

May 3rd, 2019

Spring is here! And, so is Albion's first letter of 2019. This quarter our President, John Bird, reflects on the impact FOMO (aka: the fear of missing out) can have on our better judgement. He does so through the lens of a book he recently read, [Bad Blood: Secrets and Lies in Silicon Valley](#). Our Chief Investment Officer, Jason Ware, shares Albion's investment views in **Economy & Markets** and in **Planners' Corner**, Senior Wealth Advisor, Liz Bernhard, highlights a tax strategy becoming more popular since the enactment of the Tax Cuts and Jobs Act. Lastly, we introduce the newest member of the Albion team, Paige Christensen.

Thank you for your continued trust in Albion.

Sincerely,

The Albion Team

From John Bird's Desk

The publication in 2018 of John Carreyrou's book [Bad Blood: Secrets and Lies in Silicon Valley](#), brings to mind two recurring themes pertinent to both investing and on a deeper and more important level human nature: Fear of missing out (FOMO) and how judgement is distorted when those perceived as elites are involved.

Bad Blood is an account of the meteoric rise and subsequent crash of Theranos, a company formed to bring comprehensive diagnostic blood tests to the masses at a price and speed orders of magnitude better than what was then available. Yet the company- which raised nine hundred million dollars and had a peak market capitalization of nine billion dollars - had one significant problem; the technology they were touting and selling did not exist.

This is an old story. Technology stocks at the turn of the last millennium, cryptocurrencies last year, the lure of Bernie Madoff. How does the siren song of possibility cause us to overcome our more rational instincts? One hypothesis for which there is ample evidence is FOMO. When the media is touting a trend and all of your friends and neighbors appear to be making money by jumping on the bandwagon it's hard to resist joining in.

Bad Blood also highlights how Elizabeth Holmes adroitly used her social network to attract attention, positive press, and ultimately raise a tremendous amount of money for a business plan based on nonexistent technology. With family and Stanford connections she built a network of funding boosters and a board of directors that included such luminaries as former Secretaries of States George Schultz and Henry Kissinger, former Senators Sam Nunn and Bill Frist, former military officers General James Mattis and Admiral Gary Roughhead, and former Wells Fargo CEO Richard Kovacevich. Remarkably no board members had expertise in the core businesses of the company; blood science and chemistry.

As notable names signed on positive press flourished enabling Holmes to bring even more notable names into the mix. Throughout this period there were a few people expressing doubts. But they were not in positions of power and were at best ignored and at worst threatened with legal action by Theranos attorneys. This speaks to the reality that we as humans tend to more readily believe those in visible positions of influence than those who we have never heard of.

Both of these trends are clearly related to investing behavior. We are all subject to fear of missing out and are at risk of making bad investment or financial decisions because we see friends, neighbors, or a TV personality apparently succeeding in investments we don't really understand. Yet the more people we see jumping on the theme, and the more elite those individuals are perceived to be, the more likely we will jump on right after them. And likely ride the trend right off a cliff.

Successful investing does entail accepting risk. Yet the risk should be rational – based on a sober assessment of its likely potential and pitfalls – not based on the heady belief that if others are doing it it must be ok. Our work at Albion never loses sight of this reality. We work to make sensible, rational decisions based on verifiable data to keep our clients on track toward what they want to accomplish in their lives. Does this mean we will miss a few rocket ship investments? Yes. But does it also mean we will miss massive potholes that could dramatically alter our clients' lives for the worse? Absolutely. We are confident this is a worthwhile trade off and we will continue to do our part to help each client live the best version of their life.

