



Berkshire

DIVIDEND STRATEGY

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“Casual Friday” Commentary

Casual Friday: Banks... Deconstructed + Hidden Productivity Hacks?– March 31st, 2023

#TGI CASUAL FRIDAY

Happy last-day-of-the-quarter... nice to close out the month with a rally and a less stressed market. We imagine a lot of client questions coming our / your way in April. We'll be ready with answers...

The Market Speaks?

So... what did the “voice” of the market tell us this week...

- **Bank Reprieve:** Duration mis-match appears far more tolerable than a nation of toxic loans that won't be paid a la 2008
- **Problem Solved?:** Sorta... unrealized bond losses are still on bank books, but the core problem is alleviated with the dramatic drop in rates
- **Future of Banks:** Most expect more regulation higher capital requirements which is multiple compressing and sadly, dividend constricting
- **Accelerating Recession Threat?:** We don't expect banks to be turning on the credit spigots anytime soon, which likely tightens the noose on an economy fretting over recession
- **Loud and Clear:** The dramatic steepening of the yield curve may foretell a “pause/pivot” and the reemergence of market leadership in long duration growth stocks confirm this theory.

"5" Chart Friday?

Imagine:...Thursday 3.30.2023 @ approx. 2PM Est...Berkshire Office in Wilkes-Barre PA
Jason (Berkshire Partner and regular Casual Friday contributor): “This one of the coolest charting environments I've seen”

Gerry: “I know, so many to pick from! Can we do more than 5 this??? Please? We have to talk about the banks!

Jason: “It's called 5 chart Friday for a reason. Stop being such a nerd. This issue is too long already.

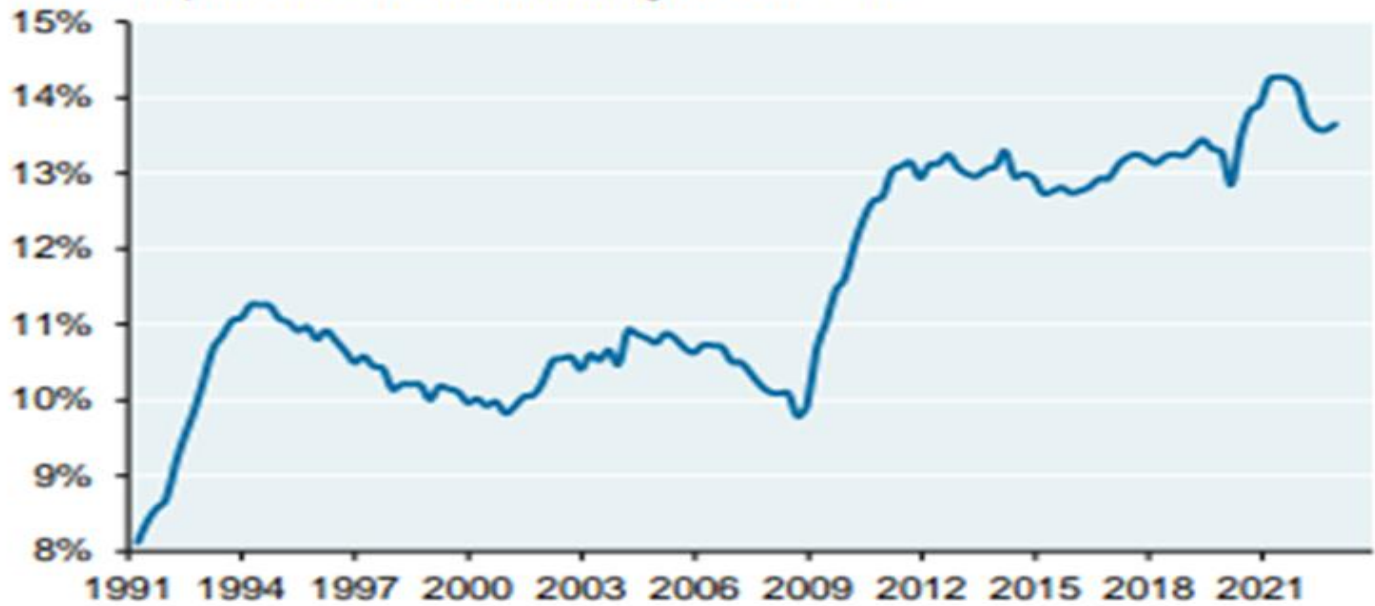
Gerry: “I know but there is so much happening....6?”

