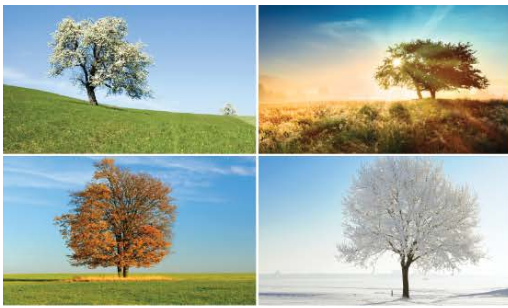

Berkshire
DIVIDEND STRATEGY

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"Casual Friday" Commentary

"Risk Off" Casual Friday: "ARKK effect?" + Update Q4 Materials – *January 21st 2022*

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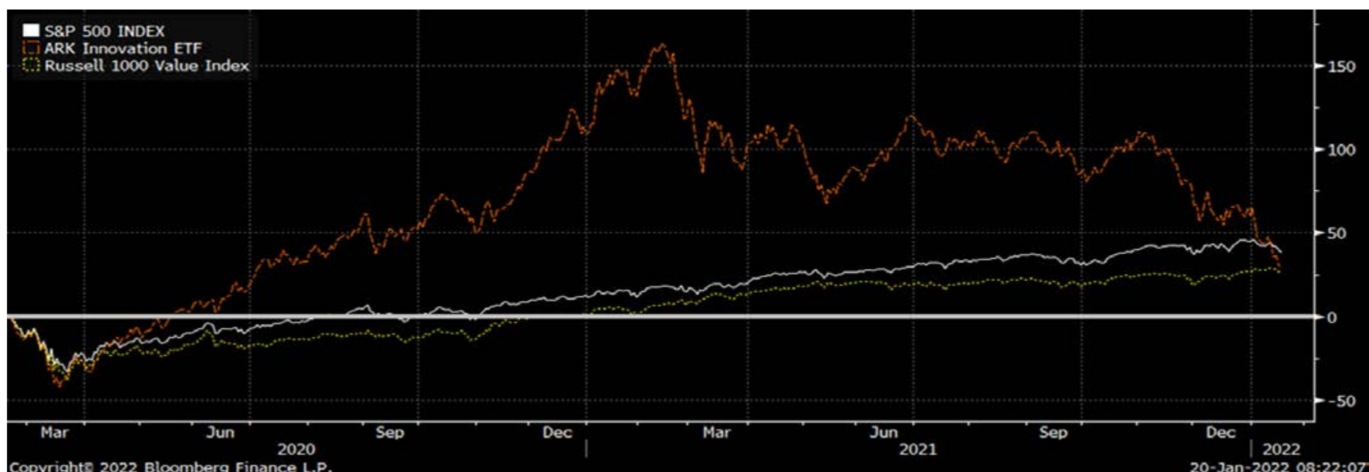
Another "Risk-off" Friday to start 22'. Currently, markets are feeling the jitters (geo concerns, "rates" and a plummeting Nasdaq). The near-term dynamic between rates and equities is interesting... Equities recently were driven down by higher rates. The panic around lower equity prices is creating a flight to quality and ironically, ten-year treasury rates are now flat to down, despite everyone worried about multiple rate hikes. And the risk off stocks from last year (stay at home, growth, etc.) are largely leading stocks lower -- especially Nasdaq, now down nearly 12% from its recent high. In our opinion this is a dynamic worth watching…

Speaking of risk off equities, ARKK fund, its holdings and many comparable stocks are down significantly from their highs. And it's doesn't appear to be "bad" fundamentals, (earnings miss, product defect, etc.) although many of these companies did not have much in the way of current earnings or cash flow. We look at ARKK portfolio holdings from time to time and understand the potential "disruption" these companies could deliver. In some cases, they *are* creating exciting new industries and may deliver impressive growth. Some may change the world… In the meanwhile, various factors have created a sharp sell-off in these types of stocks and now ARRK is lagging the S&P 500 total return measured since the start of the Pandemic.

