



Berkshire

DIVIDEND STRATEGY

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“Casual Friday” Commentary

Casual Friday: Earnings + “Gamma Squeeze?” – January 29th, 2021

First up – Earnings, Earnings, Earnings...

19 Berkshire companies reported through 9:00AM - 1.29.2020.

16 beat EPS estimates by an average of 17% (Source: Bloomberg)

We’ve long opined as earnings growth broadens out, investors may start making a meaningful shift towards value. We are pleased to see from an operating standpoint many of the companies are delivering solid results. You can read about this value rotation and a host of other topics in our advisor supplemental package: [Dividend Strategy Supplemental Guide 12.31.2020](#)

Next up - Jay Powell spoke about bank dividends

“So we’re monitoring that (large bank restrictions on bank dividend payment and share repurchases) on an ongoing basis, continuing to evaluate our restrictions, and we haven’t made a decision about whether to continue them in the second quarter or not. Let’s remember that the banks that are subject to the stress tests have taken very, very large reserves, very large loss reserves, and also increased their capital. **They have higher capital ratios now than they had at the beginning of the pandemic.**” - Jay Powell FOMC press conference, January 27, 2021

You heard it right (straight from the Chair of the Federal Reserve)... Banks have more capital now than before the pandemic. We believe this bodes extremely well for future dividends. The fed constraints of 2020 may be pent up and released when the restrictions are removed.

Casino mentality appears to be back...

Bitcoin, SPACS, Redditt, Robin Hood, AMC, and GameStop - In addition to what appears to be rampant spreading and chat boards like Redditt and Robin Hood, two interesting technical forces took hold this week.

It appears option market makers got caught in a GAMMA SQUEEZE.

What the heck is that? - Speculators, many of whom were reported using Redditt or Robinhood, were buying large amounts of out of the money call options on GameStop. When market makers sell a call option, they often hedge their risk by going long the underlying stock. Prices of out of the money options move less than the underlying stock. You measure how the option price will move given a move in the stock price is called Delta. Options far out-of-the- money have low delta (option doesn’t move much until it creeps closer to in the money) but in-the money options have high delta’s since they will move more in lock step with the stock (other things equal).

In the case of GameStop, since the calls were far out of the money, market makers assumed they were safe and were not fully hedging their positions. They were essentially short naked call options which as we know can be disastrous in volatile low float stocks.

Market makers did not fully hedge their positions relative to the call options. However, as the stock started moving up, GAMMA kicked in. Gamma is a measure of how fast the Delta is accelerating and as the stock got nearer and nearer to the strike price, gamma moves dramatically, and market makers were left scrambling to cover these naked short positions. In addition, 100% of the float of GameStop was already sold short. So, investors like hedge funds were simultaneously caught in a short squeeze and needed to get long the underlying stock - fast and at almost any price. So

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as the market makers bought and short sellers covered, it pushed the price much higher. This created immense pain for the short sellers and option market makers alike - it was a perfect storm.

Like 1999, it's amazing how the casino mentality has once again taken over Wall Street...and now Main Street. But as sensible long-term managers and advisors we know how periods like this usually end - painfully. And we know that sensible long term value investing is not dead, but sometimes like now, it seems a little boring and takes a nap. But it usually wakes up stronger and rewards investors for their patience.

Updated - [Berkshire Morningstar Report 12.31.2020](#) - Overall 5-Star Ranking*

Call/Email with questions - thanks and have a great weekend.

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