BERKSHIRE
ASSET MANAGEMENT

January 2012

46 Public Square, Suite 700
Wilkes-Barre, PA 18701
Ph. 570.825.2600

www.berkshiream.com

DIVIDEND STRATEGY

Fourth Quarter 2011 Commentary

Happy New Year

The year 2011 was a difficult one for many asset classes and volatility was again extreme.

There were 35 trading days in 2011 where the market moved 2% or more (up or down), up from 22 days in 2010. To put this number in context, in 2005 there were no moves of 2%, and in 2006, there were only two such moves.

First-quarter gains of roughly 9% were erased with a 20% correction as hopes for recovery were dashed with the Japanese earthquake and the European sovereign debt crisis.

Stocks enjoyed one of their best Octobers ever as the market rallied approximately 17% from September lows. Despite all these gyrations, however, when all was said and done, stocks barely eked out a positive gain, with the S&P 500 rising just 2%.

Large U.S. stocks proved to be the "best house in a bad neighborhood" as many international markets posted declines of -15 to -25%. Investors are realizing the Euro zone is a mess and serious cracks are forming in the emerging market story.

The dollar rallied substantially against many currencies, particularly against the Euro, and U.S. stocks boast strong balance sheets, good dividend yields and low valuations as the United States enjoys a modest economic recovery and the country's financial system continues to heal itself.

U.S. banks, unlike their European counterparts, have recapitalized, written down bad loans and are now generating excess capital. Loan growth remains weak amid deleveraging and tepid loan demand while regulatory scrutiny remains high.

Against this volatile backdrop, we are extremely pleased to report very attractive out-performance of our Dividend Growth Strategy. The portfolios benefited from strong stock selection in the financial service industry and well-timed purchases in the consumer discretionary sector. Our healthy dividend yield provided an attractive cushion against downside volatility. The portfolio is generating attractive cash flow and its potential growth should provide a meaningful component of the strategy's total return.

As always, we invite our investors to call at anytime with questions on issues important to their wealth, how U.S. equities are positioned for the future, our outlook for the economy or any other companies in the portfolio.

Dividend Strategy Process Review

The Berkshire Dividend Growth Strategy's primary objective is to generate a growing stream of equity income through investments in a diversified portfolio of stocks with a high, safe and growing dividend. We believe if we are able to achieve this primary goal by purchasing vibrant growing companies with fine economic prospects, capital appreciation will follow. A risk profile below that of the average stock in the S&P 500 is also viewed as desirable. Because of its dividend growth orientation, the portfolio also seeks to perform better than non dividend paying stocks or bonds in a rising interest rate environment.

Economic Conditions Favor a Dividend Oriented Strategy

Over time, dividends have made up a substantial portion of the total return generated by US stocks. While a high, healthy growing dividends rarely "go out of style", the current economic conditions may make the dividend component even more important.

Berkshire is a fee-based, SEC registered advisory firm serving the portfolio management needs of high net worth and institutional clients. Over the past 20 years, we have successfully implemented highly focused equity, fixed income and balanced portfolios. Our guiding principle is a belief that success is 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.

IN THIS REPORT

- Stocks go nowhere despite lots of volatility
- Macro shocks: Japan earthquake, sovereign debt risks
- Solid recovery in October; "double dip" recession averted
- Berkshire equity process review

Excessive borrowing ("leveraging") had a profound but artificial growth effect on our economy throughout the 1980's, 1990's and 2000's until the credit bubble burst in 2008. Now, consumers, businesses and many governments are being forced to pay down debt, so this paying down of debt ("deleveraging") is having a retarding effect on world economies. Economic growth is likely to be positive but below average for some time. A 2-4% dividend may have been viewed as a "quaint" in a roaring stock market, now it is likely to make up a large part of an investors total return. Many high quality dividend paying stocks offer an attractive alternative to certain fixed income investments and offer investors the chance to grow cash flow vs. accepting a fixed one. What's potentially more exciting is that many of the equities that fit our evaluation criteria are trading at valuations not seen in decades!

Equity Selection Process

Importantly, we believe that intelligent dividend investing is not just composed of shopping for the company with the highest yield. Our process spans three dimensions: current level of dividend, safety of the dividend, and importantly, the growth of dividend

Current Dividend

First we identify companies that have a dividend yield at least that of the S&P 500, preferably higher. Companies that fit these criteria should perform better in a slow growth economy and should provide a cash buffer through equity market volatility. In certain instances the portfolio may purchase securities with nominal or below average dividends, but only if there is clear relatively certain path to normal cash payouts. Philosophically however, we don't believe in paying a high price for a future promise.

Safety of Dividend

A dividend springs from excess profits after a business pays off all other providers of capital. Since the share holder is the last in line to get paid, as analysts we wish to see how substantial the claims of individual in a senior capital position are to us. This is why companies with high levels of debt and/or volatile businesses can be undesirable investments. A profitable business that has too much debt can find itself little left over to pay shareholder dividends. So we spend considerable time evaluating the company balance sheet:

Debt to Equity Ratio: How much of the total capital is funded by debt vs. equity.

Times Interest Earned: How often do operating profits cover the interest expense?

Credit rating and liquidity of under lying debt if applicable: Bond market spreads and credit ratings provide another view into the company's ability to fund itself.

Growth of Dividend

If our portfolio is going to provide an effective hedge against inflation and provide appropriate client cash flow, it is critical that the company under evaluation demonstrate the prospects for future dividend growth. This is one of the most important parts of our screening process and what makes our strategy unique relative to other dividend strategies.

