



Berkshire

DIVIDEND GROWTH STRATEGY

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Casual Friday Commentary

Casual Friday: Midyear Recap + Planning for Inflation or Deflation? – July 23rd, 2021

Equity investors are largely enjoying a solid year.

Major themes related to the advance and Berkshire portfolios:

- Pandemic appears contained
- Delta variant should be manageable
- Economic recovery aka “reopening” trade appears real
- We believe earnings should continue to impress
- Yes, the market is trading above historical P/E averages; returns may still be positive (potentially 4-7%) over the next 3-5 years
- Valuation of the equity income space still appears reasonable
- The window to buy value stocks vs. growth stocks has reopened
- “Inflation is not a problem...unless you buy stuff”
 - Money printing, supply problems, and LABOR COSTS
- Berkshire future results appear correlated to higher interest rates
 - Financials, industrials, dividend growth
- Underweight sectors correlated to lower rates such as utilities, REITS, telecom

Recent Results:

- Dividend growth is reaccelerating
- Number of dividend increases in 2021: 19
- Average increase: 7%
- Financials are a highlight: BAC 17% Raise; JPM 11% Raise; PNC 9% Raise
- Total return approaching mid-single digits YTD
- Positive forces: Industrials, financials, materials
- Negative forces: health care, staples, “growth trade”

Here is a more detailed commentary:

<https://berkmgmt.com/wp-content/uploads/2021/07/Dividend-Strategy-Commentary-2Q2021-Advisor-Edition-1.pdf>

Deflation? Inflation? Both? Impact on Planning Approaches

The Fed appears to be battling deflationary forces, BUT I think most investors would agree everything seems to cost more. If you think I’m wrong ask clients if they should try to prepare for rising or falling prices. Real rates are actually negative which of course means investors may lose money after inflation on their bond investments. Regardless of what the bond market is telling us, there appears to be a need for investors to “manufacture” more dollars in a portfolio.

Dividend growth, specifically our portfolio, may be an effective way to do just that. Our typical holding usually possesses a great balance sheet, a recurring nature to its business and a reasonable cost structure.

We like to think, and hope that many of the businesses we own may develop into cash machines that give our investors a pay raise to help off-set seemingly ever rising life style costs.

Dividend growth investing is a versatile approach that can make meeting planning needs easier. Here are some approaches to financial planning and how dividend growth may apply.

It's all about striving to create more dollars for the future.

Liability driven investing implies that advisors/clients manage portfolios to meet liabilities unique to each investor. Since these liabilities usually grow (think living expenses) showing how a rising cash flow stream can meet obligations is attractive. And since you are managing to a specific income target, it has the added benefit of keeping investor eyes of market fluctuations and random benchmark returns.

The bucket approach to planning has investors dividing their income needs into buckets based on short, intermediate and long intervals. Short term needs are often satisfied with fixed income items (annuities, bonds etc) and longer-term ones while utilizing equity income buckets to obtain higher yields/returns because time horizon may make up for short term fluctuations.

The total return method attempts to cover certain portion of annual spending from income deemed reliable and invests the balance for growth. For example, if the spending rate is 4% and the investors can earn 3% from cash flow (the approximate yield on many high-quality dividend equities) then investor could have 75% of their income needs covered easing the need to take on more principal risk.

This is not an exhaustive list, but these approaches may help clients visualize how goals can be achieved. Dividend growth can be an effective cornerstone of these strategies and clients seem to relate to the approach.

Bonus: How Much Will the Tokyo Olympics Cost?

<https://www.scmp.com/sport/article/3141899/tokyo-2020-what-price-pay-hosting-olympic-games>

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