) - Dividend Strategy Fact Sheet 9.30.17
Detailed Strategy Guide (Client Ready) - Detailed Dividend Strategy Guide 9.30.17
Advisor Supplemental Package: (call for client approved version) - Berkshire Supplemental 9.30.17
Executive Summary (Advisor Oriented) - Berkshire Dividend Strategy Executive Summary 9.30.17

Earnings Bonanza Underway:
7 of our 37 companies released earnings this AM and many will be active:
Microsoft (MSFT), Intel (INTC), Merck (MRK), Abbvie (ABBV), Chubb (CB), Exxon (XOM), and Leggett and Platt (LEG). Most headlines appear favorable (esp. MSFT, INTC, ABBV, XOM) and early indications are for positive price movement.

Dividend Increase:
AbbVie (ABBV) announced that its board of directors declared an increase in the company's quarterly cash dividend to $0.71 per share from $0.64 per share, beginning with the dividend payable on February 15, 2018 to shareholders of record as of January 12, 2018.
This reflects an increase of approximately *11 percent.*

Year End Coming Into View…
The market continues to grind higher, setting multiple records. We are pleased Berkshire Dividend Strategy is capturing a lion's share of the market's upside. (Roughly 85% S&P500 Upside Capture YTD) It appears this is equaling or exceeding many strategies in our space. Some of our aggregate sector highlights: financial stocks are up over 14% and appear poised to return more capital to shareholders, health care stocks are up over 25% and our tech stocks are up over 15%. Our mature tech stocks may not be keeping up their NASDAQ/FAANG type counterparts but the returns have been respectable. Even our capital goods sector is up over 10% year to date despite the struggles at GE.

Many complain stocks seem “overvalued.” When the market reaches all-time highs, volatility plummets and you go this long without a correction, of course extra reflection and caution is warranted. Are clients allocated correctly? Are their expectations properly aligned? Will they be able to handle the return of volatility? Are they buying stocks because they believe they will meet long term objectives, or are they piling on, worried they are ‘missing out'?

To us the term “over-valued’ implies irrational, unattractive, poised to collapse etc. Perhaps the term ‘above fair value’ is a more precise description for today’s market. If stocks are indeed trading above their fair value they can still deliver positive returns that meet long run client objectives. They will just not be as high as they were a year ago and certainly not as high as the last 5 years. We think this nuance is important as investors weigh long run capital market decisions (3-5 years) vs. those trying to speculate which way the market may go in the next 3-12 months.

GE and GE Dividend in Perspective:
Structural Problems vs. Operational Problems
- a drug company loses a key patent on its only drug
- a bank’s balance sheet is insolvent
- there is a huge secular threat from a disrupter, like retailers are from the likes of Amazon

Berkshire is a fee-based, SEC registered advisory firm serving the portfolio management needs of high net worth and institutional clients. Over the past 29 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.

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.

These are structural demand/balance sheet problems. We believe GE's problems are not structural, they are operational. GE is a company with dominant market position important industries. They profitably sell lots of important stuff the world needs!

Cash Flow Debate/Dividend:

GE's CEO was emphatic: $7 billion cash flow is "horrible" but "not the new normal" and commented even without his planned fixes, cash flow in 2018 should be materially higher. GE is also planning asset sales north of $20 billion. Successful execution along this path is supportive of maintaining the dividend.

Is it catastrophic if they cut it? Of course dividend growth is our primary objective. We want the portfolio to provide healthy pay raises every year to help beat inflation and increase standard of living. We know GE's dividend has garnered lots of investor attention… but we do own 36 other solid names in the portfolio proving their ability to raise the dividend.

The decision to pay a dividend or (own a company that pays a dividend) needs to be evaluated in greater context of what capital opportunities have the highest expected risk adjusted values over time. Companies with excess cash can:

- Acquire another company
- Pay down debt
- Buy more capital equipment
- Buy back their own stock
- Pay a dividend to shareholder

GE's management has OUR clients' capital. They are money managers just like us. It's their job to allocate shareholder capital where they can deliver the most value over time. Dividends are just one piece of that. New CEO John Flannery said it needs to be "a financial decision" but we realize "how important the dividend is to our shareholders." Our bottom line? We don't think needs to cut it. And we prefer they don't. But in the greater context of GE, its possible cutting the dividend could be in the best long run interests of GE shareholders.

Lots of leisure this weekend!

World series, key college football match ups and of course Halloween. Here is the most popular candy in every state: http://www.businessinsider.com/map-popular-halloween-candy-by-state-2016-10

Regards,
-Gerry

Contact Us:
Gerard Mihalick, CFA, Portfolio Manager,
gmihalick@berkshiream.com or (570) 825-2600

Jason Reilly, CFP®, VP Advisor Distribution,
jason@berkshiream.com or (570) 825-2600