

Fourth Quarter 2014

"I do not agree with what you have to say, but I'll defend to the death your right to say it" - Voltaire

A free and open exchange of information is essential to the proper functioning of economic systems, or for that matter society at large. While much available information is useful there is a large measure that some will find distasteful and even offensive. However one person's trash may be another's treasure. Without freedom of expression tyranny prevails. While this train of thought has been brought front and center by the horrific events at Charlie Hebdo free expression is equally important in the investment realm.

"If we don't believe in freedom of expression for people we despise, we don't believe in it at all" - Noam Chomsky

Repression of information is rarely beneficial for investors. Examples are boundless; Enron, Bernie Madoff, mortgage brokers, and hundreds of others have all been less than forthcoming in providing truth regarding financial instruments. Yet it's difficult to be the advocate for transparency in the face of a tidal wave of misleading data. It's very hard to make your voice heard and often a lone voice will find themselves bullied or experiencing professional risk for not following the thundering masses.

"I'd rather die standing than live on my knees" - Stephane Charbonnier (Charbo)

For over thirty years we at Albion have strived to remain independent thinkers. At times we are aligned with consensus, at others our thinking is against the grain. But we always work hard to form opinions and make decisions based on quantifiable data and considered thought rather than the emotional tide of the moment. We will continue to keep solid analysis and independent thinking front and center as we work on your behalf.

In the sections that follow we take a look back at 2014 and offer a view of what the coming year might hold. There is a new feature, Planners Corner, outlining how we helped a client family work through an issue, and finally in Albion News we highlight Albion Portfolios - an investment solution for those starting on the road of wealth accumulation. We hope you enjoy and find value in the sections that follow.

Nous Sommes Charlie

The Albion Team

The Economy and Markets

As the markets turn the page into 2015 we pause to reflect on the road traveled and find it curious just how similar today is to the beginning of last year. To be clear there were some changes and surprises over the past twelve months; change is inescapable. But to better understand our perspective of the similarities between this new year and last new year a look through our preferred lenses for examining markets is warranted; the economy & corporate earnings, interest rates, inflation, and valuation.

2014 began with an icy start as a polar air mass kept shoppers home and cast a chill over the U.S. economy in the first quarter. Yet in the subsequent quarters domestic economic activity markedly improved. After recording a GDP contraction in the January through March period the second and third quarters exhibited strong rebounds of +4.6% and +5%, respectively. The principal growth drivers were job gains, growing household consumption tied to improving consumer attitudes, and accommodative monetary policy.

To the surprise of the herd and despite the Federal Reserve ending its quantitative easing program interest rates fell. The 10-year U.S. Treasury yield dropped from 3.03% to 2.17%. Inflation, which began the year around 1.6% saw a brief break higher to just over 2% before reverting lower into year-end on the back of collapsing oil prices (another 2014 surprise). Core inflation, a construct preferred by the Fed that strips out volatile food and energy prices, remained quite stable.

Standard price-to-earnings (P/E) multiples hovered slightly above the long-run mean for most of the year. That said, when adjusted for low interest rate and inflation levels and generally stable earnings growth the P/E on the market made sense and reflected a fair valuation.

2014 provides a framework for our 2015 outlook. While the global economy is mixed and remains burdened by pockets of turmoil (e.g. Russia, Europe, Middle East), the U.S. economy is seeing an expansion that is becoming both sturdier and broader. We expect the labor market to continue its constructive path as we see reduced layoffs, more abundant job openings, and improving corporate confidence. Other crucial indicators of general economic health such as industrial production, retail sales, and business capital outlays remain encouraging which suggests continued domestic economic expansion. In addition, lower energy costs should begin to filter through the economy increasing disposable income for consumers.

The decline in interest rates during 2014 not only greases the gears for an accelerating economy, but it also makes stocks look relatively more attractive than cash and bonds as investments. Interest rates are very difficult to predict but we recognize that the Federal Reserve is in a multi-year process of normalizing monetary policy which will

eventually result in higher interest rates. At present our best guess for the first rate increase is in late-2015 or early-2016.

Lower oil prices have brought the headline inflation rate to its knees. This should persist in 2015 as long as crude oil and other commodities stay depressed. Meanwhile falling inflation expectations and the lack of any significant wage gains will continue to keep core inflation on a short leash. To put it simply, there continues to be too much excess labor and production capacity in the economy to meaningfully raise prices or wages.

Finally, stock market valuations began 2015 little changed from where they were one year ago as corporate earnings expanded in 2014 at a rate only slightly behind the rate of stock price increases. Valuations are still in the fair range; not cheap but not expensive. Adjusted for low interest rates and expected inflation many companies still trade at attractive valuations. All told, the climate as viewed through the lenses of the economy & corporate earnings, interest rates, inflation, and valuation looks positive for the year ahead.

Planners Corner

We feel very fortunate that our clients offer us an inside look into their hopes and dreams and find it extremely gratifying when, through our efforts, we help clients achieve clarity and comfort with their path forward.

In early 2012 we brought on a new client who was still bearing the emotional and financial scars of the 2008/2009 market crash. He was quite anxious and had a difficult time stepping away from the daily noise of the markets and dramatic pronouncements of market pundits. He believed he would never be financially secure enough to retire. Unfortunately his ongoing concerns were starting to adversely impact his health and consequently his quality of life.

As we do with many of our clients, we encouraged him to take advantage of our financial planning capabilities. We gathered data and used the insights from our conversations to model out his financial future which allowed him to see not only his current overall financial situation, but also gave him some clarity as to what his future may hold and how variables beyond his control such as investment rates of return, interest rates and inflation could alter the picture. We explored different retirement scenarios which allowed him to better understand his choices and their long-term impacts.

Although financial planning and forecasting cannot provide certainty the work we do does provide clarity and in this case gave our client the reassurance and confidence he needed to make the choice to retire. The effort also helped him be more at peace with his specific investments and overall asset allocation allowing him to step away from the

daily deluge of market commentary that had been negatively impacting his day to day life.

We have been pleased to see him enjoying retirement and spending time on those things that are most important to him. We still meet regularly to gather additional information, discuss what has changed and review the direction his life is heading. We also keep his plan current so should adverse events occur we can adjust course in a thoughtful and responsible manner.

Albion Updates

Until recently, the services of Albion Financial Group have been out of reach to many investors because our minimum required investment is \$1 million. In order to better accommodate your friends and family, Albion Portfolios has been developed to provide Albion's signature investment management service to individuals with investable assets greater than \$25,000.

Albion Portfolios is an investment solution with a human touch. Client portfolios are custom built to reflect individual financial goals and to acknowledge unique individual and family life factors (ability to tolerate risks, future cash flow needs, earnings potential, etc.) Albion Portfolios is not a formulaic or robotic solution. Rather, clients fully benefit from the experience and daily monitoring of Albion's in-house research and investment team.

Albion Portfolios is built for investors who would like to expand their net worth through regular contributions and long-term investment returns. It is an excellent solution for building financial asset investment accounts; it is also a great tool for rollover 401(k) balances for those transitioning employment. While this offering does not include comprehensive wealth advising, Albion Portfolios allows clients and the Albion team to begin a relationship that, in many cases, will evolve into a traditional, full-service relationship.

We encourage you to share the benefits of Albion Portfolios with whomever you think this service would be helpful. It is our honor to meet with those who are important to you.