# Berkshire
## DIVIDEND STRATEGY

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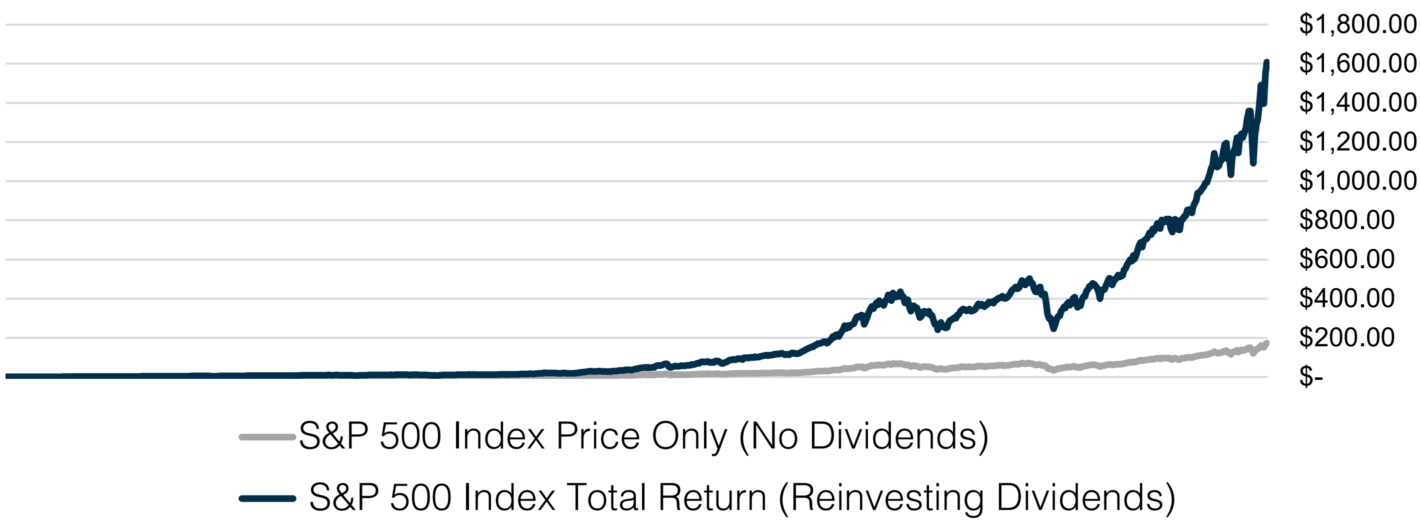
## The Power of Dividends and Dividend Growth

When launching the Berkshire Dividend Growth Strategy, our research pointed to the very tangible benefits of dividend investing. This research leads us to believe a diversified portfolio of high-quality businesses consistently paying and increasing dividends can lead to attractive long-term investment results. In fact, the compounding effect of dividends is somewhat astounding. Data since 1950 though the end of 2020, shows dividends and dividend reinvestments have made up a significant portion of the S&P 500's total return. Over this time, the S&P 500 Price Index has returned roughly 17,000% while the S&P 500 Total Return Index (dividends and dividends reinvested) has returned 160,000%. *Concluding, it is hard to ignore the pure compounding effect* of dividends and dividend reinvesting. (Source: Bloomberg)

Growth of $1 (1950-2020)




