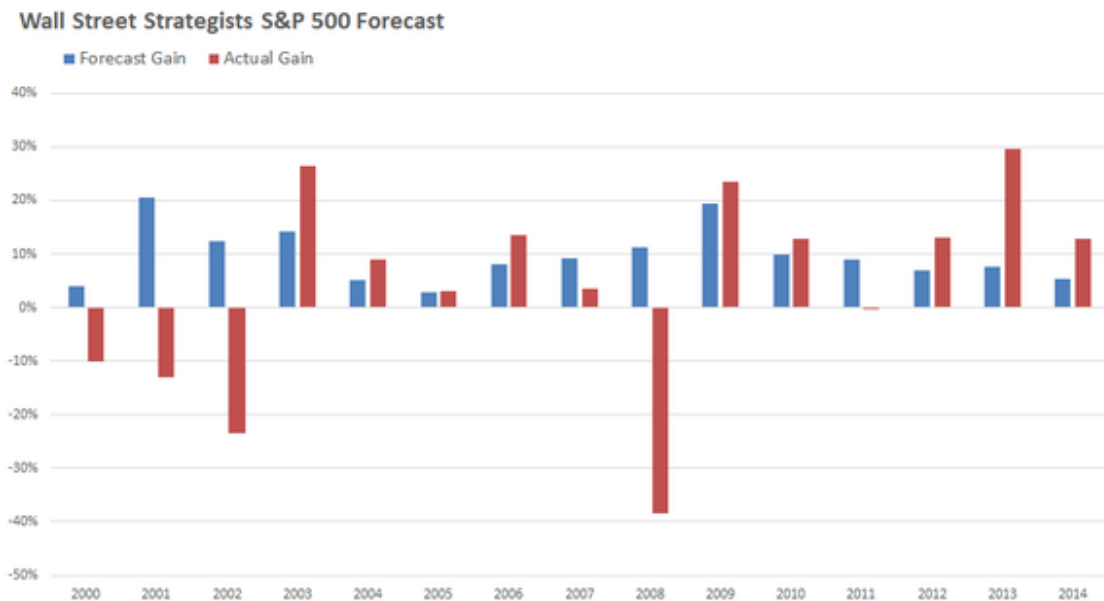


Fourth Quarter 2015

The Annual Forecast - An Exercise in Humility?

It's traditional for many financial professionals to begin the New Year with a forecast of expectations for the coming twelve months. While such predictions are thought provoking it turns out they are not particularly accurate. Morgan Housel of the Motley Fool website wrote an article last February analyzing fifteen years of year-end predictions of chief market strategists from the 22 biggest Wall Street banks and investment firms. The graph below illustrates the difference between aggregate forecasts and actual market returns for those years.



“We really can’t forecast all that well, and yet we pretend that we can, but we really can’t.”

– Alan Greenspan

The record of the best and brightest forecasters is poor yet we continue to gravitate toward such prognostications. Why? Perhaps because we like to

believe we can create order out of chaos - that there is reason and logic to everything. Mr. Housel goes on to make an analogy with physics. We want the financial markets to be predictable in the way classical physics is predictable; the apple falls from the tree and bonks us on the head because of the inviolable law of gravity. But markets are more analogous to quantum physics - a messy unpredictable science where the mere act of observing a phenomenon alters the outcome.

We recognize the difficulty of prediction. Rather we find the largest value is added by owning a portfolio of successful companies with strong and committed management teams that are likely to prosper regardless of the economic environment that comes their way.

"Prediction is very difficult, especially if it's about the future."

Niels Bohr

Planners Corner

Unanticipated Benefits of Holistic Financial Planning - (Or why it pays to have Albion remind you to keep your planning on track.)

We recently conversed with a client who - based on financial situation and long-term objectives - needs life insurance. With our urging they finally got off the mark and went through the underwriting process. All went smoothly until irregular cardiac results in the medical exam caused the insurance company to deny coverage. Our client followed up with a cardiologist who determined his left anterior descending artery was 90% blocked and shared that the blockage would lead to a stroke or heart attack. The client has since received treatment. It's not often that the financial planning process leads to dodging a terrible health outcome but when serendipity makes it so we celebrate!

"It is health that is real wealth and not pieces of gold and silver."

