

July 30, 2019

In this quarter letter, our President, John Bird, highlights a recent Atlantic Monthly article on the reality of forecasting. As Warren Buffett said, “Forecasts tell you a great deal about the forecaster; they tell you nothing about the future.” Our Chief Investment Officer, Jason Ware, shares Albion’s investment views in Economy & Markets and in Planners’ Corner, Senior Wealth Advisor, Liz Bernhard explains estimated tax payments and who needs to make them. Lastly, we introduce several new members of the Albion team.

Thank you for your continued trust in Albion. Stay cool out there. We hit triple digits on the thermometer in Salt Lake this week.

Sincerely,

The Albion Team

### From John Bird's Desk

*Keep an open mind. Seek other opinions. Don't get caught up in your own expertise.*

*Use credible fact checkers.*

For nearly four decades we have tracked the forecasts and projections of financial market experts; an effort that has made clear that focused expertise does not necessarily lead to superior insights about the future.

A recent article by David Epstein in the Atlantic Monthly explores why experts have such a challenge forecasting the future. His article focuses on the work of Philip Tetlock, a Wharton professor who has spent well over thirty years working to understand why experts are such poor forecasters and, perhaps of greater importance, looking for better ways to predict the future. Key insights Tetlock has uncovered include:

- Many well-known pundits are hard pressed to do better than chance
- Forecasting pundits are overconfident
- Forecasting pundits are reluctant to change their minds in response to new evidence

Further, Tetlock has been impressed by how little interest the public has for holding experts accountable for their wildly inaccurate projections.

As he pushed further into the issue in an effort to find a better way he uncovered a valuable insight; groups of generalists forecast far more accurately than independent specialists. Tetlock began referring to specialists as hedgehogs and generalists as foxes. The hedgehogs have detailed, deep, and specific expertise in a subject area while the foxes have shallower but broader expertise across a number of fields. Further, the foxes are flexible and readily admit when their projections have not panned out and will change their perspective based on new information while hedgehogs tend to focus on information that continues to support their existing worldview and undervalue, discredit, or discard

information that runs counter to their view. They typically double down on their previous forecasts.

In discussions hedgehogs give no ground. They will support their thesis with reams of data, regardless of how inaccurate their forecasts have been in the past. They will bury you with information in an effort to ensure their point of view wins the day. Foxes, on the other hand, use discussions as opportunities to learn. They collaborate with others and when their hypothesis is not leading to the expected outcome will look for insights into how they went wrong rather than hunting for the data that convinces them they are right.

There are myriad voices purporting to offer clear and certain guidance to investors with regard to where interest rates, inflation, corporate earnings, and financial markets are heading with their views often sensibly backed with detailed information. And while these forecasts are usually way off the mark the experts will double down in support of their position.

Plenty of financial market experts have been bearish since the Great Recession of 2008-2009. Their data is good. Their conclusion is not. They, and their clients, missed out on an incredibly strong bull market.

As investors we are better served to take a less dogmatic and more nuanced view toward market projections. It's critical to question deeply held beliefs and welcome information contradicting current thinking. Finally, regularly reassess, with a critical eye, whether outcomes are anywhere close to expectations. If so, why? If not, why? Work hard to be a fox.

*Hold your convictions... lightly.*

### Economy & Markets

As we have anticipated and shared in our prior quarterly missives, the U.S. economy in 2019 (thus far) continues to do just fine. Despite recent talk of recession the economic expansion, now officially 10 years old, endures in the face of never-ending skepticism and discomfort. Nevertheless objective measures across jobs, aggregate spending and confidence, credit markets, and Leading Economic Indicators all suggest placid economic conditions. Meanwhile inflation appears to have somehow backed off these days in the face of rising wages and a trade war – an economic mystery that even Robert Stack himself likely couldn't have helped with. It will not surprise regular readers of our quarterly letter that corporate earnings over the past couple of quarters have slowed. Indeed, we have routinely inscribed within these pages that a slowdown was inevitable given the scorching yet unsustainable earnings trajectory of the past 18 months. 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 see such a moderation. But let us be clear once again: 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 bigger picture looks fine.