### Dividend Highlights for Investors

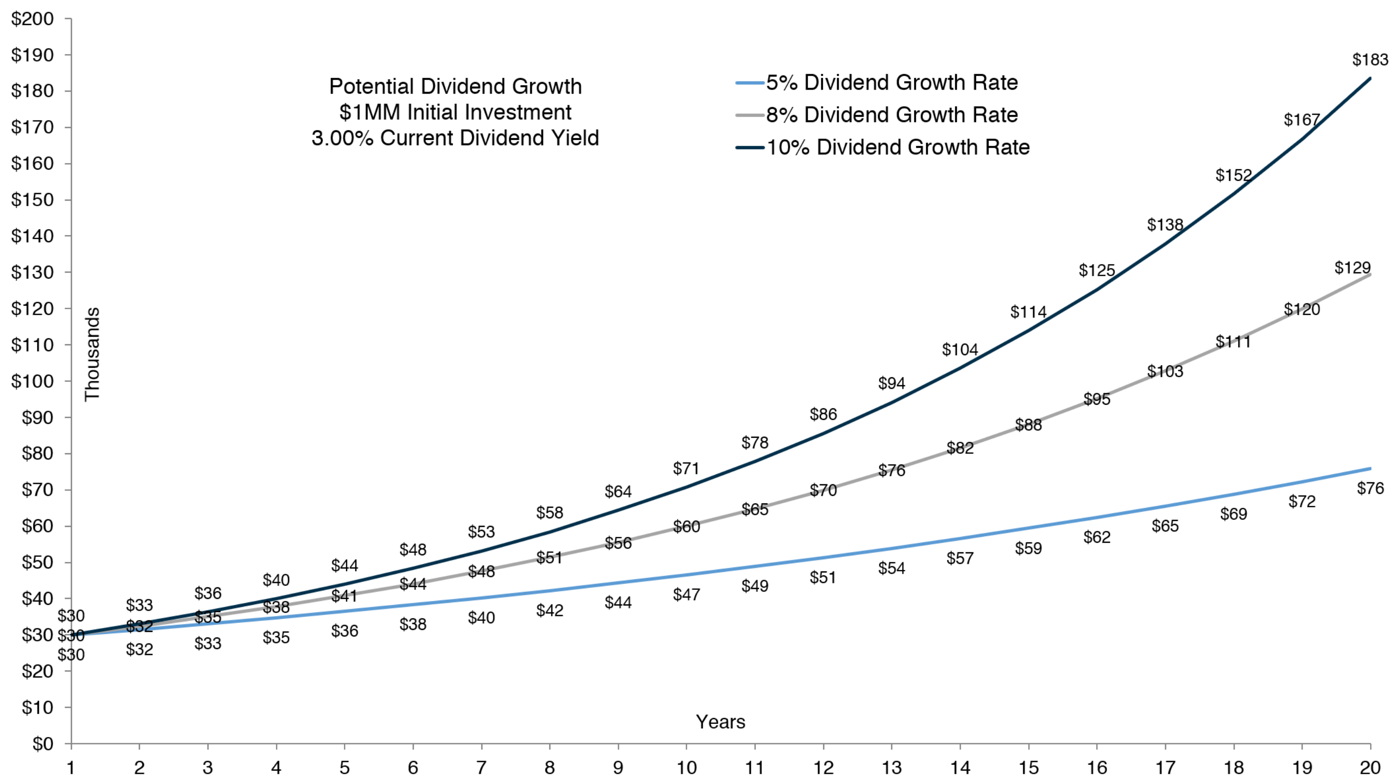
- Dividends and dividend growth provide transparency into a company's fundamentals
- Dividends have contributed a significant amount to total market return over time
- Dividends may provide downside protection in volatile markets

*For illustrative purposes only. Graph assumes a 70-year time horizon. The S&P 500 index returns are provided to represent the investment environment existing during the time periods shown. For comparison purposes, the index does not include any trading costs, management fees, or other costs, and the reinvestment of dividends and other distributions is assumed. An investor cannot invest directly in an index. Dividends are not guaranteed, and may be subject to change. The return shown may not be representative of the Berkshire Dividend Growth strategy. Growth rates of dividends vary and illustration may not be indicative of future returns.*

## Goals Based Investing

We'd argue most investors are seeking income and growth of income -- now or at some point in the future. This tends to be identified organically through a planning process. The income generated from dividends and dividend growth may help directly align these income-based objectives. Therefore, we believe designing portfolios that match income objectives actually helps investors stay on track and avoid the potential pitfalls of market timing, chasing performance, improper benchmarking and other unproductive investor habits.