Economy & Markets

Despite fears of recession at the end of last year (in lock-step with a steep sell-off in stocks – imagine that!) the U.S. economic expansion, now in its 10th year, appears to retain a clean bill of health. Job and wage growth are sturdy, spending is strong, confidence is high, and companies are dynamic and fit. At the same time inflation appears neither too hot, nor too cold – a state that the fabled 'Goldilocks' could surely appreciate. In other words, economic conditions are little changed. But *little* is not the same as *nothing*. What *has* changed recently is the pace of corporate earnings growth. Regular readers of our quarterly letter will not be thrown by this statement, nor find it alarming. Indeed, over several quarters we have inscribed in these pages that a slowdown was due given the torrid and unsustainable earnings trajectory of the past 18-24 months ... that a regression to the historical mean resulting in a mid-to-upper single digit path was a practical expectation. And after a nearly +22% stride of profit growth in 2018, the quickest rate in about 8 years in part due to a large corporate tax cut, 2019 seemed like a fitting spot to log such a moderation. But let us be crystal clear: a reduction in the pace of growth is not the same thing as a decline in corporate profits. This is a distinction with a great difference, to which we reason that on balance the big picture looks fine from our perch.

Notwithstanding the hand-wringing around the purported “slowing global economy”, world growth is doing just fine thank you very much. Something on the order of 3% to 3.5% real (global) GDP growth should be more than ample in generating the all-important virtuous economic cycle that has

propelled us to new heights across so many financial measures a decade after the Great Recession ended. And while tensions around trade have not fully receded it does appear that, as expected, cooler heads will eventually triumph. Speaking of D.C. policymaking, the long and arduous government shutdown that gripped the nation in the first quarter ended not with a bang, but with a whimper. During that mess we noted that it would be ahistorical to view this or *any* government shutdown as a compelling reason to not be invested in stocks for the long-run. And after this latest round the running scorecard looks something like this: Stocks, 22 / Government Shutdowns, 0. Undefeated.

A moment ago I mentioned economic fundamentals are little changed since our last letter went out. This statement came with a caveat about slowing earnings growth. I suppose at this time I should mention one more noteworthy alteration – the Fed’s views on monetary policy. In December and immediately after their ninth rate hike (since 2015), Jerome Powell and his FOMC performed a sudden and significant pivot away from what felt like a near-automatic interest rate path higher towards a more patient and dovish character. Not that Jay has called seeking our counsel on such matters, but we believe that this is the correct policy choice given our grading of current economic conditions (i.e., modest growth and low inflation). Naturally, this development charmed the pants off the stock market. While we certainly don’t know what the Fed will do going forward, it does seem clear that at least for now they’re content on letting economic data drive policy decisions as opposed to fears stemming from some inflationary bogeyman as described by outdated economic

textbooks. A wise course correction and attitude adjustment, in our view.

After a swift and steep decline in stocks at the end of 2018, we summoned a dose of courage and called stocks “cheap” in our last quarterly letter. At a time when many were selling and most were bracing for stocks to fall further, our bold decree was certainly out of step with the herd. Stocks have since staged an impressive rally, again approaching new highs. We claim no edge in prediction. And we certainly don’t ascribe this occurrence to any special predictive powers. Rather it’s merely an example of a humble observation when we surveyed the landscape and considered the available evidence at the time. A landscape where stocks had dropped substantially at the end of 2018 and yet corresponding fundamentals had not.

As we go forward, we will continue to rely upon our favored *‘four pillars’* framework of *economy & earnings growth, inflation, Interest rates, and valuation* to inform us as to present condition for stocks. As we stated when the calendar flipped from 2018 to 2019, save for a sudden economic recession (which we don’t presently anticipate), we think stocks can ultimately endure inherent volatility borne from what’s typically little more than changing market narratives. To be sure prices can and will decouple from fundamentals from time to time. But don’t lose sight of the simple truth that more often than not the factor that creates this chasm is investor psychology and the general mood of the crowd; not a deterioration of economic progress. We recognize this and therefore do not attempt to forecast these whims. As the late great Jack Bogel once said, *“the stock market can be a giant*

distraction from the business of investing.” We agree. So instead we consider the *four pillars* an objective and composed examination of the components that routinely inform market returns over time. As of this writing, things here continue to look pretty good.

Consequently, and as you hear us preach frequently, our core philosophy of finding and owning slices of great American *businesses* via long-term investment in stocks is a smart proposition when endeavoring to grow wealth in the years to come.

