Berkshire
DIVIDEND STRATEGY

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Dividend Growth Commentary
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PERFORMANCE BENEFITED FROM OUR FOCUS ON QUALITY

The year started with guarded optimism. The pandemic was ending, the economy was still relatively strong, and stocks had just posted another year of solid gains. These gains were especially impressive among large-cap, growth-oriented issues, though we felt their multi-year run was getting out of hand. We thought investors in these stocks would soon be disappointed, and even see a material downward adjustment. After all, stocks valued at 30 times earnings rarely provide good returns no matter how good the fundamentals might be.

On top of this, large pockets of the market looked downright silly, including SPACS, meme stocks, and some "new economy" stocks. In large part, the new economy stocks were working as they had in past years, but they were coming under pressure and had further to fall.

For growth investors, the challenge often lies in resisting the tendency to pay ANY price for a stock because the fundamentals and the story seem so compelling. Although experience shows us that sometimes a catalyst emerges, validating a large price premium, our view is that price usually does matter. Eventually, the momentum shifts, and investors move to more sensibly priced stocks — like those we prefer.

What shook growth stocks in the first quarter had been in the works for a while. Value-oriented stocks began performing better when the pandemic started to wane and investors realized that work-from-home stocks were not the only ones that could go up. But the real catalyst for value stocks came with the ever-more hawkish stance by the Federal Reserve, which became increasingly ready to raise rates. Higher rates usually mean the economy is doing well and that growth isn't scarce. In that kind of environment, why pay a big premium for growth when multiple sectors — financials, industrials and consumer — also have good prospects — and at lower prices? Higher rates also hurt growth stocks more because a greater portion of their cash flows is out in future years. So, their intrinsic values are more affected by a higher discount rate.

But, of course, the game changer was the Russian invasion, which for a time intensified the above market dynamics. Stocks suddenly faced higher rates, slower growth, skyrocketing oil prices, potentially worse supply chain problems, and inflation, not to mention all-out war (with nuanced threats of a nuclear exchange). Yet, somehow, in March, the market rallied, erasing about half the losses sustained earlier in the quarter.

So, the first quarter was not good for growth stocks. At one point, while the S&P 500® Index was down more than 13% from its high in January, the Nasdaq was down more than 21% from its high hit in November 2021. Certain high-growth stocks, such as Teladoc Health, and equity vehicles, such as the ARK Innovation ETF, were down 30-60% from their highs highlighting the boom to bust nature of these stocks.

In contrast, Berkshire stocks fared very well, benefiting from our caution on the valuations of high-growth companies and our focus on more sensibly priced issues, especially in more value-oriented sectors.

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.

The dynamics at work in the first quarter highlight a central tenet of our firm's investment strategy. Pandemics, wars, recessions, financial panics, supply chain problems, and bubbles are all part of investing. Periods of perfect peace and prosperity are rare, and when they occur, they're quickly reflected in market prices. So, if you're looking to own stocks and enjoy the upside without the drama, you're in the wrong asset class. The stress one must endure as an investor in stocks is one reason, they tend to outperform other asset classes over time.

Fortunately, there are ways to mitigate this stress. Some managers and advisors will attempt to time the market, selling when risks rise and buying when they subside. But, as most experienced investors know, timing the market is difficult.

Our preferred method is not to sidestep these market ups and downs, rather, own companies that possess the financial strength and flexibility to endure — and possibly thrive — during these periods.

In fact, during times of market stress, we hope to outperform. But sometimes we even surprise ourselves. At the beginning of the year, if someone had said, "Inflation will reach a 40-year high, growth stocks will decline 15-20%, rates will be rising, and, oh yeah, Russia will invade Ukraine, but the Berkshire portfolio will be UP,"[1] we'd have thought they were crazy. But that's what happened.

We've been writing to many of you for years, and we think this is just one more validation of the well-validated advice to avoid timing the market. Instead, own great companies that produce and grow cash flows year-in and year-out and therefore can withstand these periods of stress.

That's not to say that we downplay threats. Far from it. For example, we have done analysis of supply chains and the exposure to Russia. Direct exposure of our companies doing business with that country is relatively small. Russia makes up only 1.7% of the world's economy and about 12% of Europe's economy. Our companies in aggregate generate 50% of their revenues internationally or about the same as other large multi-national companies. (Source: Bloomberg) Direct revenue exposure to Russia is relatively small. Outside of their impact on energy markets, Russia is really not a material player on the world economic stage. So, the diversity and financial strength of our companies again gives us confidence our portfolio can ride out the storms.

Another major macro challenge is inflation. As consumers, you are dealing with rising costs of seemingly EVERYTHING. Will inflation help company earnings, and can a company perform in a way that helps you offset inflation? We believe the answer is, yes and yes — but only if you own the right companies. You should own those that can grow earnings despite inflation and also can pay you an ever-increasing dividend.

For the most part, the companies we own have the financial flexibility to manage input costs. But in many cases, they also have strong brands that give them pricing power, allowing them to keep raising prices to maintain their profit margins. They do this to differing degrees, but this is a core component of what we seek, and growing earnings and dividends have ALWAYS been a core feature of the Berkshire Dividend Strategy.

With this in mind, let's take a closer look at the first quarter's relatively solid performance. As we mentioned above, value stocks performed well. They benefited from the reopening of the economy and also were not as hindered as much as growth stock by rising interest rates.

More specifically, our allocation to the financial sector did reasonably well versus the market. Loan growth is starting to pick up, and rates are moving higher, which is increasing banks' net interest margins, a key measure of profitability. Cheap valuations, attractive and growing dividends also contributed to this sector's appeal.

Industrials were also solid performers. Though supply chain bottlenecks hampered some industries, our allocation to the industrial sector performed well, primarily due to the growing economy.

Health care stocks, laggards in 2021, also performed well. Stock selection was solid, with a few issues posting outsized gains. We continue to like the sector, given its attractive yields, growing dividends, and defensive characteristics.

Technology was also relatively solid for us. We own some of the biggest names in this sector, and unlike the riskier ones, these are well-capitalized and have reasonable valuations and solid growth prospects. Being selective in this sector paid off.

What's in store for the rest of the year? It is hard to tell near term. But regardless of the outlook, we're confident. We believe our approach — focused on companies with strong brands, pricing power, healthy cashflows, and financial strength — is potentially an attractive option for investors to stand fast in the face of the market's turbulence.

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[1] Past performance does not guarantee future results.

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