Since the beginning of the Pandemic, (2.19.2020 – 1.19.2022) S&P 500 total return ahead of Ticker – ARKK…. S&P 500 +37.96 / ARKK +28.60% / Russell Large Value +25.30%



(Source: Bloomberg) Berkshire Dividend Growth SMA does not endorse or own a position in the ARKK fund.

Does the swoon mean something for value investors or the market in general? Yes, it may portend a durable value rotation stemming from sentiment shift and the bite of higher rates.

- Speculative investors may be leaving the market. Momentum can be a fleeting thing. We can't prove it but we have a hunch the shareholder base of the fund and comparable holdings may not be able with stand the beating. Once buy high and sell HIGHER doesn't work there is often an exodus. Then the cycle of selling begets more selling.
- Scarcity of earnings: During covid the narrative went like this "There is no growth out there so only the stay-at-home stocks are going to work so we will pay up". Now the economy is broadening out and investors don't have to pay nose bleed multiples to get decent growth from a broader swath of companies.
- Why do rates really matter for these stocks? Ok, bear with the following PM "nerd-sesh". Emerging growth companies usually have more of their cash flow out in the future vs. value stocks which have most of their intrinsic value / cash flows in earlier years. Cash flows that are more distant are more sensitive to higher rates because these distant cash flows are subject to higher exponents in the discounting formula. It's the same exact mathematical reason why zero-coupon bonds are more sensitive to interest rates than high coupon bonds.

Retail clients may struggle with growth vs value stock stories – "this growth company is so great; we have to own it" or "why would we own this lousy value stock". It feels like many may have become enamored with "catching the next Amazon" and they are willing to pay huge multiples for the chance… But this fall from grace shows the asset class that seemed so attractive relative to boring old equity income shows fallibility. And while we are not rooting against any investment, (investment karma is cruel) we do believe it may be healthy to wipe out some speculative excess and remind clients why dividend investing can be attractive and valuation matters.

Updated Marketing Material is available for use:
Dividend Strategy Guide 12.31.2021
Dividend Strategy Scorecard 12.31.2021
Dividend Strategy Commentary – 4Q2021

IF your having trouble opening our material below PLEASE let us know.
We've noticed some firms beefed up cyber walls -- We can send you PDF's if you'd like access.

We also freshened up our website for 2022:
https://berkshireasset.com/advisors-institutions/

Balance Sheet Concepts?
Our recent advisor survey indicates interest in lending and balance sheet concepts is low. We think we know why, but ignore this one at your own peril - especially if you want or deal with UHNW clients. Why only talk about the left side of the balance sheet? That's almost akin to only checking one kidney or examining half the body. HNW investors need guidance on ways to finance businesses, commercial real estate, second homes and other major liabilities. We know one advisor who is pretty creative at creating tax efficient lending strategies and structured credit solutions. It's a bit of a learning curve, but it's one more way you can demonstrate value. We understand lending may be a bad word for advisors at some institutions. We see both sides but if you are not talking about lending someone else is. We've seen a couple situations where advisors lost IM business because a competing advisor was more creative and aggressive offering solutions. We've also heard stories where advisors lost business because they presented lending and their lender messed up the deal! So, we see both sides of this, and banks are wise to offer, but not jam lending down advisors' throats!

Have a great weekend!
Gerry

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index. Gross returns are presented before management and other fees but after all trading expenses. Net returns are calculated by deducting actual management fees from gross returns. Returns reflect the reinvestment of dividends and other earnings. Valuations are computed and performance is reported in U.S. dollars. To receive a complete list of composite descriptions and/or a compliant presentation, contact Jason Reilly, CFP® Tel: 570-825-2600 or info@berkshiream.com. Past performance does not guarantee future results.

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. Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992. Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992. You cannot invest directly in an index. BEst (Bloomberg Estimates) Earnings Per Share (EPS Adjusted) estimate returns Earnings Per Share from Continuing Operations, which may exclude the effects of one-time and extraordinary gains/losses. Beta is a measure of volatility vs. an index. Upside/Downside capture ratios refer to a portfolios performance as a percentage of either positive returns (upside) or negative returns (downside) vs. an index. Standard Deviation is a measure of total risk. Alpha, Beta and capture ratios are represented as calculated by Morningstar.

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