Berkshire DIVIDEND STRATEGY

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1st Quarter 2020 Commentary

IMPORTANT OPERATIONAL NOTE

Berkshire is operating remotely and fully functional, operating under its longstanding Business Continuity Plan. If you need anything, call our normal phone number and the call will be answered and routed to our cell phones. So far, we are pleased to report Berkshire has not missed a beat and is committed to that standard throughout the crisis and beyond.

STAY SAFE

As of this writing (early April), COVID-19 confirmed cases and mitigation efforts such as social distancing are at the highest levels since the start of the crisis. Everything that happens to clients is deeply personal for everyone at Berkshire. We hope and pray you are safe, healthy and living with as little disruption as these times afford. We will do our best to share what is happening in your portfolios, good and bad, and share sound ideas we believe will lead to favorable portfolio outcomes during this truly remarkable time in American and world history. Please call us for a personal discussion.

MARKET CORRECTION: HOW BAD WAS IT?

It took only 25 trading days for the market to go from its all-time high (February 19th) to its intraday low (March 23rd), which was a decline of nearly 36%! To put that into perspective, it took over a year and a half from 2007- 2009 for the market to decline about 50%.

The policy response in today's case has been swift and of great magnitude. The Federal Reserve plans on buying up to $4 trillion in various bonds to support credit markets. Congress passed a $2 trillion bill to help individuals and businesses bridge the crisis. Since the lows reached on March 23rd, it took the market only 3 trading days to rise 17.5% (a record 3-day rise), which shows how difficult it is to time market gyrations.

After this whipsawing, the S&P 500 and Russell 1000 Value indices posted a decline of -19.60% and -26.73% respectively. Large cap growth stocks fared somewhat better posting a decline of -14.08%. No sector was spared. Through government policy and investors clamoring for safety, yields on U.S. 10-year treasuries dropped all the way to an all-time low of 0.318%. Berkshire equity portfolios finished up the quarter down roughly -22.05%.

Source: Bloomberg

WHAT IS THE BERKSHIRE VIEW ON THE CRISIS?

By nature, we are believers in the resiliency of the U.S economy and U.S stocks. Therefore, it should come as little surprise we believe in an "on-schedule" mitigation and relatively quick recovery in stock prices. The short-term economic impact is likely to be severe, but could be short and manageable. Unlike other crises, this one appears it may have a shorter and more definable expiration date.

Berkshire Asset Management, LLC (Berkshire) is a fee-based, SEC registered advisory firm serving the portfolio management needs of high net worth and institutional clients. Our guiding principle is a belief that success can be achieved by combining rigorous, well crafted investment processes with an exceptional level of client service and attention to detail. Asset Management with a Difference... Diligence, Integrity and Focus. Berkshire Asset Management, Inc. was formed in 1986 as a SEC registered investment adviser. In 1999 the company was sold to Legg Mason. In 2007, senior leadership repurchased the firm, forming Berkshire Asset Management, LLC, the company built to serve you today.

IN THIS REPORT

We are sober to the multitude of risks and potential ripple effects post containment. We anticipate small business failures, supply chain disruptions, bankruptcies, etc. But for the most part, we expect the world to mostly get back to business as usual. Yes, there will be some change to the economy and some industries may be challenged. After 9/11 new protocols had to be implemented and it was inconvenient, but in time people traveled again. Eventually, capitalism finds ways to help people and systems adapt.

The entire health care system and much of corporate America is now mobilized. Treatments and understanding of the virus improve daily. U.S. health care companies are the envy of the world, and believe they will develop cures, vaccines and testing. Swift progress here could be a game changer. Bond markets are functioning. Overall interest rates remain low. Bank balance sheets are in good shape, and they are eager to expand credit. Most importantly, as we get back to "normal", demand will return. And while stocks have recovered, many are still trading far below their 52-week highs, creating what we think is a good long-term buying opportunity.

QUALITY/STRESS TESTS: HOW DOES THE BERKSHIRE PORTFOLIO HOLD UP?

Our philosophy is to buy U.S companies with strong balance sheets, moats around their business and solid cash flow. Many of these companies are the world's most successful and largest (by market value). Berkshire diversifies across sectors, based on a blend of business growth, consistency of operations, and valuation.

At times like these it's important for us to ask a number of questions about our companies:

- Will companies need to cut their dividends?
- Will a company be able to handle the stress of the business downturn?
- Will it be able to rebound when the market turns back up?

For the overwhelming majority of Berkshire's portfolio, we believe the answer to these questions is YES. The one area with heightened stress is energy. The companies in this sector were facing sluggish growth and a downturn in demand before COVID-19. Then the Saudi-Russian price war forced crude oil prices down more than 70% from January 1st of this year. Given this negative climate, we see potential for dividend cuts, and it could be a long road back, even for the industry leaders with the best relative balance sheets that Berkshire prefers.

Next up? Bank stock prices have been hit hard during this crisis with many investors saying, "its 2008 all over again." In our opinion, nothing could be further from the truth. Bank balance sheets, by a multitude of metrics, are in the best financial shape in decades. While not totally immune, they are much better equipped to handle this downturn than in 2008. In fact, while their earnings may be lower in the short term, we do not believe they will need to cut dividends. Often maligned, we believe these companies ARE quality and should rebound quite nicely.

