



Berkshire

DIVIDEND STRATEGY

Berkshire Asset Management
46 Public Square, Suite 700
Wilkes-Barre, PA 18701
570.825.2600

"Casual Friday" Commentary

Casual Friday: It's All Under Control, Right? + Berkshire 3 Minute Quarterly Review – October 4th, 2024

By popular demand – we present an alternative to 30-minute zoom calls where the PM drones on and on... Here is our super succinct yet content-rich 3Q slide deck that will get you prepped on all things Berkshire Dividend Strategy – in about 3-5 minutes.

- [Berkshire 3 Minute Portfolio Review 9.30.2024](#)

And if you prefer a bit of longer form prose where we cover everything from the Fed, clear thinking on inflation, to stock sectors we present:

It's All Under Control, Right?

The stock and bond markets sure got what they wanted this quarter.

The Fed delivered its big rate cut, 50 basis points, in late September.

Equities rallied, and the market broadened out, meaning more than just a handful of stocks performed well, unlike the rest of the year. Berkshire portfolios and the general investing public were happy to see a wider number of stocks go up, not just a few.

Bond yields and interest rates dropped, which, in a way, is a quiet little bailout for the marginal borrower (either a household or a business) who was feeling the choking effect of higher interest rates.

The Federal Reserve Board essentially claimed victory in taming the inflation it ironically created. If you recall, a few short years ago, they embarked on an overly aggressive easy money campaign eventually causing prices to increase at a rate of 8-10% per year, (rates not seen since the '70s) but now have cooled.

Although, let's be clear when we talk about inflation. Virtually everything in 2024 now costs a great deal more than it did a few years ago and will likely continue to do so. So, despite what your pundits, Fed, and government officials say, be skeptical when you hear them say, "Inflation is under control."

Inflation? Deflation? Dis-inflation? It's all about the RATE of price change, not necessarily whether or not prices are going UP or DOWN. A period of inflation technically means the rate of price increase is accelerating. For example, if prices were rising at a rate of 2% per year and now are rising at 5%, one could say inflation is accelerating. If prices were going up at a rate of 5% and then the rate of that increase slows down to 3%, the technical term for that phenomenon is disinflation. But make no mistake, prices are still rising, just not as fast. Tuitions, healthcare, shoes, food, gas—you name it—are still bound to keep rising around 3%, not 8%. After such a huge run-up is that a victory? We will let you decide.

If you want to actually pay less for something than you did last year, you are rooting for deflation, which policymakers usually FEAR at all costs. What's so bad about that, you ask? Wouldn't deflation and lower prices be a good thing? Well, it depends on how much DEBT is out there. Because while many want to root for prices to go down on things they *consume*, they don't want the price of what they *own* to go down, especially when it is financed with debt. Debt stays fixed, but if the asset goes down it's a big loss. And debt? It's pretty much everywhere!

There are plenty of bloated debt levels throughout the world: credit card debt, mortgage debt, private equity debt, commercial real estate—and it's all been financed with a lot of easy money over the past years. Yes, all the profligate spending is what made prices go up in the first place.

And policymakers, of course, don't want to be the ones pulling away the good time punch bowl, let alone have blood on their hands from a crisis. So, when faced with hard trade-offs—like balancing the tension between easy money sugar highs that might create inflation and the tougher medicine of restrictive policies that might actually cleanse the system of speculative excesses—guess which ones they choose? The stealthier, but make no mistake, deadly inflation.

If you need a little less “wonky” and a little more practical, consider this: It's simple. Investors in this type of climate, (where everything costs more) need to compound income and their assets to keep up with what feels like ever-higher prices.

Keeping it “Real”

And we believe ownership in common stocks may be able to do just that, given enough time and patience. High-quality companies can inflate your purchasing power in a good way. Unlike Fed officials who can print money out of thin air or government officials who can mail a bunch of stimulus checks, high-quality companies compound investment by creating real value from the businesses they run. And that's a good thing. They use investor capital to buy productive machinery, invest in R&D to innovate, make stuff, and then sell stuff—hopefully for a lot more than that stuff costs to make. They use some of the profit to reinvest back in their business to create even more products, serve more customers, and do so more efficiently. And after they do that, the really good companies have enough left over to pay you out—drum roll please—a nice healthy dividend as a reward for your ownership and the risk you took. If all these factors stay in reasonably good shape and the company continues to grow earnestly, the stock price may also compound as other investors want to get in on such a virtuous cycle. Real. Tangible. Compounding. Boring? Sometimes. Volatile? Sometimes. Sure, companies may make mistakes, or the market may get nervous about the company's economic prospects. But is compounding effective over the long term? We think so. And that's why we've been so passionate about our dividend growth strategy, which just celebrated its 15th anniversary.