Jason: “Ok... ok... I guarantee our friend _____notices...”

Capital Ratios -- Prepped for a Hurricane?

US bank tier 1 capital ratios

Tier 1 capital as a % of risk-weighted assets



Source: FDIC, Bloomberg, JPMAM. Q4 2022.

Loans not the problem this time?

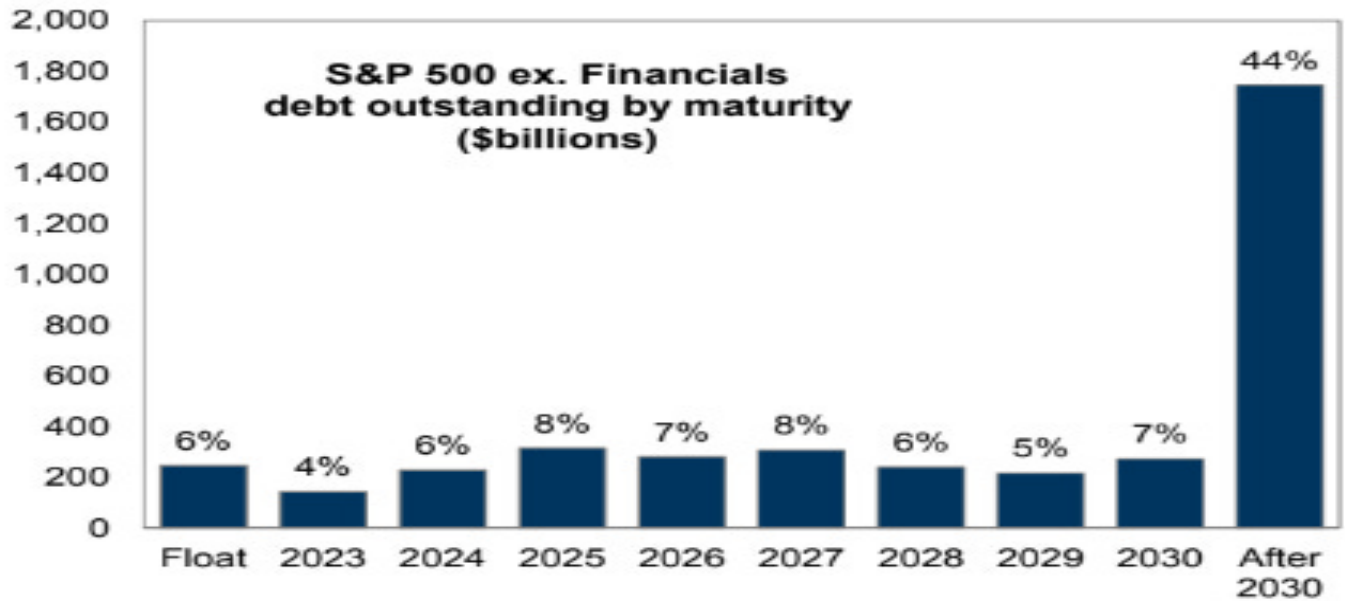
US loan-to-deposit ratio, all commercial banks

Ratio, loans / deposits



Source: St. Louis Fed, Bloomberg, JPMAM. February 22, 2023.

