Berkshire DIVIDEND STRATEGY

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"Casual Friday" Commentary

Casual Friday: Macro Drum Beats On + "Valuing an Intangible" – *February 21, 2020*

Recent advisor question: "What the heck do I do with client portfolios and cash on the sideline today?"

Obsession with "macro" has ruled investor consciousness over the past few years and today it's no different...

- In 18' investors had two big bouts with stock market volatility
- In 19' we had a "melt up" leaving many investors sidelined w/ too much cash
- In 20' we're dealing with an election, Coronavirus, full valuations and historically low interest rates

The macro confusion beat drums on...

We don't attempt to predict these macro forces. Countless prognosticators often send conflicting signals to the market. Instead, long term investors may benefit most from accumulating equity positions that provide shareholder value over long holding periods - ie. stocks with strong cash flows, healthy balance sheets, secular growth advantages, solid management and reasonable valuations. Buy stocks for "ownership" not for "trading profits".

Our approach to equity "ownership" has us finding opportunities but we're also finding stretched valuations in areas of the market. Growth continues to widen the gap on value. On the yield side, many dividend investors are paying big premiums (absolute and relative to history) and are overweight sectors like utilities, REITS and telecom services. These investors have felt starved for yield and have bid up prices accordingly. This "trade" has worked as the 10 Yr has pulled back to 1.50% (source: Bloomberg) largely based on macro fears. We've seen this environment a number of times in the past decade. Recent history has shown sharp under-performance from these sectors when rates begin to rise:

May 1st, 2013 – December 31st, 2013
10 Yr. Treasury moves from 1.60% to 3.00%
Total Return: S&P 500 +18.37%, Utilities -4.53%, REITs -9.88%

January 30th, 2015 – June 10th, 2015
10 Yr. Treasury moves from 1.65% to 2.50%
Total Return: S&P 500 + 6.38% Utilities -11.10% REITs -10.45%

July 8th, 2016 – March 13th, 2017
10 Yr. Treasury moves from 1.38% to 2.60%
Total Return: S&P 500 +12.97%, Utilities -1.06% , REITS - 7.83%

Sept 5th, 2017 - Nov 8th, 2018
10 Yr. Treasury moves from 2.05% to 3.25%
Total Return: S&P 500 +16.75%, Utilities +3.93%, REITs + 4.94%

(Returns analysis source: Bloomberg)

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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.

This is not a call for the bottom on rates... Instead we're observing areas where investors have "priced in" recession, and with the exception of this mornings PMI, recent economic data has been strong:
More rate cuts are already priced in to the market - Market Currently Pricing in 35% chance for a cut by Sept 20 Fed meeting
Valuations are stretched - Utilities trading at a premium again the broader, usually trade at big discount
Economy has shown recent signs of strength - Citi Economic Index 2.20.2020
Depending on the composition of dividend stock holdings, various rate environments can produce vastly different outcomes. We believe our focus on dividend growth and owning securities which may benefit from higher rates can give us an edge against competing strategies.

"Valuing an Intangible"

"In just 43 years, intangibles have evolved from a supporting asset into a major consideration for investors – today, they make up 84% of all enterprise value on the S&P 500, a massive increase from just 17% in 1975". - This makes sense given how our economy has tilted away from pure manufacturing to more services. Not all intangibles are created equal. But patents, intellectual capital, trademarks, and technology licenses can support: brand equity, higher margins, and repeat customers. The list has some usual suspects in today's information economy, but you will also notice many traditional companies – a number of which are in our Dividend Strategy made the list: https://www.visualcapitalist.com/intangible-assets-driver-company-value/

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