Around the Markets and Sectors

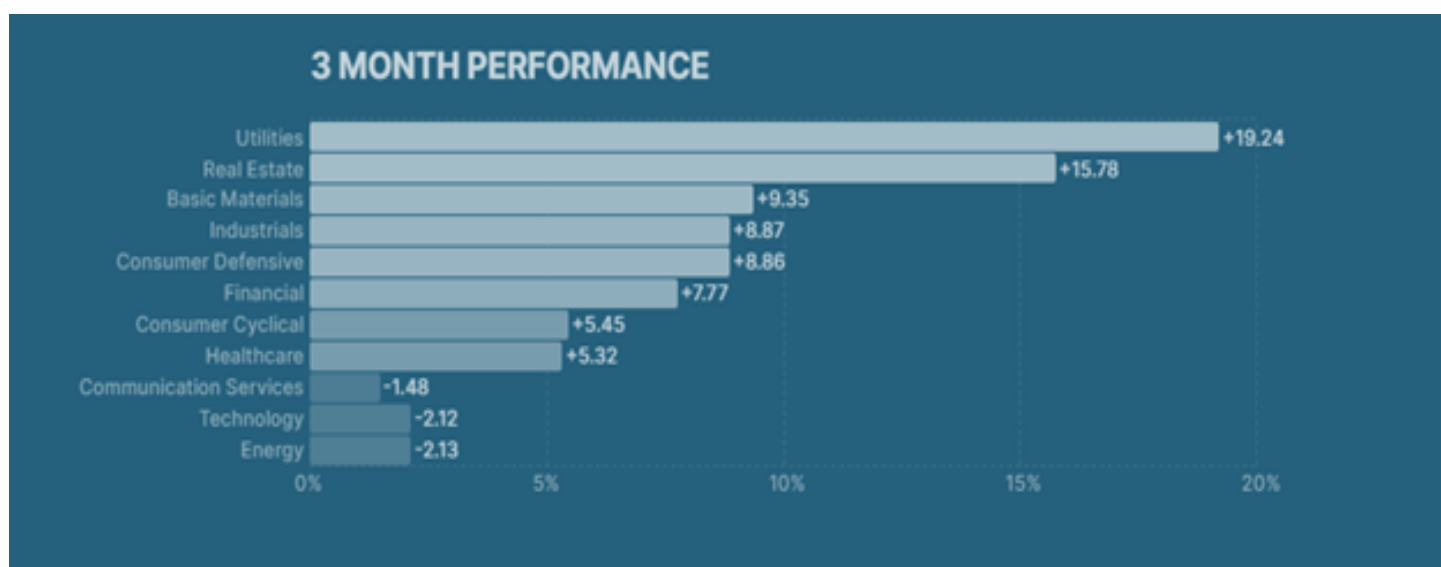
U.S. markets are enjoying another impressive year, but the summer was quite volatile. You

see, on the way to all this so-called investment “nirvana”—inflation low, threats of a recession fought off—there were undercurrents that shook some investment foundations. During the mid to late summer, the market worried growth and the economy might slow down too much. This caused some of the more speculative parts of the market—i.e., high-valuation growth stocks—to suffer a meaningful correction of nearly 10%. Some of the so-called Magnificent 7 declined much more than that—some by 20-30%. Meanwhile, the other 493 stocks in the S&P 500 started to show some signs of life, either declining less or increasing more than the stocks at the very tippy top of the market. Value stocks are starting to close a wide performance gap that has frustrated many.

(Source: Bloomberg)

And sector-wise, leadership may be changing.

Consider this past quarter (Source: Finviz 6.30.2024 – 9.30.2024)



Common Threads?

Sectors that were either a beneficiary of lower interest rates or more economically sensitive performed relatively well. Utilities and Real Estate are typically direct beneficiaries of lower rates, so it makes sense they had a solid quarter.

Industrials and materials which are usually more economically sensitive may keep the momentum as we avoid recession, hence their strong advance.

Financials also put up a good quarter. Our observant followers will note the stress banks and financials were under this year and many believed commercial real estate concerns would spark another 2008. Since that time, the sector is up over 33%. (Source: Bloomberg) It's a combination of better balance sheet management, conservatism, a steady economy and an easing of monetary policy.

“What’s our “outlook? “Which way is the market going?” What about interest rates?” “Will we have a recession?” Will we have war?” What’s up with China” And of course who will win the election? (does anyone win?)

As our dividend strategy marks its 15th anniversary, our approach of “quiet compounding” has endured and prospered through a great many unforeseen events we draw on Mark Twain: “I’ve lived through some terrible things in my life, some of which actually happened.”

Keep it “real.” Keep it growing. And most certainly keep the faith, folks.

We are.

Serious Laser Beam!

"NASA's Deep Space Optical Communications technology demonstration broke yet another record for laser communications this summer by sending a laser signal from Earth to NASA's Psyche spacecraft about 290 million miles (460 million kilometers) away. That's the same distance between our planet and Mars when the two planets are farthest apart.

They actually streamed a video using the laser from that distance!

<https://www.nasa.gov/directorates/stmd/tech-demo-missions-program/deep-space-optical-communications-dsoc/nasas-laser-comms-demo-makes-deep-space-record-completes-first-phase/>

Have a great weekend!

Gerry

Gerard Mihalick, CFA
Dividend Strategy Portfolio Manager/Partner
Berkshire Asset Management, LLC

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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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