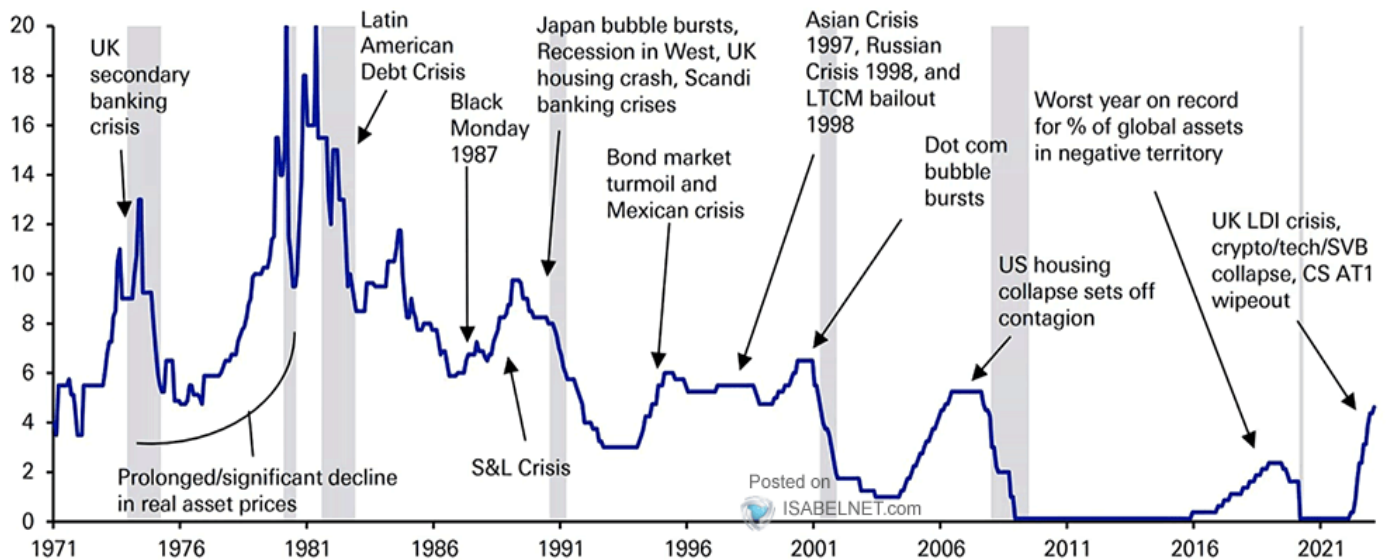
Exhibit 2: S&P 500 debt maturity wall



Source: Bloomberg, Goldman Sachs Global Investment Research

Thanks Guys! The Fed creates a crisis...fixes the crisis...then creates a new one from the one they just fixed.

Figure 1: When the Fed hikes, something usually breaks.... this time is no different...



Source: Bloomberg Finance LP, Haver Analytics, Deutsche Bank

Where are the bank deposits going?