Planners' Corner

In our last quarterly letter we discussed the benefits of Donor Advised Funds as a tool for charitable contributions. Another charitable donation strategy that has become more popular since the Tax Cuts and Jobs Act (TCJA) is donating directly to a charity from an IRA. With the increased standard deduction (\$12,000 for single filers and \$24,000 for married filing jointly) the Joint Committee on Taxation estimates that the number of filers who itemize deductions will fall from 46.5 million to just over 18 million. If you are one of the close to 30 million taxpayers who will now take the standard deduction instead of itemizing you have lost the tax benefit associated with your charitable contributions.

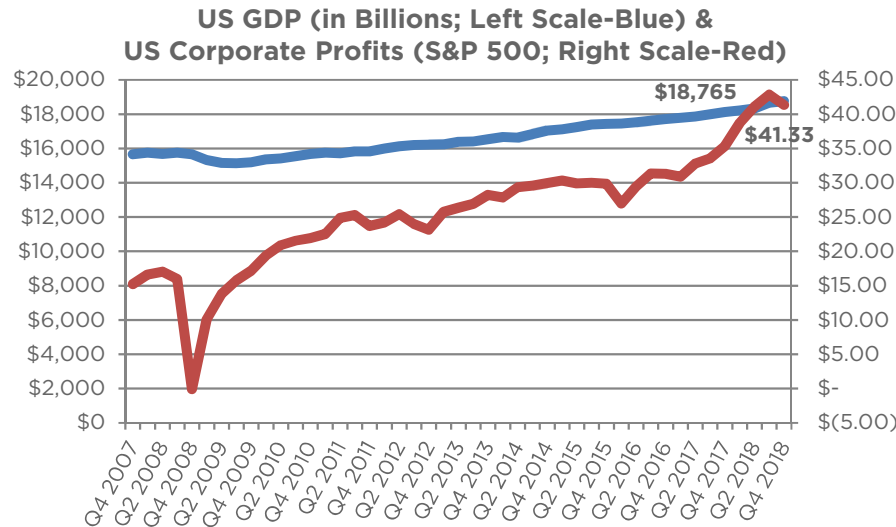
But wait! For taxpayers who have an IRA and are subject to required minimum distributions one option to consider is gifting to charities directly from your IRA. This strategy,

known as a Qualified Charitable Distribution (QCD), allows you to still receive a tax benefit from your charitable donation by eliminating some of your required minimum distribution income from your tax return. Giving a portion of your required IRA distribution to a charitable organization (a registered 501c3) eliminates income in the amount of the charitable gift (up to \$100,000 per person). Essentially this strategy is more valuable from a tax reduction standpoint than itemizing your charitable donations as it provides a dollar-for-dollar offset of above-the-line income versus below-the-line itemized deductions. The charitable donation must come directly from an IRA - it cannot first go through another account such as checking or savings held at a bank. If you are interested in learning more about this strategy, please contact us.

Albion Community

We welcomed Paige Christensen to the Albion team in March. Paige came to Albion after eight years at Morgan Stanley where she worked as part of their Tax Operations team. Paige has joined Albion in the role of Associate Wealth Advisor and is working closely with Senior Wealth Advisors Michelle Buxton and Debbie Knotts. Paige has three teenage boys who keep her busy and active, but she still finds time to road bike with her friends on the weekend.

