The Berkshire Dividend Growth & Income SMA

Dividend Strategy Fact Sheet 6.30.18 - Dividend Growth Scorecard 6.30.18

Good Morning,
As Florence moves along the eastern shoreline, we send our prayers and best wishes to those impacted. We are hoping for the safety of our advisor friends, their families and everyone in the path of this storm.

Value Making a Comeback?
As we suspected, broader market participation seems to be occurring in the second half of 18'. Russell 1000 Value is up 5.35% QTD (through 9.12.18). Perhaps this is indication investors are coming to terms with two key concept we have been discussing:

- There is broad earnings growth amidst many companies and sectors. Prosperity is not contained to the FANG stocks. In fact, full year Bloomberg BEst EPS YOY guidance has the RLV up 23% vs RLG 24%
- The valuation gap between "Growth" and "Value" has widened so much over the past few years, the risk/reward profile seems to be in "Value" favor.

Financial Crisis Rewind
There has been terrific media coverage over the past week commemorating the 10 year anniversary of the Financial Crisis. For many of us industry veterans, it's the most impactful event of our careers and the lives of our clients. It still shapes our industry and investing behaviors for many today. While it's a time many of us would like to forget, Nelson Mandela said "You either win or learn" so in the case of the Financial Crisis, we will elect the latter.

In the coming weeks we will use this seminal event in world finance, to highlight observations, lessons learned and insight that could help yield better client outcomes today.

Part One: Seeds of Crisis and "Adaptive Systems"
In 2008 the highly charged worlds of media, politics and finance collided and culminated into a financial cataclysm for the world's largest economy. The natural reaction of course, is find a villain, to sensationalize and of course to try to answer the questions:

- "How could this happen?"
- "Who is responsible for this?"
- "How can we prevent this from happening again?"

Politicians wanted to blame the banks, banks wanted to blame the speculators, and of course each political party wants to blame the other. Perhaps the lives of ordinary people affected wanted to blame everybody. Given the magnitude of the crisis, the words "finger pointing" don't seem to do it justice.

So how did it all start? How far back does one have to go? Should we go back to the very first quasi government sponsored entity that attempted to influence home buying or the real estate market? After all many investment models behind the crash had nearly 100 years of real estate data that said "home prices only go up." Perhaps by artificially lowering the cost of capital through government intervention home prices were artificially propped up. Wikipedia defines the first GSE as the Federal Farm Credit System, founded in 1916, and The Federal Home Loan Bank in 1932. *"Their intended function is **to enhance the flow of** credit to targeted sectors of the economy and to make those segments of the capital market more efficient and transparent, and to reduce the risk to investors and other suppliers of capital*.

Or should we blame the 9/11 attacks which caused a painful recession, lowered rates and had scorned investors running away from the stock bubble to create a real estate bubble. As we see it, the story is very entangled and hard to synthesize an event 100 years in the making.

But the modern day part of the story probably starts with the Fannie Mae.
If 2007 - 2008 was the giant oak crashing down, the early and mid 90s created the massive root system.

Lending standards began to change drastically in 90's. Fannie Mae ramped up easy lending standards and the banks followed. Many third parties (Boston Fed included) fueled the flame by publishing research on the issue showing discriminatory lending practices across the industry. Congress pushed Fannie Mae and Freddie Mac to deviate from their traditional 20% down mortgages to accept smaller down payments and sub-prime mortgages in order to put lower income citizens on the path to homeownership. It may have been a noble pursuit but it had the effect of creating excess demand for real estate and pushed housing prices higher. Banks assumed real estate prices across a diverse geography never go down. Virtually no bank or rating agency even had a model incorporating a scenario of falling home prices.

government guarantee. These relaxed lending standards came with additional risk to the underlying mortgages. But through the wizardry of finance Wall Street felt by rearranging the payment structure these risks could be mitigated.

In time the system grew. Non-traditional mortgage and credit providers emerged. New technology created sophisticated quant systems to model and “mitigate risk.” And of course a new breed of real estate mortgage investors emerged – those who wanted to own real estate directly or those who sought higher incomes from securities derived from real estate. This made asset managers and hedge funds all too happy to create and market new structures. And since everyone believed real estate “never goes down” what could possibly go wrong?

For a while this system was a finely tuned mortgage creation machine which could efficiently generate massive volume. Everyone (politicians, investors, Wall Street) was all too happy. That was until cracks started to emerge in late 2006.

This week marks the ten year anniversary of what turned out to be the true commencement of the crisis…the fall of Lehman brothers. How did it start? What was the true catalyst? In the final analysis we think the best answer is…no one *really* knows for sure.

Application for Today’s Investor?
Why go through the exercise of laying out the seeds of this crisis?
To reinforce our belief intelligent investing (of any kind) or true understanding of finance does not lend itself to mechanized thinking, rules, and oversimplifications.

Psychology tells us investors have this need for reductionism, and in certain fields like engineering and science the approach is effective. But like we described above, financial systems or the forces that move a market or a stock involve an intricate web of diverse players, with complicated and constantly changing connectedness.

If the events of the financial crisis taught us anything its:

- Realize the limitations of backward looking data (even if it’s a 100 year data series!)
- Invest with an eye to the future, incorporating as many variable as possible vs. a narrow set of criteria
- Use a probabilistic approach range of outcomes

More to come...
If you have an interesting personal story during the Financial Crisis - Please share!

Roth IRA "Back Door": A Continuing Education Find...
We often hear the stated goal of advisors to "get ahead of year end client planning". To help you kick start the process, we offer a creative tax strategy to boost your value with both clients and potential prospects.

Often, non-discrimination testing doesn't allow a wealthy business owner to max out pre-tax 401k contributions. But drafted correctly, your client may be able to hit full contribution with a combination of pre-tax and *post tax dollars*:
https://www.financial-planning.com/opinion/retirement-savings-with-backdoor-roth-ira-contributions

Regards,
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Berkshire Dividend Growth Strategy is available through various platform/custodial arrangements. Please call or email to discuss. - (570)825-2600 *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. Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992. Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992. You cannot invest directly in an index. BEst (Bloomberg Estimates) Earnings Per Share (EPS Adjusted) estimate returns Earnings Per Share from Continuing Operations, which may exclude the effects of one-time and extraordinary gains/losses. Beta is a measure of volatility vs. an index. Upside/Downside capture ratios refer to a portfolios performance as a percentage of either positive returns (upside) or negative returns (downside) vs. an index. Standard Deviation is a measure of total risk. Alpha, Beta and capture ratios are represented as calculated by Morningstar.

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.

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**Platform restrictions may apply. Preliminary returns are based on composite estimates only. Individual accounts will vary.*