



Berkshire

DIVIDEND STRATEGY

Gerard Mihalick, CFA
gmihalick@berkshiream.com

46 Public Square, Suite 700
Wilkes-Barre, PA 18701
570.825.2600

Dividend Growth Commentary
3Q 2021

EQUITY MARKETS HAVE BEEN TRICKY THROUGH 9.30.21

We've come a long way since the depths of the pandemic, and many U.S. large-cap indices have gained well in excess of 50% since that time. This year the momentum continues largely uninterrupted, and stocks are posting solid gains from the mid to high teens. However, markets wobbled a little towards the end of the third quarter as Delta-variant issues surfaced, as well as a potential real estate problem in China. After outperforming since coming off the bottom of the pandemic, value stocks were about flat for the quarter, and growth indices posted slightly positive gains.

The macro picture remains cloudy, and making broad-based decisions based on it is generally not our style. But we still closely monitor indicators that market timers and macro strategists care about, as eventually these may affect our views of individual companies. China's real estate problems top the current list of worries, as does fiscal policy (infrastructure bills, potential tax hikes, etc.) and threats of a government shutdown. Add in some border issues and potential instability from the withdrawal in Afghanistan, and it becomes easy to see potential risk in the environment.

Long-term inflation is also in the news, as labor shortages and supply chain issues continue to push the cost of virtually everything much higher. Of course, the Delta variant and vaccination policies are also being hotly debated. But even with all the potential problems, we'll point out that earnings and corporate performance remain absolutely stellar, which in large part justifies the market's healthy advance. We are still optimistic fundamentals are good enough and valuations are reasonable enough to generate positive results over time.

FOCUS ON INTEREST RATES

But the big macro news that really does affect our outlook, portfolio positioning, and performance is interest rates.

Over short intervals — three (3) to perhaps thirty-six (36) months — performance can often be chalked up to idiosyncratic market movements that don't make a trend or make for meaningful analysis. Conclusions about investment results should be better when they are based on trends five years or longer. While that's true, there may be some bigger forces currently at work that are worth commenting on.

Recent manager performance, we believe has been dictated by two interconnected things: growth stocks and interest rates. Let's break this down, beginning with the start of the pandemic.

At the start, rates plummeted on fears of slow economic growth. Given many of the S&P 500's top companies are growth and technology stocks and have the allure of being transformative (and in many cases, that's true), investors believed they would thrive regardless of, or potentially because of, the pandemic. They were willing to pay up for these companies and ignore almost everything else — especially cyclical companies, which make up most of the value or equity income space. Interest rates dropped to all-time lows and locking up your money for 10 years in a U.S. Treasury got you a paltry 1.30% per year — and that's before inflation. So, a huge performance gap developed in which growth outperformed value by a wide margin, and this continued from March 2020 to about September 2020.

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

- Macro Backdrop?
- Focus on Interest Rates
- Leadership Changes
- Waiting for "Normal"

When we came out of the pandemic, people realized earnings from many companies would likely recover and they didn't need to pay 30+ times earnings for growth stocks to get growing earnings. So, a meaningful outperformance of value/equity income occurred from September 30, 2020 to March 31, 2021. Berkshire, along with other managers who follow a similar style, generated attractive advances. The Russell 1000® Value Index exceeded the Russell 1000® Growth Index by nearly 25%. (It's worth noting performance gaps can be made up in a hurry, especially when a large valuation anomaly exists.) Interest rates climbed to nearly 1.70% — still low, but rising steadily, which often happens during periods of economic expansion.

But from April through mid-September 2021, investor fears resurfaced regarding the Delta variant and potential real estate problems in China. The market briefly corrected by 5% on these fears. Rates again dropped to 1.30%, and growth outperformed value once again.