The rest of the portfolio is comprised of well-known high-quality companies in the consumer, technology, health care and industrial sectors. Some companies may end up benefiting from changes in the economy. We believe there will be a new appreciation for health care innovation, and we own companies with leading technologies. Work from home. Educate from home. Recreate from home. These shifts favor technology companies with networking, broadband, security and 5G expertise. These could all be meaningful growth drivers for the economy and our holdings as a result of this crisis.

Company evaluation is on-going at Berkshire and we have re-checked our balance sheet metrics. Virtually all the remaining companies possess investment grade balance sheets and while not immune from a sharp downdraft, are far better prepared than the average company.

We hope our clients will review the companies in the portfolio and also come to the conclusion they own quality companies. These companies are well equipped to handle this crisis and rebound when it's over.

THE SAME…YET DIFFERENT

2020 marked the 34th year of Berkshire's operations*. Our team possess a wealth of industry experience and longevity working together. We view consistency as a key firm asset. Our firm has worked through numerous harsh investment climates, including the banking crisis of the early 1990s, 9/11, the bursting of the tech bubble, and the great recession of 2008 (and its numerous aftershocks). We've navigated tough waters before, and we have found most large-scale corrections share certain traits. What's typically common?

1. The swiftness of the sell-off takes most by surprise. Often, prices go up like a slow escalator but drop like a bowling ball in an elevator shaft.
2. The catalyst down is usually from something unknown. Known threats are likely already reflected in current prices.
3. Most financially driven corrections have financial media amplifications (CNBC, Bloomberg, etc.) that potentially sensationalize the magnitude of the event. COVID-19 has virtually all media providing round the clock coverage. Coverage is justified given the magnitude of the event, but more coverage does increase the threat of misinformation, overreacting, or market myopia. This partially explains why markets sometimes overshoot.
4. Recently, machine driven/program trading seems to accelerate the wild swings in both directions, making it very difficult to call tops and bottoms. In the case of February, selling begat

more selling. It now appears in hindsight much of this machine-based selling/deleveraging has abated.

5. **But most important, each correction appears to have some unique problem associated with it, to which there appears no plausible solution. That's what makes it a crisis. In this case it's a run-away virus, destined to cause a severe recession which will keep stock prices far from previous highs for a long period of time.**

We've often said: Everyone wants to buy stocks at lower prices… until they see the news, and the fear and uncertainty creating the lower prices. This goes for indexes, sectors and companies. Many investors want to wait in cash because they don't see a catalyst or solution.

But remember: If the catalyst were visible, stocks would be already be higher – negating the opportunity to buy low. What happens in the next 3-6 months is anyone's guess. The situation is fluid, and large intraday swings have become downright common. But we suspect this correction's path will share something else in common with the others - Investors will look back and, in hindsight, be happy they resisted the urge to sell great U.S. companies just because they are volatile and down in price. Because time and time again, high-quality U.S. companies, and the entire U.S. economy, have demonstrated their resilience.

"WHAT CHANGES ARE YOU MAKING?"

Sometimes, an event like COVID-19 creates secular changes likely investable for years to come - favoring some sectors and hurting others. Potential beneficiaries/trends: work from home, home schooling, 5G networking, cyber security, chip makers, health care delivery, vaccine/drug and tele-medicine solutions.

More often, seismic market shifts like these simply create the opportunity to purchase a great individual business at an attractive price.

Q1 2020 CHANGES IN THE PORTFOLIO

New Purchase - Apple Inc. (AAPL)

- $200 Billion+ in cash on balance sheet (foundation for dividend and dividend growth and/or acquiring distressed assets)
- Dividend yield 1.20% - Relatively short dividend history but strong coverage and significant room to grow
- A company we always looked at owning, valuation/price currently now at attractive level
- We anticipate continued success w/ hardware and more aggressive growth in service

Source: Bloomberg

Sell BP (BP) - Add to Chevron Corporation (CVX)

- Chevron upgrades the balance sheet strength from BP and allows us to stay in a sector that we feel is very attractively positioned once we are "back to normal"
- 6.75% dividend yield - management committed to payment
  - https://www.nasdaq.com/articles/chevron-ceo%3A-we-can-use-debt-and-asset-sales-to-protect-dividend-2020-03-24
- Purchase allows us to move to a more diversified, integrated oil play
- CVX's downstream refining and chemical businesses are attractive, add diversification
- While other major oils are invested for longer term projects to pay off, CVX is in a better position to generate free cash flow now

Source: Bloomberg

New Purchase - Southwest Airlines (LUV)

- Coming in to crisis, one of the fastest growing airliners – EPS growing at 20%+ YOY
- Rapid historical dividend growth – current payout ratio < 15% of free cash flow
- We believe one of the best managed airliners in industry
- Strong balance sheet and healthy ROE components (low 20% range)
- Very possible Southwest does not accept assistance and there does not have to cut/suspend dividend

Source: Bloomberg

Thank you and we hope you stay safe and healthy during these times.

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Definitions: The S & P 500 Index is a market capitalization weighted index of the largest 500 U.S. stocks. It is a market-value weighted index (stock price times # of shares outstanding), with each stock's weight in the index proportionate to its market value. The index is designed to measure changes in the economy and is representative of most major industries. You cannot invest directly in an index. Beta is a measure of volatility vs. an index. Current yield is the mean estimated annual dividend amount based on current calendar year, divided by the current stock price. Dividend Payout ratio is the fraction of net income a firm pays to its shareholders in dividends, in percentage. Forward Price Earnings Ratio (P/E) is the ratio of the price of a stock and the company's projected earnings per share.