## The Dividend Growth Rate Can Have a Significant Impact on Dividend Income Over Time




*For illustrative purposes only. Graph assumes a 20-year time horizon. Dividends are not guaranteed, and may be subject to change. The current yield may not be representative of the Berkshire Dividend Growth current yield. A current yield estimate can be provided by request. Investing based on dividends alone may not be favorable as it does not include all material risks. There is no guarantee any stated (or implied) portfolio or performance objective mentioned by Berkshire can be met. Fees are not included in the analysis and would lower values. Growth rates of dividends vary and illustration may not be indicative of future returns.*

**Dividends and Inflation…**
Statistically, inflation has been kept in check since 1982 and rates have grinded to historic lows. Although we have somewhat limited data pre-1990 (dividend specific indices not widely available prior) we were still able to compare dividend aristocrats (a good proxy for dividend growth stocks) vs. the S&P 500 when monthly inflation was over 3%, and over 4%.

**S&P 500® Dividend Aristocrats Performance - (7/1/1991 - 6/30/2021)**

- Monthly CPI YOY of +4% or greater, 18 observations
    - During observation months, the Div Aristocrats outperformed by +1% on average
- Monthly CPI YOY of +3% or greater, 96 observations
    - During observation months, the Div Aristocrats outperformed by +0.65% on average
- Absolute compounded total return during +3% CPI observation months, S&P 500® Dividend Aristocrats +78% vs SPX +17%

(Source: Bloomberg - S&P 500® Dividend Aristocrats® Index)

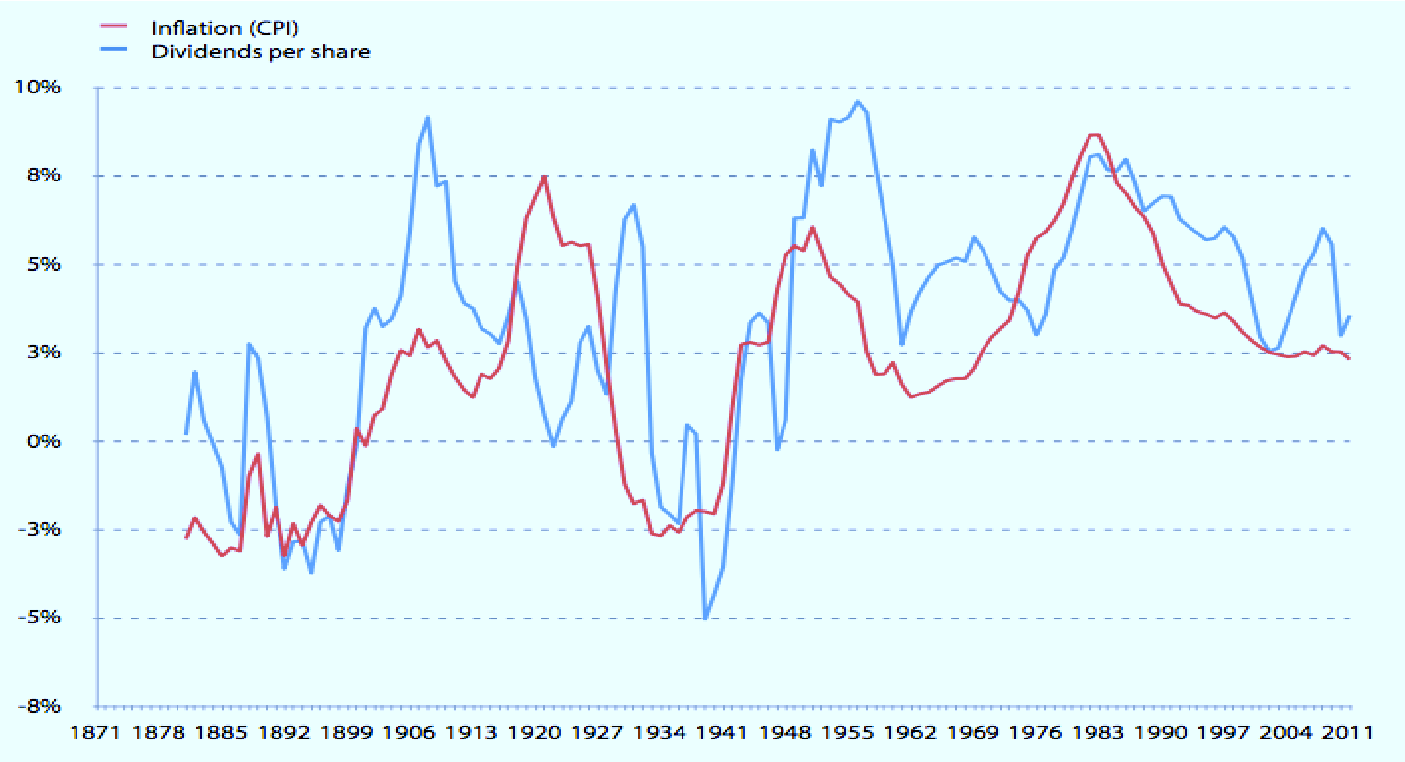
**3 Theories on Outperformance?**
<u>Duration Theory --</u> Since value and dividend stocks are generating more cash flow in the early years (and paying out to shareholders) and growth stocks tend to have their cash flows further out, value/dividend stocks essentially have lower duration. Similar to high coupon or shorter duration bonds, dividend stocks should do better as rates rise. Recent price action seems to bear this out -- When the 10Yr Treasury goes up in yield, value seems to do better and when rates go down, growth seems to do better.