First we seek a company that has a history of raising the dividend. This gives us good insight into management's view of the dividend, how they allocate shareholder capital, and prospects for growth opportunities within the business itself.

A key metric we use to quantify growth prospects is return on shareholder equity or ROE.

In our opinion, return on equity (ROE) is the best financial yardstick to identify, evaluate and compare the desirability of investments. ROE is the rate of growth a company can maintain in its earnings and dividends, without needing to raise capital. By decomposing ROE into its component parts, we understand the 4 key dynamics of that drive company profitability, namely:

Operating Margins: Operating Profit/Sales
"How profitable are core operations?"

Asset Turnover: Sales/Assets
"How capital intensive is the business?"

Leverage: Assets/Equity
"How much does the company's use of debt affect returns?"

Tax Retention: Pretax Income/Net Income
"How well does the company manage its tax obligations?"

Keep in mind there is no "right" number for ROE or any one of the individual components. Some companies have high but volatile ROE's and some companies have lower but highly stable ROE's. Both can be equally desirable. A company that has very stable operating margins and consistent sales growth allows for management to utilize (think drugs or consumer staples) versus a company that is more cyclical (think semi conductors or energy companies). In the end the evaluation of ROE is a highly reliable metric that helps us forecast future dividend growth. Other subjective factors which may play into our process include competitive positioning in the company's end markets, intangibles such as brands and patents, past acquisition strategies of management, and volatility of earnings, just to name a few.

Summary of Process

So while there are many factors, some quantitative and some qualitative the goal is to buy companies with an attractive, safe and growing dividend so as the risk adjusted total return profile is superior.

Sell Discipline

A company is typically sold when its yield falls below that of the S&P 500, its ROE falls below acceptable levels, loses its superior competitive position in the market place, the company

abandons sound dividend policy, increases debt to uncomfortable levels or does a misplaced acquisition.

Portfolio Construction

So long as there are attractive candidates, the portfolio will attempt to be broadly diversified across a wide range of economic sectors. While the portfolio will be largely "bottom up" some consideration to macro factors may play a minor role. At any one given time certain portfolios, in aggregate may appear more attractive than another (fundamental or valuation wise). However large or extreme sector concentrations relative to the benchmark in general should not occur. In aggregate we seek a final portfolio: reduced systematic risk, above average quality, lower volatility. From a cash flow perspective, we believe and history has shown that a typical Berkshire holding can deliver **cash flow growth should of at least 7.5% per year**, and the yield on the portfolio should be around 180% of the S&P 500. If our companies can deliver earnings and dividend wise, attractive appreciation should follow and thus providing strong total return characteristics.

Potential Risk and Performance Characteristics

We owe our investors a frank discussion of potential risks associated with our strategy and baseline expectations of our performance in various market conditions.

Dividends arise from the profits of a business after all other legal obligations to other providers of capital have been satisfied. These include trade creditors, bank loans, senior bond holders, subordinated bond holders, preferred shareholders and of course taxes owed to the government. The dividend is last in line. So while these claims are mandatory, dividends are paid at the discretion of management. Some managements view growing the dividend as a "implicit promise", while some managements want to remain flexible to right size the dividend to adapt to changing business and capital needs.. For a very stable business with low capital needs, the former approach is appropriate. For businesses that have higher capital needs but perhaps higher growth prospects, the latter approach is appropriate. Dividend policy often sends a powerful signal about how management views its own prospects. Management needs to make tradeoffs between growing the business and maintaining the dividend. Not all decisions will be correct.

There are no guarantees even the best businesses remain profitable, that past growth rate of dividends will continue, or that management will remain committed to its dividend. So there have been instances where a dividend appeared "safe" only to have management cut it at some point due to: deteriorating business conditions, or even they, at their discretion, find what they think is a better use of the money. We believe our screening and fundamental research will be effective in aggregate at selecting the managements capable of generating the type of cash flow growth our clients expect.

As for share price fluctuations, we stick to the premise that that risk and return are directly related. The Berkshire Dividend Strategy seeks a risk posture that is below that of the S&P 500. So in theory the portfolio should perform better in a declining market, but we are realistic for its prospects in a rapidly rising market – particularly one characterized by speculation and where low quality assets are coming back in favor. Still in that rising market we still expect a total return that will beat inflation and satisfy individual client objectives.

Commentary Disclosures:

Investment Risk: All investments are subject to risk, including possible loss of principal. Because Berkshire Asset Management, LLC's investment style expects to hold a concentrated portfolio of a limited number of securities, a decline in the value of these investments would cause the portfolio's overall value to decline to a greater degree than a less concentrated portfolio. Our equity investment style may focus its investments in certain sectors or industries, thereby increasing the potential vulnerability to market volatility.

The views expressed in this commentary reflect those of Berkshire Asset Management, LLC (Berkshire) as of the date of the commentary. Any views are subject to change at any time based on market or other conditions, and Berkshire disclaims any responsibility to update such views. These views are not intended to be a forecast of future events, a guarantee of future results or investment advice. Because investment decisions are based on numerous factors, these views may not be relied upon as an indication of trading intent on behalf of any portfolio. The information contained herein has been prepared from sources believed to be reliable, but is not guaranteed by Berkshire as to its accuracy or completeness. Past Performance is no guarantee of future results.

References to particular securities are intended only to explain the rationale for the portfolio manager's action with respect to such securities. Such references do not include all material information about such securities, including risks, and are not intended to be recommendations to take any action with respect to such securities.

BERKSHIRE
ASSET MANAGEMENT