Berkshire
DIVIDEND STRATEGY

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“Casual Friday” Commentary

Casual Friday: Volatility... Unpacked? + Income Alignment – October 14th, 2022

#TGICF!

Good morning, feeling whipsawed?
What a day Thursday… CPI hot, equities swing wildly.
Rates, gilts and major currencies made violent moves.
Crazy day, week, month and year for markets

Let's think big picture and try to unpack what’s relevant, actionable vs. noise:

Berkshire/Market Vitals and Performance YTD as of 10.13.2022

- S&P 500 Index – 22.06%
- Russell 1000 Value Index – 14.87%
- Russell 1000 Growth Index –29.79%
- Barclays Intermediate Govt. Bond Index – 10.16%
- Barclays Aggregate Bond Index - 15.49%

- Berkshire Dividend Strategy:
  - Performance: -11.75% Net of fees (Composite Estimate)
  - # of dividend increases: 28 out of 36
  - Average dividend increase: approx.7%
  - Dividend yield: 3.05%
  - 2023 P/E: 12x

Source: Bloomberg

Macro

- Tough policy decisions: raise rates and kill the economy, or print and create inflation? Hawks rule the nest…for now
- Inflation is still hot but deflationary forces building
  - Mortgage rates: 6.50% - 15-year high
  - Key indicators: Oil, steel, lumber, shipping -- all declining – fast
- Inverted yield curve – rarely good for the economy

- Earnings, growth and valuations are likely to "recede off their current highs" and maybe that means stock prices do the same. Unlike 2008's near-apocalyptic collapse, so far this looks like a normal ebb and flow where yes, stocks might experience a prolonged correction. It just comes with the territory of owning equities.

Is the market still expensive? Have we seen the bottom?

- S&P 500 $3,610 / $235 F12 EPS estimates = 15 P/E
- EPS outlook too optimistic? Maybe… but if EPS comes in at $220 you are still buying stocks around 16 – 17 times EPS (reasonable we think)
- At these P/E levels, forward returns average*
  - 5.2% S&P 500
  - 6.3% Value

"Recession?"

- Is the economy destined for a recession? Nothing is certain yet
- How severe will it be? Fed could engineer a soft landing, where EPS declines and multiples recede which are normal ebbs and flows of a business cycle
- Will it create contagion? Probably not. Bank underwriting appears adequate and there is way less leverage in the system than 08'.
- Are recessionary forces already priced in? Markets are already down sharply YTD, S&P 500 typical drawdown in a recession = -30% -35%
- Berkshire P/E = 12x EPS.

Growth vs. Value?

- Growth appears expensive relative to value, based on P/E and P/B
- Why is growth down so much? A growth stock's cash flows tend to be more distant, so they are more sensitive to interest rates and act almost like long bonds.
- Growth seems to be faring worse on "risk off days" unlike the pandemic
- Undergoing structural valuation reset/value rotation: like tech stocks in 2000-2005, people might not want to pay high valuations… regardless of how good the fundamentals might look
- Playing out like 2000? It took years to recover – i.e., When did MSFT reclaim 99' highs? 2016

Bonds: "You cannot be serious!"

- One of the worst bond markets ever
- US: 10yr hit 32 bps in March 2020 (lowest EVER)
- 100-year Swiss bonds? (now down 60%)
- Negative yields?

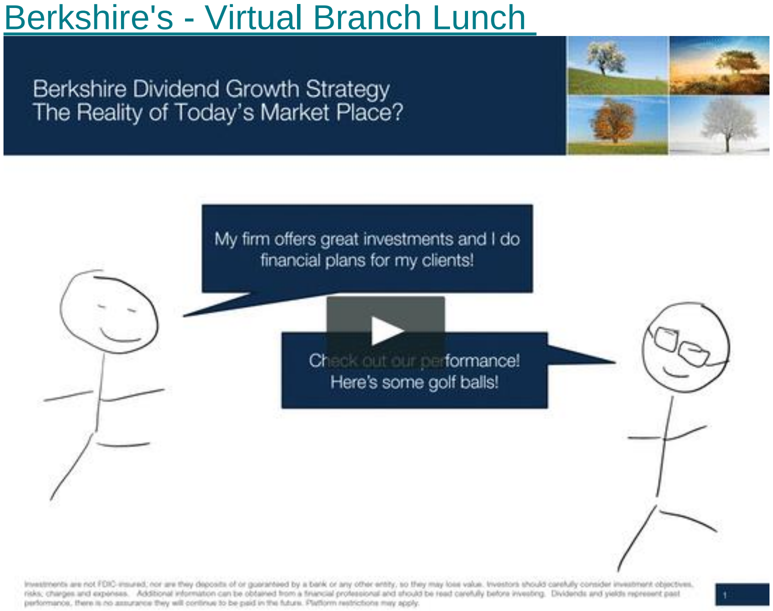
- It's a head-scratcher... So many investors stretched for yield (duration, low quality or funky leveraged structures) at such epically low rates and now they wonder "what happened?" Current feedback reveals a very high aversion to bonds/bond funds in favor of fixed products like CD's or annuities. Reminder while it's tempting to switch to something that doesn't seem to fluctuate in value, the reality is if rates go up from here the value of those fixed products still go down... you just can't see it because it doesn't trade every day. Extreme example to make a point. If you buy a 4% fixed annuity and interest rates go to 20% does anyone want to own that 4% annuity? Is the value of that annuity really unchanged?
- Not a bond market call, but combine the worst bond market ever, deflationary forces lurking beneath the surface and such high aversion to an asset class, the contrarian in me thinks rates could be topping out.

Conclusion?

Is this the bottom for equities? No one knows the near term, but declines are painful already. We don't see another 2008-style collapse in the tea leaves. Statistically, stocks look reasonable and bonds have endured such a correction they may look decent again. But there is no true formula…no "all clear signal" Investing is probabilistic, not mechanistic…you can't use absolutes or definitive. So, to us, it appears the decline has set investors up for a better risk-return profile going forward… So, for accounts that need/want the growth associated with longer-term equity investing, we believe it looks like this is a better time to buy than it was 6 months ago. *Based on Berkshire internal regression analysis where y=P/E and X = %return 10 year forward

Income and Other Alignment for Practice Efficiencies?

Berkshire's - Virtual Branch Lunch



Berkshire - Advisor Welcome Video

If you're having issues accessing our video, visit directly @ https://berkshireasset.com/strategy-info/

Dimorphos Thrown Off Course?

Analysis of data obtained over the past two weeks by NASA's Double Asteroid Redirection Test (DART) investigation team shows the spacecraft's kinetic impact with its target asteroid, Dimorphos, successfully altered the asteroid's orbit.

Have a great weekend,
Gerry

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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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