UNITED STATES GDP ANNUAL GROWTH RATE



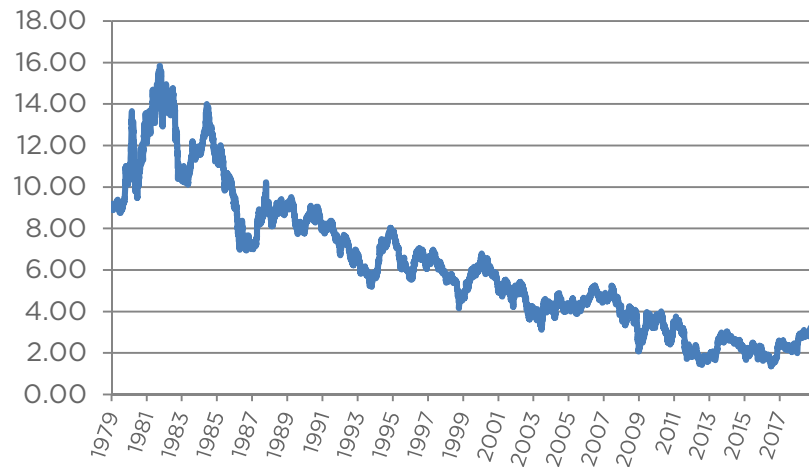
UNITED STATES INFLATION RATE



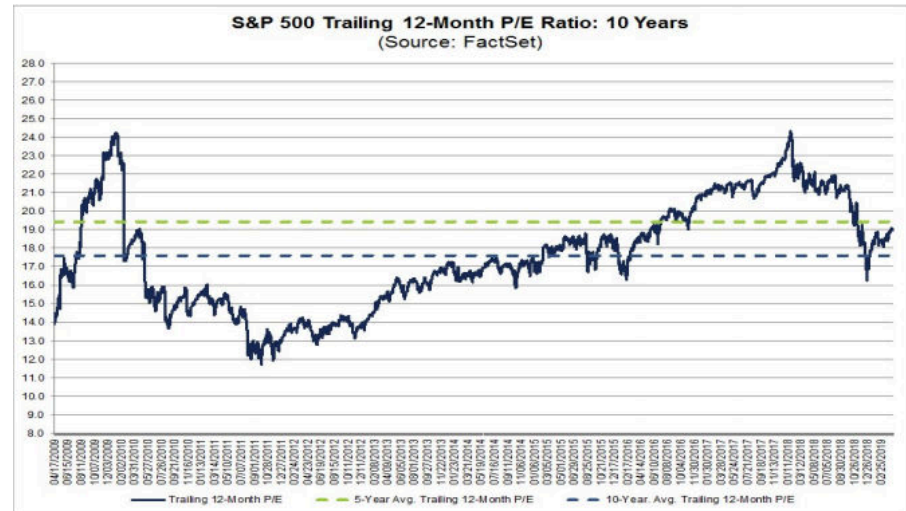
Recent U.S. economic data continues to show a solid, well-balanced economy. That said a “slowdown” in 2019 is possible after the near 3% real GDP growth experienced in 2018, fueled primarily by a large tax cut. As we’ve stated previously, any boost here will probably be short-lived. The trend in this cycle of 2% to 2.5% real GDP growth is a practical baseline given underlying structural economic forces. But this shouldn’t be cause for alarm; it’s a sturdy enough growth rate to create jobs, support wages, consumption and confidence all while keeping inflation at bay. Trade tensions with China still loom. But we endure in our belief that ultimately this will get resolved with limited economic damage.

Using the Fed’s preferred measure core inflation remains in-check with the most recent data showing a pace just below the Fed’s 2% target. Additional measures like CPI and “5-year, 5-year forward” data also reflect stable, modest price growth. We continue to carefully monitor the pace of inflation. For now, our view remains that inflation is unlikely to run ‘hot’ anytime soon.

UNITED STATES 10 YEAR TREASURY YIELD



TRAILING 12M P/E RATIO: 10 YEAR



In December and immediately after their ninth rate hike (since 2015), Jerome Powell and his FOMC performed a sudden and significant pivot away from what felt like a near-automatic interest rate path higher towards a more patient and dovish character. While we certainly don't know what the Fed will do going forward, it does seem clear that at least for now they're content on letting economic data drive policy decisions as opposed to fears stemming from some inflationary bogeyman as described by outdated economic textbooks. U.S. 10-year Treasury rates have fallen over the past couple of quarters in part due to this change in tone. Indeed, interest rates remain low, particularly in real terms, which should be a positive for both stocks and the economy.

After a swift and steep decline in stocks at the end of 2018, we summoned a dose of courage and called the market "cheap" in our last quarterly assessment. At the nadir that sell-off had left the S&P 500 priced at just ~14x earnings, the lowest valuation since mid-2013 and below both the 5- and 10-year average. At a time when many were selling and most were bracing for stocks to fall further, our bold decree was certainly out of step with the herd. Stocks have since staged an impressive rally, again approaching new highs. At current levels we reason that the P/E on the stock market is neither expensive nor unusually cheap relative to the above-described fundamentals - a satisfactory position that does not have us nervous.