ALBION FINANCIAL GROUP

April 20th, 2018

At Albion, we guide clients to make a lifetime of good financial decisions. Good decisions start with a solid education. April is Financial Literacy Month and in the spirit of education, this edition of our quarterly letter will focus on different aspects of financial literacy. We'll take a high-level view of the state of financial literacy in the U.S. as well as a tool called Spent that can help us all gain some perspective about the challenging decisions many Americans make every day regarding where to allocate their limited dollars. As always, we will also provide some insight and education on the economy and markets and introduce a new member of the Albion Team, Scott Kellner, Operations Analyst.

We are all taking a deep breath at Albion now that Tax Day is behind us and looking forward to May flowers.

Sincerely,

The Albion Team

Financial Literacy – When is it Effective?

For the fourteenth year in a row April has been designated financial literacy month, a time when proclamations are issued, online self-help quizzes and tools are highlighted and we are encouraged to become more "literate" about our personal financial situations.

Financial security boils down to a few key tenets: Spend less than you earn, build a reserve fund for unexpected contingencies, avoid debt, and save and invest diligently for the future. Pretty simple, right? Why then do we have an ongoing crisis as families nationwide struggle with their finances? Turns out most financial struggles are not all about self-indulgence or an inability to resist temptation. The biggest cause of financial woes is medical debt.

According to the Kaiser Family Foundation 25% of U.S. adults struggle with medical bills - and it's not just the uninsured. Health care bills are the number one cause of personal bankruptcy filings and such debt impacts 40% of adults nationwide. Per the New York Times, in 2016 20% of Americans under age 65 with health insurance had trouble paying medical bills, of these 63% used most or all of their savings to pay down health care costs and 42% took on an additional job to pay the bills.

Most American households do not have the financial resilience to withstand a health care shock. A GoBankingRates survey indicated 69% of us have less than $1,000 in savings and 34% of us have no savings at all. These households struggle to come up with $500 to fix the car to get to work; never mind the thousands of dollars in bills even a minor health issue can create. And while several studies indicate personal finance high school and college level courses have no discernible impact on behavior there is plenty of room to be optimistic.

Two people were out for their morning walk when they noticed thousands of starfish washed up on the beach. One of them bent down picked one up, and threw it back in the ocean. "Why did you do that?" asked the friend. "You'll never make a difference."
"I made a difference for that one", he replied.

Guiding people to successful financial lives is a lot like throwing starfish back in the water. Programs that attempt to broadly create financial literacy and good financial behavior have a mixed record at best. However one on one advice - when the advice seeking individual or family is ready to accept it - has a great track record of making a positive difference.

812 East 2100 South, Salt Lake City, Utah 84106 | 801-487-3700 | info@albionfinancial.com | albionfinancial.com

"Just-in-Time" learning has a demonstrable positive impact. For example, when a new hire is schooled on the tax advantages and long-term wealth building potential of the company 401(k) as part of the onboarding process she is far more likely to participate in the plan. When a financial advisor works with a young couple to help them create a budget, improve their credit score, and build an emergency reserve in order to achieve their goal of home ownership the couple is receptive to changing behaviors.

While solving the health care challenge, the underemployment of many, and the skills gap between available careers and skillsets of job seekers is way beyond the scope of this missive, we can circle back to the basics of a successful financial life and can continue to look for "just in time" opportunities to share these lessons with our loved ones and anyone else willing to listen.

Spend less than you earn, build a reserve fund for unexpected contingencies, avoid debt, and save and invest diligently for the future.

Planners Corner

Most of us carry concerns and anxieties about our financial well-being but fortunately do not count worrying about where our next meal is coming from among them. While such a concern is one we hope none of you ever face, and further hope more and more families move out of such a situation, it can be insightful to get a little flavor of the financial decision process of those least fortunate among us. The Urban Ministries of Durham in Durham, North Carolina created an online game called Spent. It puts the player in the position of trying to make it through the month without running out of funds. If you are interested it can be found at playspent.org.

Economy & Markets

The first quarter of 2018 brought continued global economic strength yet stock markets around the world experienced increased volatility and in many cases a correction. The U.S. economy - thus far into 2018 – continues its years-long expansion. Principal measures of domestic economic health are positive with jobs, household spending, and business activity driving growth. Of note, quarter one was the first period where the Tax Cuts and Jobs act of 2017 were in full effect. So far the economic impact appears minimal, but the jury is still out on their ultimate effectiveness in boosting growth. We are in the camp that thinks, all things equal, these tax cuts will likely promote an ephemeral and mild stimulus to the economy at the expense of markedly increasing the federal debt. One thing is almost certain, however, and that's the increase in aggregate corporate profits that will result from dramatically slashing their tax payments to the U.S. Treasury.

