
STOCKS THAT RIVAL BUFFETT'S BASKET OF COMPANIES

Jeremy Schwartz – Global Chief Investment Officer, Kara Marciscano – Associate, Research
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Warren Buffett views Berkshire Hathaway's stock portfolio as more than a basket of tickers.

In his 2018 letter to Berkshire Hathaway shareholders, Buffett wrote that stock performance converges with business performance over time if the original purchase price is not excessive.

He expects the returns on Berkshire's equity portfolio to be commensurate with the returns of the underlying businesses. And his basket of stocks earns approximately 20% on net tangible equity, which is almost exactly what his portfolio has returned over the long run.¹

[Return on equity \(ROE\)](#) is a metric Buffett has written on extensively: it's a "quality" indicator for stocks, reflecting how much profit a business earns relative to its net equity capital.

Buffett and his business partner Charlie Munger are known for saying, "It is far better to buy a wonderful business at a fair price than to buy a fair business at a wonderful price."

When we launched our [quality dividend growth](#) family of Indexes, we described the screening process as including a "Buffett factor" in stock selection.

The Indexes utilize both ROE and [return on assets \(ROA\)](#) as part of the selection requirements. Using ROA as a screening criterion penalizes firms using [leverage](#) to drive ROE.

Buffett has been hoarding cash—he now has over \$100 billion to put to work. He worries that market opportunities are limited because of rising prices and high valuations to complete full acquisitions.

Yet there is a basket of 300 U.S. listed stocks that offer similar fundamental attributes to his current collection of equity holdings.

Let's take a look.

DGRW: 300 Candidates with Similar Aggregate Characteristics as Buffett's Portfolio

The [WisdomTree U.S. Quality Dividend Growth Fund \(DGRW\)](#) invests in high-quality companies within the dividend-paying universe.

We performed a quality check on our collection of tickers and compared it against

Berkshire’s equity portfolio.

Based on Buffett’s preferred measure of business performance, return on net tangible equity, DGRW has a higher level of profitability than Berkshire’s latest equity portfolio.

Figure 1: Aggregate Quality Fundamentals

Aggregate Quality Fundamentals					
Fund/Index	ROTE	ROE	ROA	Assets to Equity	Debt to Equity
DGRW	24.2%	23.8%	5.5%	4.3x	1.1x
BRK Equity Portfolio	20.8%	17.6%	2.1%	8.5x	1.9x
S&P 500	18.4%	16.6%	3.8%	4.4x	1.0x

Sources: WisdomTree, FactSet, as of 2/28/19.

Performance is historical and does not guarantee future results. Current performance may be lower or higher than quoted. Investment returns and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Performance data for the most recent month-end is available at wisdomtree.com.

WisdomTree shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Total returns are calculated using the daily 4:00 p.m. EST net asset value (NAV). Market price returns reflect the midpoint of the bid/ask spread as of the close of trading on the exchange where Fund shares are listed. Market price returns do not represent the returns you would receive if you traded shares at other times.

For standardized performance of DGRW, please click [here](#).

Also key to Buffett’s investment model is his requirement that companies do not employ excessive levels of debt. DGRW’s assets-to-equity ratio—a measure of how much of a company’s assets are financed with debt and other liabilities—is significantly lower than Berkshire’s portfolio. Berkshire’s higher assets-to-equity ratio and lower ROE and ROA are driven by large positions in Financials which operate with higher levels of assets and liabilities than other sectors. At the time of writing, 9.5% of DGRW’s weight is in the Financials sector.

The key caveat to Buffett’s argument that business performance converges with investment returns is that valuations must be reasonable.

He explains, “On occasion, a ridiculously-high purchase price for a given stock will cause a splendid business to become a poor investment—if not permanently, at least for a painfully long period.”

DGRW is a fund that tracks the investment performance of a [Dividend Stream](#)[®] weighted index, which means constituents are weighted based on their proportionate share of the aggregate [cash dividends](#) paid by the basket of equities. Dividend weighting anchors DGRW to a measure of fundamental value instead of price. The end result is DGRW’s ability to tap into quality factors—which are typically expensive—without sacrificing on valuations.

DGRW is a slightly more expensive than Berkshire’s equity portfolio on [estimated price-to-earnings \(P/E\)](#) as well as [price-to-book](#). This is driven by DGRW’s under-weight allocation in Financial stocks, which tend to have lower return profiles and valuations.

For investors seeking exposure to Buffett’s style of investing, DGRW proves to be a top candidate.