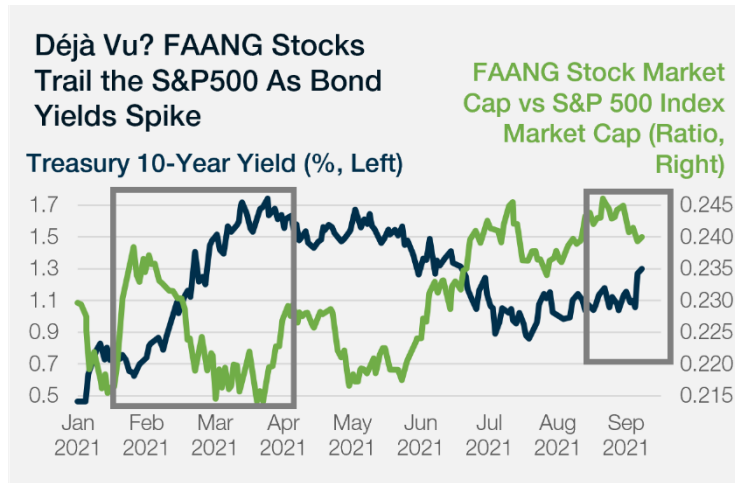
Late September 2021 brought news that may lead to yet another meaningful pivot. The Federal Reserve's meeting gave an upbeat view of the economy, and the Fed announced it was on track to make monetary policy slightly more restrictive. Interest rates again went higher, and like clockwork, value started outperforming growth in a meaningful way. A recent Bloomberg headline highlighted "Tech stocks lag on higher rates," showing how interest rates are driving investment returns.

OUTLOOK – WAITING FOR “NORMAL”

The point of all these twists and turns is to try to share with you how our portfolio is positioned now and how we believe it should perform as things return to “normal.” What's normal? An economy and market environment where earnings growth is solid across a wide range of sectors, and interest rates rise from artificially low levels to levels consistent with positive real rates of return. This should help the areas of conviction in the portfolio — financials, industrials, and to a lesser degree, consumer, energy, and materials.

Right now, the portfolio appears to do relatively better when rates rise and economic prospects are favorable, which is consistent with our longer-term outlook for corporate performance. In times of volatility, time frames get short, but we are making our portfolio decisions based on three to five years, not three to five months.

“Normal” may seem a little elusive right now, but that's one reason we focus so much on company fundamentals and financial relationships that endure over time. The portfolio still performs more or less as we expect it to given changes in the environment. And if market trends are working against us, our portfolio still provides consistent results in the form of dividends. We find these aspects of our portfolio comforting during tricky times.



Source: Bloomberg

Even if you are not currently drawing dividend income, stocks with above-average dividends can work wonders for your portfolio over time. In our latest BONUS, we put together a report that shows the power of dividends:

<https://berkmgt.com/wp-content/uploads/2021/09/The-Power-of-Dividends-and-Dividend-Growth.pdf>

CONTACT BERKSHIRE:

Gerard Mihalick, CFA | Portfolio Manager

gmihalick@berkshiream.com
(570) 825-2600

Jason Reilly, CFP® | VP Advisor Distribution

jason@berkshiream.com
(570) 825-2600

Registration with the SEC or any state securities authority does not imply a certain level of skill or training. The views expressed reflect those of Berkshire Asset Management, LLC (Berkshire) as of the date of this document. Any views are subject to change at any time based on market or other conditions, and Berkshire disclaims any responsibility to update such views. This information is not intended to be a forecast of future events, a guarantee of future results or investment advice. Because investment decisions are based on numerous factors, these views may not be relied upon as an indication of trading intent on behalf of any portfolio. The information contained herein has been prepared from sources believed to be reliable but is not guaranteed by Berkshire as to its accuracy or completeness. Index performance discussed is for illustrative purposes only and does not predict or depict performance of any Berkshire investment strategy. While index comparisons may be useful to provide a benchmark for a strategy's performance, it must be noted that Berkshire's investments are not limited to the investments comprising the indices. Each of the strategy benchmark indices are unmanaged and cannot be purchased directly by investors. Risks: Past performance does not guarantee future results. All investing carries risk including risk of principal or income loss. Dividends are subject to change, are not guaranteed, and may be cut. 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. Berkshire's equity style may focus its investments in certain sectors or industries, thereby increasing potential volatility relative to other strategies or indices.