Berkshire
DIVIDEND STRATEGY

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"Casual Friday" Commentary

Casual Friday: Drone Zone? + "Ill Just Pick The One Wit The Highest Yield" January 12th, 2024

Updated 12.31.2023 Strategy Material:

- Dividend Strategy Guide 12.31.2023
- Dividend Strategy Scorecard 12.31.2023
- Dividend Strategy Commentary 12.31.2023

Happy New Year! Instead of a 30 minute, 50 slide webinar where a PM drones on and on about "macro this" and "stocks for the long term "and you shut off after 3 minutes…

Here's 10 themes and a 360 view of the strategy to speed your client reviews and due diligence...all in about 3 minutes! If you *really* want more detail, call us we are happy to drone on as long as you like via zoom or teams! schedule Zoom, Teams or phone call here!

Like they say on TikTok, "Let's get into it."

Review why clients selected Berkshire in the first place

- Generate dividend income (~2.7% yield)
- Grow dividend income (35 of 36 increases, average ~6%)
- Relative safety on downside ~70% downside capture (Morningstar, Bloomberg Analytics)

(Source: Bloomberg, Morningstar as of 12/31/2023)

2023 Growth, tech & AI dominate –the exact opposite of 2022

- 7 stocks made up 68% of the return, while most stocks including dividend payers lagged.
- Growth stocks @30 times earnings appear wildly overvalued. Needless to say, we think this is one of the biggest valuation anomalies of our careers…
- Do advisors and clients have 'the guts to rebalance' towards more value?

(Source: Bloomberg, Morningstar as of 12/31/2023)

As Expected? Almost every consultant's due diligence questionnaire asks: "In what type of market do you expect to underperform?"

- Our response? A high P/E, speculative, momentum-driven market – just like '23.
- No one likes to miss out, but we believe dividend stocks are behaving about as expected in this environment

Two Silent Killers in 2023

- “I'll stay out of the market. There’s a recession coming” -- It never came again leaving many investors out of a big rally. Call it yet another “macro-miss out”
- “I’ll just buy a T-Bill” -- Investors learn about re-investment risk as rates drop. While it felt great to earn 5% risk-free, investors may have missed out on a big equity market upswing and nice returns in long bonds. Sidebar: Using “yield” to gather assets gathering tool is fine, but it’s not a long-term inflation or retirement solution. Remind clients that over 5, 10 years and beyond, stocks usually trounce cash and bonds. Client's long-term goal should drive the allocation, not short-term market predictions.

“Investor Amnesia?” – It’s not entirely surprising growth stocks rebounded in 2023. But with rampant “euphoria-ignore everything else- investor-amnesia”, it’s like investors forgot many of these stocks were down 30, 40, or 50% or more in 2022. *(Source: Bloomberg)*

What worked? In addition to solid dividend growth in the Berkshire portfolio…

- Maintained ownership in MSFT, APPLE JPM which added to returns
- Added three great new businesses (Lowes, EOG, MDLZ)
- Avoided distressed sales of select banks, REIT and utility companies. Some have rallied sharply from lows

What do we wish we did better?

- Avoided some of the drawdowns mentioned above! in the first place. Call it the perils of low turnover and yes sometimes stuff looks “too cheap to sell” and then it gets cheaper
- After a terrific 2022, our pharma and industrial selections lagged
- We should have “Paid up for growth” in some cases.

Best Practice management ideas?

- Complexity out, simplicity in. Show clients reliable simple transparent investment strategies they can stick with
- Focus on goals-based vs. market chasing. Remind them it's your job to get them to their goal with the least amount of risk, not beat a benchmark or make them the most amount of money possible.
- Who has the guts to rebalance take control and set expectations

Berkshire Overall? Healthy, growing, committed to investment discipline, and helping your practice.

(Source: Bloomberg, Morningstar)

Question from an advisor’s client:
“I don’t need you or a manager I’ll just buy some stocks with the highest yield”
Asking for counterpoints, we shared the following risks of exclusively focusing on “yield”:

- *Not Enough to Beat Inflation?* Stocks that keep the dividend fixed will not offer a "pay raise" and the cash received by the investor is likely to be eroded by inflation.
- *Bond-Like?* Stocks that offer high dividends but limited growth are more likely to behave like bonds and perform poorly in a period of rising interest rates.
- *High Yield = High Risk?* Stocks with the highest yield might indicate companies facing challenges or in declining industries, posing higher risks of dividend cuts or company distress.
- *Lack of Diversification?* Focusing solely on high-yield stocks could lead to an undiversified portfolio, exposing investors to sector-specific risks.
- *Dividend Sustainability?* High dividend yields might not be sustainable; a company could be distributing more than it earns, which may not be viable long-term.
- *Limited Growth Potential?* Companies with high yields might not prioritize growth or reinvestment, potentially impacting future stock price appreciation.
- *Market Volatility Impact?* During market downturns, high-yield stocks can be more vulnerable to price declines, leading to significant capital loss.
- *Ignoring Quality and Stability?* Stocks with a history of growing and compounding dividends often reflect stable, well-managed companies with solid financials, which might be overlooked when focusing solely on high yields.

(Sources: Morningstar, Bloomberg, https://www.spglobal.com/spdji/en/documents/research/research-a-case-for-dividend-growth-strategies.pdf)

Potential Benefits of Dividend Growth

- Inflation Fighter? Companies with a history of growing dividends can provide a consistent and increasing income stream over time that may exceed inflation.
- Strong Fundamentals: These stocks often belong to companies with robust financials, demonstrating stability, profitability, and potential for sustained growth.
- Capital Appreciation Potential: Companies prioritizing dividend growth often show potential for both dividend increases and stock price appreciation.
- Reinvestment and Growth: Companies reinvesting profits back into the business for growth may offer better long-term returns compared to high-yield stocks that may have limited growth prospects.
- Resilience in Market Downturns: Such companies tend to be more resilient during market downturns, potentially reducing the impact on overall portfolio value.
- Diversification Benefits: Dividend growth exists across a wide spectrum of industries that generate high free cash flow such as financials, technology, health care, REITS and industrial offering greater diversification benefits

(Sources: Morningstar, Bloomberg, https://www.spglobal.com/spdji/en/documents/research/research-a-case-for-dividend-growth-strategies.pdf)

Casual Friday Bonus: New dining trends...The End of Small Plates?

Enjoy the long weekend!

Regards,

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