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Berkshire DIVIDEND STRATEGY

"Casual Friday" Commentary

Casual Friday: "Predictably Irrational" but it's not their fault… – *February 7, 2020*

Benjamin Graham: "The investor's chief problem – and even his worst enemy – is likely to be himself."

"Predictably Irrational"

Over the past decades the industry has made great strides in understanding the thinking, behaviors and common mistakes of investors. Most notably, the Dalbar study shows the average investor left to their own devices likely under-performs the market. Investors keep making the same mistakes over and over (predictably irrational) and there seems to be no end in sight... In 2018 alone, the average investor loss nearly - 10% vs the S&P 500 - 4.38%. Average Investor blown away by market turmoil in 2018

Panic selling, chasing returns and timing the market are all contributing factors to this terrible relative performance.

Why Do We Keep Making the Same Mistakes?

Imagine this… someone blindfolds you. They take you on a journey somewhere completely unknown. You get to your destination, they ask you to stand still…They remove your blindfold – you look down and you see this….

**Photo Credit: SkyDeck Chicago at Willis Tower*

Your'e looking out from the observation deck of the Willis Tower 1,353 ft about the city streets of Chicago!

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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.

What's Your Initial Response?

If you're like 99.9% of people you'll likely experience a rush of adrenaline and quickly jump back in fear for your safety! Reasons this is likely to happen:

- At first glance, the glass makes it appear you're unsafe
- "Why the heck am I way up here!"

But there's a scientific reason behind this response and the reaction is innate in us all. Your brain's Amygdala told the body to respond this way in that exact moment. You simply perceived risk and your brain immediately responded. The Amygdala is the part of your brain responsible for the response and memory of emotions, especially fear. https://brainmadesimple.com/amygd. It serves many useful purposes but can also send false positives. The example above details how your brain can trigger this false positive. If the blindfold was kept on, it would have felt like you were standing on firm ground, there would have been no perceived risk and you would have never experienced this response. You were never really at risk and the same can often be true with investing...

Investing Lessons - False Positive Responses

The Amygdala can generate the same biological responses in investors when they read negative headlines perceived as a threat to their wealth and well being. "Corona Virus Spreading" - "If _______ gets Elected the Market will Go Down - 20%" - "China Trade Wars" - You're body's "flight mechanism" is wired to spur you to take action now! "I'm going to lose money, sell before it goes down"! The Dalbar study seemingly proves the average investor simply **cannot overcome** that innate response. Biology trumps logic - at least initially.

Certain clients may be the perpetual culprits. One advisor just discussed how the same client asked to "raise cash now, the market is way overvalued" and then turned around the following week and instructed the advisor to "buy Tesla stock" - after the huge run up. But successful investors don't tend to think of investing as "lets get rich quick" or "I might lose some money over the next few months so I better not invest."

Instead, successful investors overcome the biological response to risk and take long term view based on logic - not emotion. They understand over the long run, they are investing in viable, sustainable companies with the ability to compound cash flow over time.

Ignoring the "noise" of the market's near term price action, they take a long term approach by asking:

- "How does this company generate profit"
- "What is the sustainable edge"
- "How much am I paying to own this company relative to its long term value"

Next, they align that thinking with real life objectives:

- "Will this basket of stocks help me generate enough consistent income in retirement"
- "Is my lifestyle going to change if the market goes down 10%, 20%, 30% etc"
- "Am I taking on more risk than I can handle"

Client Solutions?

With the endless stream of CNBC headlines, our clients' Amygdalas are firing on all cylinders – how then do we keep them on track and help them avoid value destroying behavior?

1. **Awareness**: show clients behavior studies like the Dalbar Studies. They prove how knee jerk, emotional responses usually destroy value. Statistics show equities return about 10% per year with the odds of success increasing over time. So client the market is programmed to win, but client brains are wired to lose.
2. **Emotional management**: *"The stock market is a device for transferring money from the impatient to the patient."* – Warren Buffett
   This info-graphic shows the six common psychological pitfalls investors face: https://www.visualcapitalist.com/6-biggest-mistakes-ordinary-investors-make/
3. **Objectives Based Portfolios: "Leave the Income Stream On"** - One idea? Closely align client income goals through dividend growth investing. Here's a chart of Berkshire's actual dividend growth and market value over the last 10yrs, with a list of reasons investors were reluctant to invest/sell stocks: [Berkshire Income Charts with Max Annual S&P]()

500 Draw-down - (Source Bloomberg) The point to share with clients is pretty self-evident. If they constantly tried to be in and out of the market, they would likely miss out on some attractive compounding, and end up another casualty in the aforementioned Dalbar study! On the contrary, if they stayed focused on the chart above, they would have attained income growth to achieve spending goals. As a bonus perhaps owning recognizable companies, collecting dividends and receiving periodic "pay raises" could help clients stay calm and on track.

Follow some of these common sense guidelines and help clients keep their "CNBC Blindfolds" on.

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