Berkshire
DIVIDEND STRATEGY

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1st Quarter 2019 Commentary

TOO HOT OR TOO COLD? EVEN GOLDILOCKS WOULDN'T BE SURE

It's been an interesting past six months as the market has been trying to make up its mind about the overall health of the economy. After a very challenging Q4 2018, U.S equity indices have broadly advanced this year. But no one seems able to let go of their macro concerns, especially as it relates to monetary policy. Let's review how the consensus view has unfolded over this stretch:

DECEMBER 2018

- Trump criticizes Fed Chair Jerome Powell for being too restrictive as additional rate hikes loomed for 2019.
- Markets tanked, fueled by forced selling, trade wars and fear of government shutdown.

JANUARY 2019

- After a miserable December for risk assets, Fed chair Powell makes a speech on January 5 declaring that the U.S. economy has "good momentum" but the Fed could "adjust policy quickly if needed."
- This comment becomes known as Powell's "Dovish Pivot." Markets start to anticipate only 2 rate hikes in 2019, instead of 3.
- Sensing the 'easy money' era for stocks is **not** over, the SP 500 rises 8% for January.

FEBRUARY/MARCH 2019

- By mid-quarter, reports of weaker global GDP growth start to creep in - especially from Europe. European Central Bank estimates for GDP growth slump from +1.9% (mid-February) to +1.1% (mid-March). A weak report on Eurozone factory orders released on March 22 sent a chill through the markets.
- In a speech on March 20, Powell stated that the Fed is now unlikely to raise rates at all this year.
- Sensing growth is now *slowing*, U.S. 10-year Treasury yields plunge nearly 40 basis points during the quarter. The onset of an inverted yield curve begins prompting market fears of a recession.

It's unclear how the next round of macro news will make the market respond. If the Fed cuts rates, will the market respond positively? Because lower rates (in general) lift asset prices. But a rate cut could also be interpreted as a signal that the economy is weak and needs stimulus. On the other hand, if rates begin to rise, it could mean the economy is doing well. But higher rates tend to be bad for equity prices.

As of this writing, the consensus seems to be that the economy is moving along at a modest growth trajectory – not too hot and not too cold. But for those who try to base investment decisions on macro themes, there is a lot to sift through.

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

- Stocks post strong first quarter results as markets digest several macro cross currents
- Shifting monetary policy?
- Growth expectations (especially in Europe) begin to slow
- U.S. large cap stocks appear attractive relative to bonds and other global alternatives
- Energy, technology, and industrial sectors lead Berkshire's performance

OUR VIEW? LOOK AT THE BIG PICTURE

Focusing on short-term macro themes, while interesting to talk about, is a tough way to make money. Our typical investor doesn't have a 6-month time horizon, so in our view, neither should our investment decisions. When we take a step back and look at the big picture, we see plenty of reasons for optimism.

The longer-term potential for stocks remains tilted to the positive. U.S GDP continues to expand as do corporate profits (albeit at a slower pace than was expected a few months ago). The unemployment rate remains extremely low, and the interest rate paradigm remains low.

Perhaps more important, U.S. stocks are very attractive relative to other investments at home and abroad. For example – the rate on U.S. 10-year Treasuries now stands at about 2.54%, while many dividend-paying large cap stocks yield more than 3% (as of 3.31.2019).

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Another important point: while interest rates in the United States are low, in many developed countries interest rates are actually negative. That's right –bond prices in many areas are so high that, when you add up all of the interest payments and your principal, the return is actually negative. That's particularly true when you factor in inflation.

Right now, it is estimated that nearly $10 trillion of global government debt carries a negative rate of return. Yet investors – particularly large, institutional investors – continue to accept negative returns because they need to store assets somewhere where it is easy to access and move around.

In this environment, we think a better store of value is to own U.S. stocks that pay dividends or generate attractive free cash flow relative to their price. This is especially true for individual investors with a time horizon longer than three years. Instead of investing in the obligations of a government entity at a guaranteed loss, why not invest in a business that offers products, brands, patents, intellectual and human capital and a track record of generating profits?

Equities still have more potential for volatility than bonds. But given all the macro confusion today, we like our investment universe. Quality business operations with good balance sheets seem like a good way to balance risk and return – especially when they are so attractively priced relative to many other asset classes throughout the globe.

BERKSHIRE DIVIDEND STRATEGY NOTES Q1

- The portfolio showed strong participation in an up market
- Leading relative performers came from the Energy, Technology and Industrial sectors
- The portfolio lost ground in the Health Care sector (perhaps giving back a slice of its strong relative results in 2018)
- Top performing holdings included General Mills **(GIS)** and Kinder Morgan **(KMI)**
- Worst performing holding were Abbvie **(ABBV)**, Pfizer **(PFE)** and Kraft **(KHC)**

LOOKING FORWARD

We don't see an immediate end to these many, hard-to-decipher cross currents going on in the economy and markets. But while other market participants try to get a gauge on what things look like, we're continuing to put our effort into what is *real* – actual, mathematical evaluations of business performance and relative market value.

Our process off analyzing companies one by one to find those that can compound and grow – regardless of the macro environment – is a beacon of clarity in an otherwise foggy environment. In our view, our investment universe offers clear relative value and a chance to earn steady positive returns through dividends.

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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.