Berkshire
DIVIDEND STRATEGY

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2nd Quarter 2019 Commentary

MARKET REVIEW

U.S. markets have been a rocket ship in the first half. Large caps, small caps, growth, value – virtually every major market segment is soaring and most indices are eclipsing all-time highs. Global GDP and corporate earnings have supported this run even if they aren't quite as strong as we'd like. Specifically, worldwide economic growth lost momentum in the second half of 2018 and the slowdown continued into the first half of 2019. U.S. corporate earnings growth remained positive in the second quarter but not as robust as past cycles.

As trade wars weigh on investors' minds, uncertainty and global market volatility are ticking up. The Federal Reserve has responded by shifting to a more accommodative monetary policy, hoping to ease the tightening of financial conditions and the resulting drag on corporate confidence. U.S. interest rates are near record lows and the Fed dropping "patience" from its language hints at rate cuts ahead. Over $10 trillion in world bonds now have negative yields, reflecting steady inflows from nervous investors who are seeking protection from potential global trade distress.

BERKSHIRE STRATEGY NOTES Q2

Berkshire equity portfolios enjoyed solid total returns year-to-date relative to major benchmarks. Most of our sectors of emphasis enjoyed attractive gains.

LEADING

- **Industrials:** This cyclical sector benefited from continued economic expansion and earnings growth during the period. These results were especially notable because slower economic growth and a low interest rate environment typically make it harder for cyclicals to gain traction with investors.
- **Financials:** Similar to industrials, financials did well in the face of slowed economic growth and declining rates. Continued earnings growth, solid balance sheets and dividend increases continue to propel our holdings in this sector.

LAGGING

- **Health Care:** This sector lagged major indices as political rhetoric about the Affordable Care Act and "Medicare for All" fueled price volatility. On the positive side, demand is on the rise for health care products and services.
- In particular, shares of AbbVie (ABBV) were weak after the firm announced the acquisition of Allergan (AGN). However, we believe in the long term the deal will create value.

MIXED

- "Old tech" holdings (like Microsoft and Cisco) posted competitive gains, but still trailed "new tech" (like Amazon and Facebook).

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 implemented highly focused equity, fixed income and balanced portfolios. Our guiding principle is a belief that success can be 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.

IN THIS REPORT

LOOKING FORWARD

After such a strong run, the time is right to start asking tough questions. While the global economy continues to grow at a reasonable rate, there are notable downside risks. Are the flat yield curves and ultra-low/negative interest rates in the bond market signaling underlying economic weakness? How deep will the current trade wars cut? Is the sluggish European economy following the same path that led to Japan's prolonged period of low-growth and what does that mean for the rest of the world?

In our view, the risks of a recession and/or an equity market correction are increasing, but they are also manageable. The good news is, despite the recent run-up, equity valuations remain reasonable. P/E ratios are roughly in line with history, which suggest many risks are already "priced in." Investors seem bullish, but not blindly optimistic, and low interest rates support continued economic gains.

It's no secret professional and individual investors alike are notoriously bad at timing the markets and making large scale decisions based on macro events. Keep in mind recessions and stock market corrections are part of normal economic cycles. We feel confident our focus on high-quality U.S companies carrying reasonable valuations will continue to meet client needs in coming quarters.

IS IT 1999 ALL OVER AGAIN?

A proliferation of hot tech IPOs, soaring growth stocks and markets hitting all-time highs, has many investors wondering if the environment is similar to 1999. Looking back to 1999, there was a virtual feeding frenzy for new economy/internet/growth stocks and "the Internet was creating a new paradigm for perpetual growth" (as some observers said). Day trading was all the rage and many people quit their day jobs to get in on the action. The Nasdaq was up 400% in a few short years (up 65% in Q4 99' alone), creating one of the great bubbles of all time which eventually burst in March of 2000.

What's similar? The macro environment was relatively similar due to low inflation, unemployment and a rosy outlook for the economy. IPOs and growth stocks were the vehicles of choice and investors needed to be talked into boring old value/dividend stocks and active management.

What's different? Today, investors seem more sober about risks vs. the pure "nothing can go wrong" euphoria of 1999. While the P/E spread between growth stocks vs. value stocks are similar, the absolute P/E multiples are trading far below 1999 – 2000 levels. The Russell 1000 Growth Index traded at 65x earnings in 1999 compared with 27.5x today. Today's modern tech/growth stocks have more tangible applications and generate revenue and cash flow – not just speculative concepts. Does anyone remember companies being valued based on "eyeballs"?

Bottom line? The environments are similar but not the same. Still, we believe value appears attractive relative to growth. High-quality companies at low valuations may protect account value during the next market correction, while some of today's popular but expensive growth stocks may decline faster than the market in general.

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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.