Likewise, you'll forgive us if we \*roll our eyes\* just a little bit at the alarmists view of happenings overseas. Real global economic growth is on track to be around 3.0% for 2019. Not incredible, but certainly not bad. We prefer to think of it as well balanced. While it is likely too early to make any concrete conclusions on the economic impacts of the trade war with

China (and various skirmishes with other countries), we feel quite confident in saying that 3.0% number would probably be 3.5% or better without such unfortunate and self-inflicted distractions. We sound like a broken record, but our view continues to be that this trade war will eventually work itself out without major calamity. More of a slow burn (with political soundbites) than a spectacular explosion.

Probably the biggest change since our last letter has been the Fed. We could fill up the entire page with new developments and discussion about what Jerome Powell and his band of economists on the Federal Open Market Committee (FOMC) are up to these days. But we won't put you through that. Instead, we'll simply say that the "Fed pivot" we began discussing earlier this year – the idea that in rather sudden fashion the Fed went from an almost auto-tightening stance to being quite dovish – has taken shape at a quicker pace than we anticipated. This has helped send bond yields lower, especially at the short-end of the curve, and stocks higher. Putting it as succinctly as possible – the Fed stands ready to support the economic expansion as needed and seems more attune to the potential "downside risks" present in the economy. Or, as Powell recently stated in his semi-annual testimony to Congress (edited for brevity): "The Fed will act as appropriate to sustain the recovery, crosscurrents have emerged, and weak inflation could be more persistent." (Recall on inflation, just a couple of months ago Powell called it "transitory"). Translation ... expect a rate cut soon. Perhaps as early as the end of July. Wait! What? So soon? I suppose the late, great Prince would have told us that "this is what it sounds like when doves cry."

In the time since we called the market "cheap" at the end of 2018 stocks have embarked on an impressive rally recently hitting new highs. Given this run it's much harder to argue that they remain cheap, but we do reason that they are not "expensive" either. To wit, as of this writing the S&P 500 trades at -16.2x expected earnings in 2020. This is right around the 5-year mean, and just above its 10-year (~15x). And when you consider that bond yields and inflation have fallen yet again, this furthers the case that stocks are not expensive in today's environment.

As always, we continue to rely upon our 'four pillars' framework of economy & earnings growth, inflation, interest rates, and valuation to inform us as to present conditions for stocks. Save for a looming economic recession (which we don't presently expect) we think stocks can endure innate volatility borne from what's typically little more than changing market mood. Keep in mind that every so often prices can and will decouple from fundamentals. But don't lose sight of the simple truth that the reason for this crevasse is investor psychology and the general sentiment of the crowd; not a deterioration of economic progress. We recognize this and therefore do not attempt to predict these whims. As of this writing, things across all four pillars continue to look pretty good.

Accordingly, our core philosophy of finding and owning slices of wonderful American businesses via long-term investment in stocks is a smart strategy when endeavoring to grow wealth in the years to come.

### Planners' Corner

As we listed in the Reminders section of this report, September 16th is the deadline for paying third quarter estimated tax payments. But what are estimated tax payments? Who needs to make them? And why? For individuals, estimated tax is a way to pay tax on income that isn't subject to withholding. Regardless of how your income is earned (i.e. employment wages, investment income or retirement benefits) the IRS requires income tax to be paid as you earn/receive income throughout the year. For most people, withholding taxes from their paycheck is sufficient. However, we do recommend reviewing your withholding elections due to recent tax changes. For more info go to <https://www.irs.gov/individuals/irs-withholding-calculator>. If you have income from other sources or, if you are not withholding enough from your paychecks, you may be subject to estimated tax payments.

If you expect to owe at least \$1,000 in tax (2019) and you expect your withholding to be less than 90% of the tax you will owe in the current year or less than 100% of the tax you owed last year, you must pay estimated tax payments to the IRS. You can pay all of your estimated tax by the annual tax filing deadline (i.e. April 15th), you can make four equal payments per the IRS schedule, or, if your income is uneven throughout the year, you may be able to lower or eliminate your required estimated tax payment for one or more periods. The idea is to match your tax payments to the timing of your income earned so you are paying in throughout the year

instead of one payment in April. If your payments are late or you don't pay enough, you may be charged an underpayment penalty.

