Berkshire
DIVIDEND STRATEGY

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"Casual Friday" Commentary

Casual Friday: Boiling Frogs? + Who's The Boss? - August 18th, 2023

#TGICF

Reminder Housekeeping: JNJ / Kenvue Tender

Today is the deadline. Berkshire is choosing NOT participate in the tender offer.
Call / email for more insight gmihalick@berkshiream.com; Jreilly@berkshiream.com or 570.825.2600

Boiling Frogs?

This market reminds us of the old story about frogs and boiling water: if you throw a frog in boiling water, it will jump out. If you place it in lukewarm water and gradually turn up the heat, it will stay in until it's too late.

The recent sell-off that sunk the S&P -5.5% from its high (as of 8.17) at first could have been chalked up to a simple summer doldrum or investors banking some pre-beach profits. 'Nucleate boiling' is the early stage where a few small bubbles start to develop from the bottom and selectively rise to the surface. Here our frog is warmer but still relatively happy.

'Film boiling' starts when temperatures rise and more bubbles start to form and move to the top. Here the frog might start to realize there's a problem but maybe isn't sure what to do about it. Perhaps that's where investors bathe now.

Transition and then rolling boils come at 212 degrees and the bubbles become so agitated they burst at the surface releasing steam. By then you are cooking "le ragout de grenouilles" (French Frog Stew) a dish often served up to investors in October. Let's hope the market turns down the heat before we relive that.

The heart that's causing the water to bubble now is multifaceted yet interconnected at the same time.

Higher for longer?" 10-year treasury hit 4.32% this week and Mortgage rates now average 7.5%. Global yields lurched to 15-year highs. Recent stamina from housing (cash buyers, shortages) and the consumer breed optimism but it's hard to believe economic data a year from now doesn't recede. Today's rates drive the data a year from now.

"Commercial real estate?" Well-advertised, maybe even priced in? Yes, but credit is surely tighter, work from home is real, and every fissure in the banking systems harkens fears of '08.

“The Fed's got this?” The same guys who brought you “lower for longer” and “inflation is transitory” now tell us they can create a soft landing?

“China's got this?” A collapse in China's shadow banking system was one of the top 5 most read Bloomberg headlines this week. What exactly does THAT mean anyway? Are they just going to sweep a few trillion in bad loans under the Oriental rug without creating dislocation somewhere? We’ve prayed (literally) that massive bubble never pops.

Result? Tech stocks, growth stocks and the “risk-on complex” is finally unwinding. Investors again correctly surmise sharply higher rising rates are usually crush high multiples regardless of how good the story is (AI).

Bonds, last year's train wreck, are also posting losses- again putting investors in a tough spot. We do believe high quality low to medium duration bonds are still an effective hedge against equity market volatility. Even in 2022, intermediate bonds were down less than half of what many equity indices were.

So if you happen to know of a strategy that leans defensive-quality-downside capture and who tends to keep the heat at lower temps, maybe now is the time to protect some of your favorite frogs and move them to our side of the stove. At 14 times earnings, a 2.80% dividend yield with decent growth potential, (source Bloomberg) we will try to keep the temperature for your clients just right - even as risk heats up.

"Who's The Boss?

Below we highlight a recent advisor success story.

“Our performance has been good. We've been raising assets. Our life is efficient,” said one bank advisor team leader we spoke to this week.

“What's behind your good performance?' I asked.

“We don't let clients have a say.”

Dead. Straight. Perfect.

“We guide our clients to a choice 4 investment models. If they don't like one of them or are arguing with us about the make up, they are not going to be clients.” Again - bull's eye.

Next, we reflected on the classic Dalbar study which shows individual investors usually massively underperform the very funds they are investing in.

We wondered: “If an our compensation is tied to AUM, why on earth would we let clients steer the ship?”

“I create the models. Clients accept one or they don't. It lets my advisors be portfolio experts, and they are always hunting for new business and deepening relationships.”

This is likely formula for business and client success.

So why aren't advisors more willing to adopt this approach? It's subtle, but we think it stems from fear that if an advisor doesn’t say yes to the client, they risk getting fired and lose the revenue. We get that. Appeasement keeps revenue near-term, but it also lessens your brand, likely creates bad client outcomes, and generates huge DIS-economies of scale in the long run. Saying yes to clients is a bad model.

The scale, efficiency, and investment compounding with you at the helm will likely dwarf the revenue you get by caving in - over time. Not to mention the peace of mind…

We've said it for years: the absolute silent killer in an advisor's practice is clients who don't take your advice." Remember, you are the boss.

Casual Friday Bonus:
In the off-chance you are suddenly craving frog leg soup: here is how to pair it

Where are they now? The cast of the ABC hit TV show: Who's the Boss?

Have a great weekend,

Gerard Mihalick, CFA

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