-Mahatma Gandhi

Economy and Markets

“The key to making a good forecast is not in limiting yourself to quantitative information.” - Nate Silver

A couple of things to understand with our forecast:

- 1) We are not rigid thinkers. As incoming data arrives, our outlook is subject to change - either at the margin or entirely.
- 2) This exercise is best used as a guidepost, a framework, for how we are currently looking at markets and opportunities. It is not to be taken as an exact science, nor is it wise to marry yourself to these concepts or figures.
- 3) Hopefully, when reading this section what you'll take away is a sense of the lens through which we are presently viewing the world and how this informs our approach toward portfolio management in 2016.

With that said, let's get to some forecasting!

The fourth quarter is in the books. The U.S. economy grew at about the contemporary trend of the last decade or so for the whole of 2015: A trajectory of approximately +2.25% GDP growth has been quite consistent throughout much of this economic expansion. And this pace - while certainly less robust than in past recoveries - has been enough to add jobs (nearly +14M from the recession nadir), trigger investment, and improve general levels of confidence and household spending. The result has been solid economic progress, including surging corporate profitability and consequently a strong stock market. Meanwhile, the Federal Reserve has remained tremendously accommodative to both the real economy and the financial markets, and inflation has been at most lukewarm. Over the medium-term we expect more of the same from the U.S. economy as we see little out there that is likely to alter the present flightpath.

How can we remain cautiously optimistic in light of current volatility, worries over China and potentially slower global growth? First, while numerical information is important and is something we monitor constantly, it doesn't always reveal the entire story. For example, as we write this letter oil prices are -70% off their highs some 18 months ago and a menu of other commodities have been thumped as well. The prevailing view among

forecasters has been wrong most of the way down. Now, these same seers are telling us that low commodity prices spell trouble for the global economy. They make a case for this by looking at subjective hard figures (i.e., price in this case): Lower prices must mean weak demand, right? And if true, such weak demand can't be good. We see it differently by looking past the commodity price decline to shape our views.

Demand for commodities hasn't changed much over the past couple of years. Folks are still driving, consuming, engaging in commerce. Businesses remain productive and the number of "widgets" produced is increasing. Labor markets and income - the lifeblood of demand - are salutary. All told we simply do not see a backdrop that fits the aggregate demand erosion thesis. Rather what makes more sense is that recent challenges in commodities markets are primarily a function of supply, not demand. Simply put, production growth of oil, gas, copper, zinc, wheat (etc.) over the years has outrun demand growth. Indeed, on a global basis companies made capital investments and contract commitments to mine, drill, and grow commodities for a world where China was going to grow at double-digit rates forever. This assessment was neither prudent nor probable. Add to this backdrop gains in technology, like fracking for oil & gas, and growth on the supply-side has been colossal.

Seven years into this global economic recovery the imbalance of supply and demand in commodities markets was bound to catch up to price. This is what has happened. And we don't view this as a harbinger of impending doom. Instead we see this as a period of adjustment to match a world where growth isn't +5 to +6% per year, but perhaps more like +3%. This is neither sudden nor disastrous. It's a natural process in which the American economy and American business can succeed. We recognize that this narrative is counter to what we see in a financial media that wants to draw attention to every tick. We see an environment where the U.S. economy is still expanding and most companies are still profitable. With that said, the "easy" gains have likely been made for the foreseeable future, equity correlations are lower, and investment selection is therefore increasingly important.

A quick note on the Fed: Our House call all year was for a +0.25% December rate hike to commence the normalization of monetary policy and on December 16th Yellen & Co. finally raised the Federal Funds rate. We think that the Yellen Fed will be slow, steady, and pragmatic in normalizing rates. This "lower for longer" narrative should be supportive to both the U.S. economy and the stock market. This slow tempo is even more likely now given recent volatility and growing anxiety.

On net, we contend that the underlying fundamentals for equities – the “four pillars” as we’ve outlined in the past – are unbroken and we remain cautiously positive.

Albion Updates

One of the great attributes of the Albion team is longevity. Many of us have been with Albion for not just years, but decades. However we do lose team members from time to time and after 15 years John Bergerson decided to move on from his role at Albion in pursuit of a new chapter in his life. We are sad to see him go, but wish him the best of luck with his future endeavors. There were a few other changes to the Albion family in 2015 as well. Danielle Gregory was promoted to the advisor role for our Wealth Builder program. Danielle, or Dani as she goes by around the office, joined Albion as part of the Associate Wealth Advisor Team in 2011. The newest addition to the Albion team is David Clark who joined us as an Associate Wealth Advisor in October of 2015. Before joining Albion, David worked as an Apple Genius. We are excited to have him onboard.