<u>Cyclicality Theory --</u> Rising rates could also be a signal the economy is growing. During periods of strong economic growth, earnings are broader and cyclical type stocks may have strong earnings. These cyclical type stocks could often pay a dividend as well -- i.e., industrials, financial services, energy, real estate, etc.

<u>Growing Cash Flow Theory –</u> Finally, it's all about the allure of growing cash flow. As people decide there is inflation, they may buy assets that give them a growing stream of income.

As always, the economy and markets are fluid. Technology disruptions and a globalized economy are aspects to study as you build a stock portfolio – you can't just rely on a single indicator and predict outcomes. But overall, we do believe dividend and dividend growth stocks in particular are positioned very well relative to the broader market during periods of inflation.

**Over Time Dividends May Provide a Hedge Against Inflation**




Source: https://www.dividend.com/sponsored-why-dividends-matter/

## Dividend Growth vs Dividend Yield

There's been plenty of debate over the years. Folks like Ned Davis have illustrated the importance of dividends and show how various dividend policies have outperformed over the decades.  For Berkshire, we've always been in the camp of -- both current yield and dividend growth can play an equally important role. EVEN MORE IMPORTANT, dividend yield and growth are a byproduct of business fundamentals. Various factors are in play – consistency and growth of profit/cash flow, management policy, payout ratios and valuations. In aggregate, Berkshire's goal is to create a portfolio of roughly 35 high quality businesses that maintain an attractive yield with an ability to raise dividends at roughly 8% annually.  Based on Berkshire's view of the markets, our portfolio may have characteristics that tilt towards "growth" or "yield" at various points in time. We believe this fluid approach to dividend investing may give us an edge through market cycles.

**Berkshire "Forward Looking" Approach to Dividends?**

We believe there is an epidemic for managers and funds in the dividend and dividend growth space. Countless processes begin with over simplified screens – "We screen for companies that have a dividend yield of 4%" or "We screen for companies that have raised the dividend for 10 years straight". Our view -- Simple screens of historical data may fail to capture the full dividend growth opportunity set…

*Berkshire's Process:* Identify perennial dividend growers before they are fully recognized by the market using a "*Forward Looking*" bottom-up selection process:

- Understand how a business generates free cash flow by decomposing ROE components
- Model *future* income statement, balance sheet and free cash flow
- Measure dividend growth potential by analyzing capital structure & future payout ratio
- Own tomorrow's dividend growers trading at discounts to intrinsic value estimates

Some of our highest conviction dividend growth stories would have flunked traditional backward-looking screens at time of Berkshire's purchase*:

- Emerging tech and health care businesses
- High quality financials
- Contrarian energy

Our edge? Patience, discipline and the ability to capitalize on the short sightedness of others.

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