Figure 2: Value Fundamentals

Aggregate Value Fundamentals							
Fund/Index	Price-to-Earnings	Dividend Yield	Net Buyback	Shareholder Yield	Price-to-Book	Price-to-Sales	Price-to-Cash Flow
DGRW	14.8x	2.6%	3.1%	5.7%	4.1x	1.7x	11.2x
BRK Equity Portfolio	12.6x	2.1%	5.4%	7.5%	2.5x	2.3x	9.0x
S&P 500	16.5x	1.9%	2.8%	4.7%	3.3x	2.1x	12.0x

Sources: WisdomTree, FactSet, as of 2/28/19.

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Buffett characterized current U.S. equity valuations as “incredibly” inexpensive relative to the 30-Year U.S. [Treasury yield](#) of approximately 3%. He expects Berkshire to be a net purchaser of stocks in 2019 because he views companies earning returns on net tangible equity within the range of Berkshire’s equity portfolio as “incredible in a world of 3% bonds.”

The [WisdomTree U.S. Quality Dividend Growth Fund \(DGRW\)](#) implements Buffett’s investment approach in a more systematic and scalable fashion. With aggregate profitability that is comparable to Berkshire’s equity portfolio and a valuation below the S&P 500, DGRW provides the exposure to high-quality, mid- and large-cap U.S. equities that could serve as the core in an investment portfolio.

In addition, valuations for high-quality, dividend-paying U.S. equities are also favorable compared with their equivalents in other developed and emerging markets.

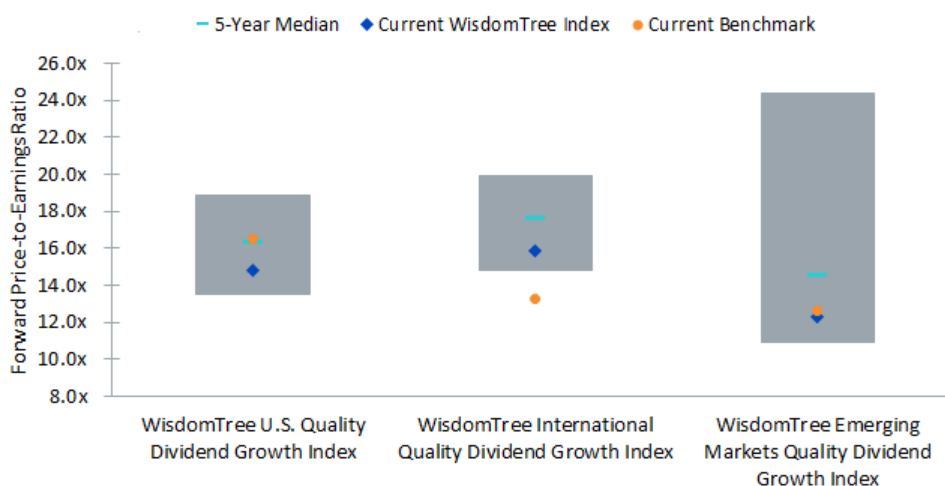
DGRW is currently valued at an 11% discount to the [S&P 500](#) based on forward P/E, while our International (WITDG) and Emerging Markets (WTEMDG) Quality Dividend Growth Indexes are valued at a 19% premium and a 2% discount to their benchmarks, respectively (as shown in Figure 3).

Figure P/E 3: Forward

Current Forward Price-to-Earnings	
WisdomTree U.S. Quality Dividend Growth Index	14.8x
S&P 500 Index	16.5x
WisdomTree International Quality Dividend Growth Index	15.8x
MSCI EAFE Index	13.3x
WisdomTree Emerging Markets Quality Dividend Growth Index	12.3x
MSCI Emerging Markets Index	12.6x

Sources: WisdomTree, FactSet, as of 2/28/19. Past performance is not indicative of future results. You cannot invest directly in an index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns. WisdomTree, its affiliates and their independent providers are not liable for any informational errors, incompleteness or delays or for any actions taken in reliance on information contained herein.

Figure 4: Five-Year High, Low, Median and Current Forward P/E



Sources: WisdomTree, FactSet, for the five-year period 1/31/14–2/28/19. Past performance is not indicative of future results. You cannot invest directly in an index.

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For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

Return on Equity (ROE): Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Quality: Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

Return on assets (ROA): Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.

Leverage: Total assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative.

Dividend Stream: Refers to the regular dividends per share multiplied by the number of shares outstanding.

Regular cash dividends: Dividends that companies indicate they will commit to paying on an ongoing basis at a set frequency.

Estimated P/E ratios: Share price divided by estimated 12-month earnings per share. Lower numbers indicate an ability to access greater amounts of estimated 12-month earnings per dollar invested.

Price-to-book ratio: Share price divided by book value per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Treasury yield: The return on investment, expressed as a percentage, on the debt obligations of the U.S. government.

S&P 500 Index: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.