Corporate profits continue to swell as broad-based profitability measures hit yet another record high in the most recent reporting period. For a variety of reasons the current pace of growth in the corporate bottom line is extraordinarily strong – a rate we haven't experienced since 2011. While we expect the earnings growth rate to taper we posit that it is this fundamental factor that has done much of the heavy lifting in the stock market over the past year. And while corporate tax cuts should provide an additional boost in 2018, core earnings *growth* is likely to moderate into the single-digits. Against this backdrop a market valuation at approximately 16.5 times earnings is compelling; the P/E multiple on the S&P 500 has recently drifted down as the stock market dipped into correction territory amid rising earnings. Again, this valuation level is fairly *attractive* in our view as long as the economy and profits charge ahead with modest inflation and low interest rates – all of which we presently anticipate.

It is a time-tested market truth that policy out of Washington D.C. can both giveth and taketh away. Recall the lift to business confidence and stocks in the fourth quarter on freshly passed tax cuts. This major development, coupled with the persistent removal of regulation, was cheered by investors. And yet what was once a tailwind for financial markets - the D.C. narrative - has quickly shifted to a headwind in the face of tariff and trade war risks. It is unclear where this talk of trade protectionism and tariffs will lead, but if it escalates and spirals out of control it will be harmful to U.S. and global economic output. To be sure, an unforced policy error here would be ill-advised.

For the past eighteen-months, the global economy has been in a rare harmonized upturn. As we've past stated, this is the first truly coordinated and sustained world increase in economic output in over a decade; undoubtedly a good thing for U.S. growth and corporate profitability. Perhaps the award for "most improved" should go to Europe as after years of deep economic, social, and political challenges a true recovery looks to be taking place. The strength of the recovery is such that the European Central Bank is preparing to begin winding down unconventional monetary stimulus, much like the U.S. Central Bank began doing in 2014. Meanwhile, other regions around the globe that make up the majority of worldwide production are seeing moderate-to-solid economic improvements.

As we anticipated, in March the Fed – now led by Chairman Jerome Powell – hiked their target rate an additional 0.25%, the sixth such hike since they began along the path of "normalization". Simultaneously, the Fed is reducing the size of their large balance sheet by allowing mature Treasury bonds to "run off" without replacing them. Our thinking has been that this behavior may cause longer yields to gradually rise, which we have in fact seen over the past many months as the 10-year Treasury yield approached 3%. Nonetheless interest rates remain quite low, especially in the context of history, and we expect Mr. Powell to maintain a gradual and thoughtful course toward interest rate normalization.

Despite all of the recent volatility – in both financial markets and Washington – we retain our optimistic tilt, and continue to regard owning great businesses through investment in equities as worthwhile.

Albion Community

Last quarter we introduced Albion's new team member, Brady Jeppsen. This quarter we are introducing another new member of our team, Scott Kellner. Scott joined Albion in the role of Operations Analyst in September 2017. He brings with him a passion for financial markets, data integrity, process improvement, and project management. Scott facilitates effective data management and reconciliation for all of our client accounts as well as contributes his efforts to calculating and presenting performance reports and investment portfolios.

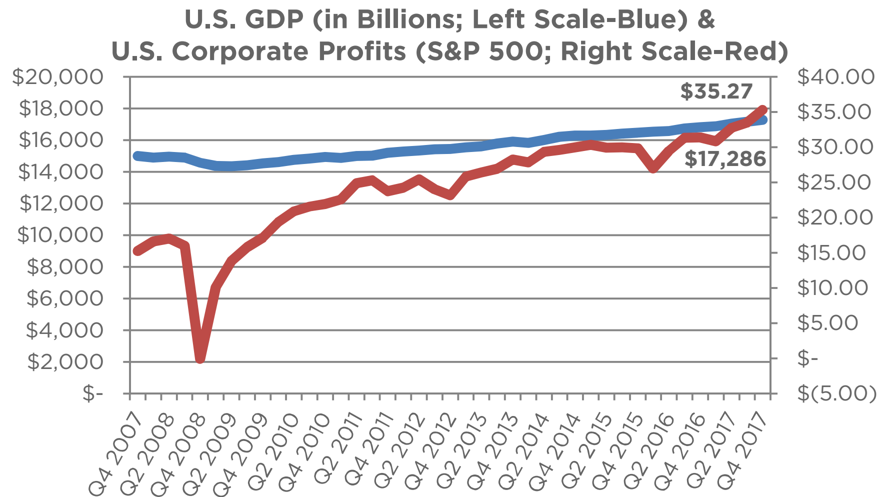
A lifelong learner, Scott was a finalist in the ACG Cup Case Competition, an investment banking competition, during his Master's in Business Administration studies at Westminster College. Scott also excelled in the Certified Financial Analyst Undergraduate Investment Research Challenge, an equity research competition, where he received a grant to sit for the CFA exam while still a college student.

