Berkshire
DIVIDEND STRATEGY

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"Casual Friday" Commentary

Casual Friday: Earning Wrap + "Eendragt Maakt Magt" – *February 18, 2022*

Earnings Season Wrap:

- Downside/relative performance in focus: Berkshire Dividend Strategy year to date (net of fees composite estimate: -1.75% through 2.17.22)
- Berkshire earnings season: 34 of 36 reporting. Average sales surprise = +2.11%; Average earnings surprise = +6.56%
- Upside earnings surprises: Materials, Energy
- Downside earnings surprises: Telecom, Industrials

Comment: Berkshire companies along with many other S&P 500 companies are participating in a broad-based earnings recovery. (Source: Bloomberg)

Recent Dividend, Earnings Announcements:

Walmart (WMT): 2% dividend increase

- Solid top-line growth
- Margin improvement despite a ridiculously challenging supply chain
- Web/delivery continues to impress proving other companies besides Amazon can thrive on-line

Cisco Systems (CSCO): 3% dividend increase

- Good top, bottom line lead by cloud product suite
- Increased buy-back by $15 billion (approx. 6% of current capitalization)
- Low valuation

Comments: Both dividend increases are below what our investors and what we would like to see. WMT has delivered solid share price performance of late. A low-double digit P/E multiple ascribed to Cisco probably dictates share repurchases are a better use of cash and, at these prices could prove highly accretive to earnings dividend, per share growth. Qualcomm did a similar financial engineering move, forgoing large dividend increases for buy backs, which provided a great deal of leverage to the upside. (Source: Bloomberg)

Do Inflation and lower returns = a new world of retirement?
We’ve said before: there’s a huge expectation chasm separating advisors and their clients. (Source: Natixis) Advisors expect mid-single digit equity returns for the next 10yrs. Investors expect mid-teens! That’s highly unlikely in most environments, let alone when so many stocks are trading north of 20x earnings. (We estimate Berkshire’s forward P/E 14.95 - much more reasonable IMHO)

Mix in the bitter tasting cocktail of inflation, dismal rates on bonds, annuities, and advisors probably feel their backs are against the wall.

The good news? Advisors can differentiate by implementing fluid and holistic retirement strategies vs. “you need to earn x and spend y per year” -- Static “set it and forget it” approaches are non-starters in this environment.

Start by identifying the expectation “Gap”: Educate clients about reality vs. what they may want to hear. Point out how other advisors may be unwilling to share tough news. And if they want to chase returns and unrealistic assumptions somewhere else? Let them. Clients like these are at best “rented assets” and at worst, future compliance nightmares. It's better to under-promise and over-deliver.

Act like a retirement life coach: Can clients downsize their home? Rent vs. buy a second home? Can they “consult” for a handful of years during retirement? Work life in retirement is changing. Get creative about lifestyle choices. Help them network, support their new business, share case studies of other successful people.

Address spending... in a flexible way. The 4% rule might not be realistic. Does the client have assets to live off 3% or even 2% for the next number of years? Maybe distributions are a little higher in good years, and lower in others. Maybe it's time to let dividends accumulate and compound now, so you can take out more later years.

Plan/defer in advance: Business owner nearing retirement; can you restructure retirement plan to “pump” more assets in for a few years through the use of deferred comp or cash benefit plans? Many are using these strategies as a great way to get in front of prospects - especially now.

Here are two articles to support these concepts:
https://www.financial-planning.com/articles/retiring-early-to-lie-flat-keep-an-eye-on-inflation
https://fortune.com/2022/01/12/baby-boomers-retirement-flexible-hours-savings-covid/

The First Asset Based Fee? Thank you Adriaan va Ketwich Circa 1774!

Loyal readers know I'm sometimes outspoken about fee compression. No one wants to see margins go down or make less than they did the year before.

Still, the nearly universal consumer acceptance of asset-based fees that are propelled by a (usually rising) stock market, creates very favorable economics for advisors and managers alike. So let's not get too worked up! The industry's future is still very bright! Other professions can only work so many hours, or charge so much per hour.

At one time lawyers used to get paid by the word, (which explains a lot) but it got us thinking…

Who came up with the idea of asset based fees in the first place*?* I couldn't find a definitive answer. However, historians believe the first version of a mutual fund dates back to 1774 when Dutch merchant Adriaan van Ketwich, created an investment trust in 1774 called "Eendragt Maakt Magt" which means "unity through strength" in Dutch (funds always need catchy names right?). Part of the fund (which had an expense ratio of .20 bps) held bonds used to bail out banks who over extended themselves to the East India Company who was "experiencing massive short falls in land values" (sound familiar?).
https://www.investopedia.com/ask/answers/09/what-was-first-mutual-fund.asp

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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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