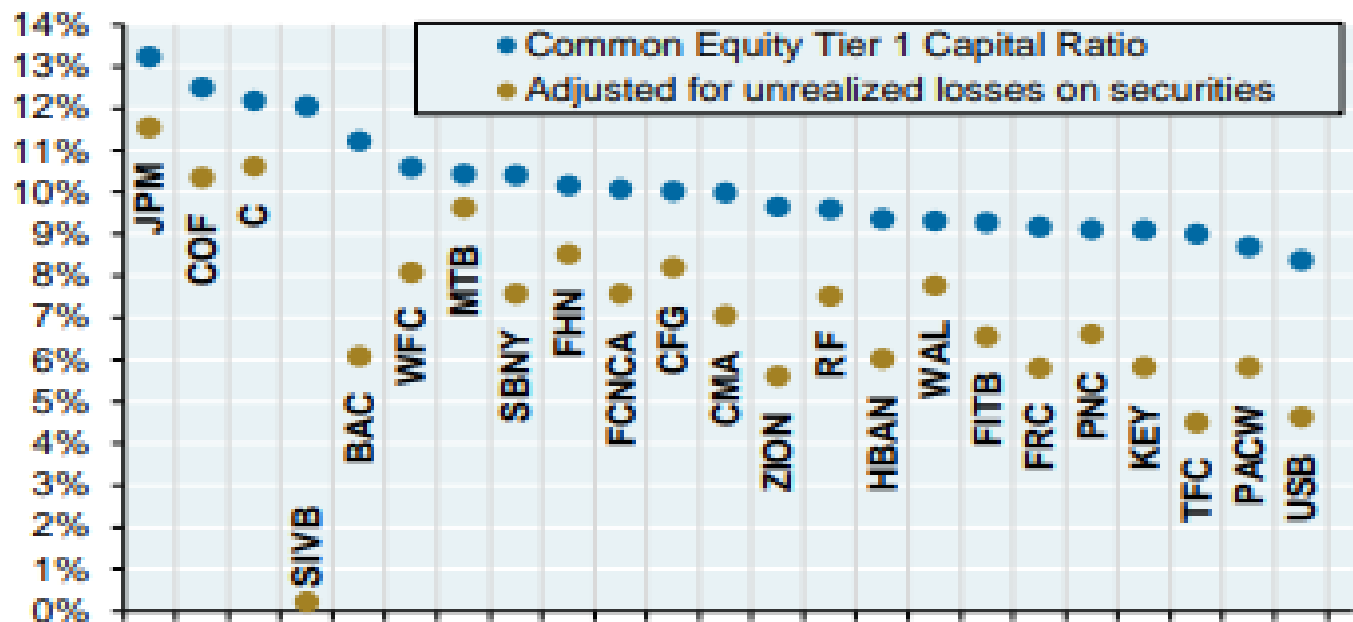


Source: BofA Global Investment Strategy, Bloomberg

Bank unrealized losses and impact on capital ratios?

Impact of unrealized securities losses on capital ratios

Percent



Source: JPMAM, Q4 2022. See page 3 for methodology

Berkshire sample analysis: Bank of America's balance sheet 12.31.2022.

While a bank faces many risks (regulatory, interest rate risk, bad loans, adverse developments in the capital markets) we believe much of the panic is overdone.

Consider Bank of America (BAC):

- Total Assets: \$3 trillion total (72% earn more with higher interest rates)
- Cash: \$230 billion
- Fed Funds: \$267 billion (excess liquidity swapped to other banks)
- Trading Account: \$295 billion (MTM gains or losses flow through income statement)
- Available for Sale: \$230 billion (MTM gains or losses add or reduce book value)
- Held to Maturity: \$632 billion (No balance sheet or income statement or impact unless they are deemed "impaired") – nearly all of these are government guaranteed
- Deposits: \$1.9 trillion
 - 32% uninsured
 - 29% pay customers no interest
 - Net inflows of deposits last two weeks
- Loans: \$1 Trillion
 - C&I: 30%
 - Commercial Real Estate: 5%
 - Resi mortgages: 21%
 - Credit card: 12%
 - Other: 20+%

Current P/E Ratio: 8.3. You tell me. What should this diverse high-quality, well run bank franchise that generates tangible return on equity more than 16% trade for? Challenges? Sure. But remember the adage...if it's in the papers it's in the price.

Can Dividend Strategies Enhance an Advisors Productivity?

Its always a pleasure to leave the office and spend time with advisors and productivity consultants. Advisor question: "How does Berkshire sell a dividend strategy and keep raising assets when no one seems to be switching managers or doing much." My slightly tongue in cheek answer: "We don't sell a dividend strategy... at least not in the traditional wholesaling sense. Instead, advisors have practice aspirations and challenges. Our dividend strategy paired with our service model offers a potential solution, not just a product.

Examples:

- I have too many strategies on the books and need to consolidate so I don't have to keep track of a zillion strategies.
- I need to outsource to managers to scale my practice, but I really need help and support to guide me through the change

- I need to change managers but I'm worried about incurring a bunch of taxes when the second manager restructures the portfolio
- I just took over a book but I don't want to be a stock picker like they were
- I want higher service from my manager... the big impersonal firms with sales people aren't helping enough
- I'm tired of being a slave to the ups and downs of the market... how can I annuitize, while matching goals based planning and strategies?
- I would love to work with a firm who also has a lot of experience helping advisors grow their business

If any of these sound like you, call us! 570.825.2600

Bonus:

[Would you spend \\$5,400 on a workout?](#)

Have a great weekend,
Gerry

Gerard Mihalick, CFA

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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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