Outside of the office Scott enjoys working at Promontory Country Club in Park City where he has been for the past 12 years. If he is not golfing or coaching lacrosse for Highland High School or local club True Lacrosse, you might catch Scott out on the slopes or studying finance.

Macroeconomic Highlights from the First Quarter

ALBION FINANCIAL GROUP

UNITED STATES GDP ANNUAL GROWTH RATE



Steady economic growth endures and S&P 500 corporate profits continue to swell. Broad-based earnings hit yet another record high in the most recent reporting period. The general economic data – output, labor market, private sector balance sheets, and sentiment – are conducive to a sturdy economy. With that said, fresh threats of protectionist trade policies, tit-for-tat tariffs, and the risk that all of this could escalate bear watching as it could have an impact on the economy.

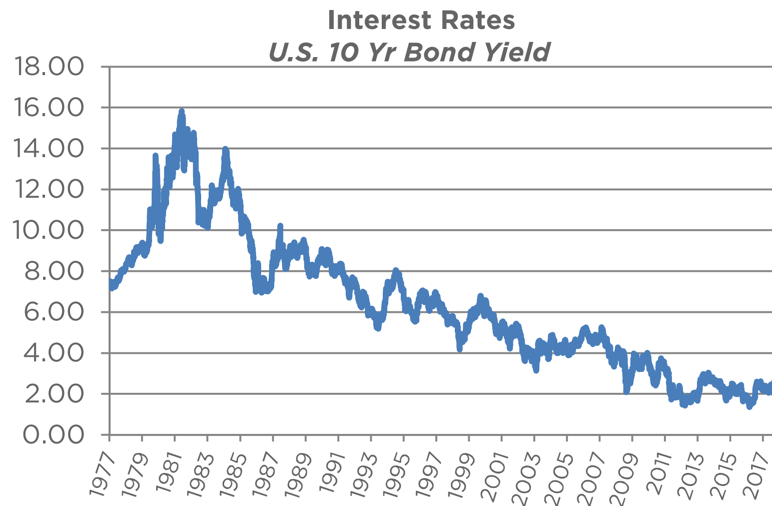
UNITED STATES INFLATION RATE

Using the Fed's preferred measure, inflation remains balanced with the most recent data showing a pace still below the Fed's 2% target. Additional measures like CPI have picked up some, while various other inflation-oriented information have begun to warrant closer attention. We continue to closely monitor the pace of inflation against the preponderance of data. On net, our opinion is that general price growth remains in check and shouldn't run 'hot' anytime soon.

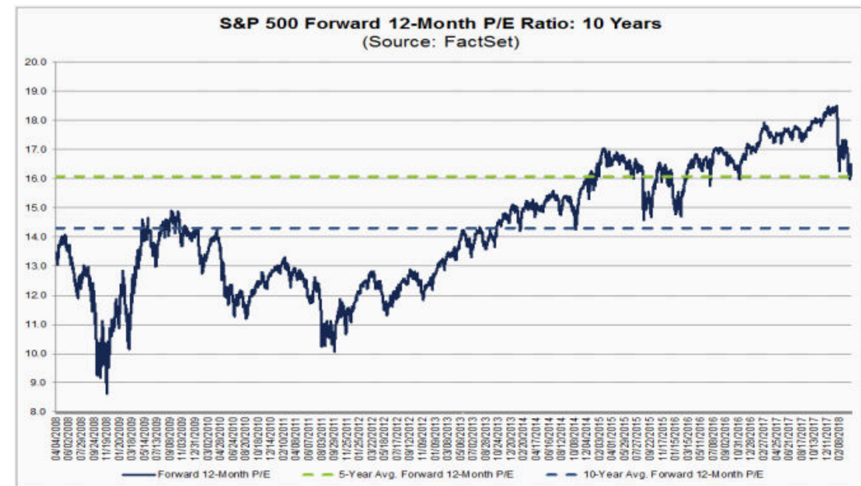
Macroeconomic Highlights from the First Quarter

ALBION FINANCIAL GROUP

UNITED STATES 10 YEAR TREASURY YIELD



FORWARD 12M P/E RATIO: 10 YEAR



In March the Fed – now led by chairman Jerome Powell – hiked their target rate an additional 0.25%, the sixth such hike since the Fed began down the path of policy "normalization." Simultaneously, the Fed continues to reduce the size of their large balance sheet by allowing mature Treasury bonds to "run off" without replacing them. Our thinking has been that this behavior may cause longer yields to gradually rise, which we have seen over the past few months as the 10-year Treasury approached 3%. Nonetheless interest rates remain quite low, especially in the context of history.

At about 16.5x forward earnings the P/E on the S&P 500 has recently come down as the stock market dipped into "correction" territory, while earnings continued to grow. This level is quite attractive in our view as long as the economy and earnings charge ahead, while modest inflation and low interest rates persist – all of which we currently anticipate.