There are special rules for farmers, fishermen, certain household employers and certain higher income taxpayers.

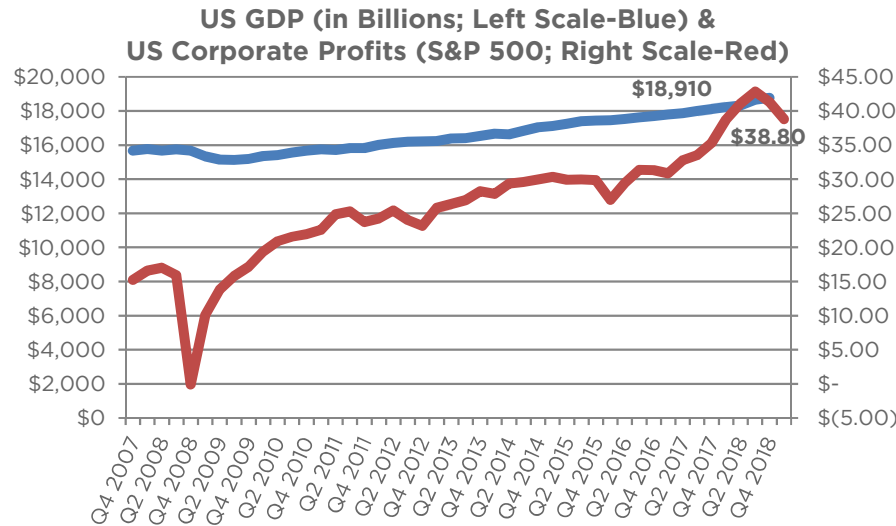
Estimated tax payments for states vary. Utah does not require estimated tax payments for individual tax payers.

Please note that Albion does not provide professional tax advice and defers to CPAs and other tax professionals. However, we do help clients with estimated tax payments. Please give us a call if you have any questions.

### Albion Community

Albion is growing! We recently welcomed Natalie St. Denis, Patrick Lundergran, Mike Kessler and Jennifer Swindler to our team. Natalie joined Albion in May of this year and is working closely with our Senior Wealth Advisor, Liz Bernhard, in the Associated Wealth Advisor role. Patrick joined the team in July and is also working closely with Liz in the Financial Planner role. Mike is the newest addition to Albion's investment team. He started in June in the role of Portfolio Manager. Jennifer also joined the team in June and is working closely with our Senior Wealth Advisor, Debbie Knotts, in a dual role of Associate Wealth Advisor and Financial Planner.

## UNITED STATES GDP ANNUAL GROWTH RATE



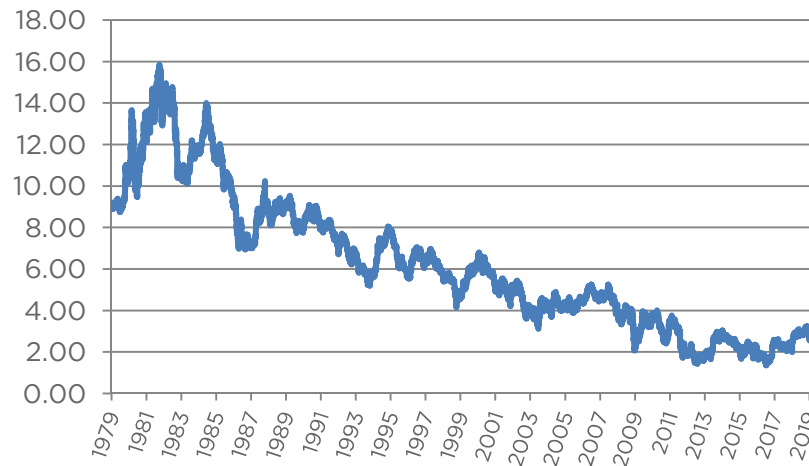
## UNITED STATES INFLATION RATE



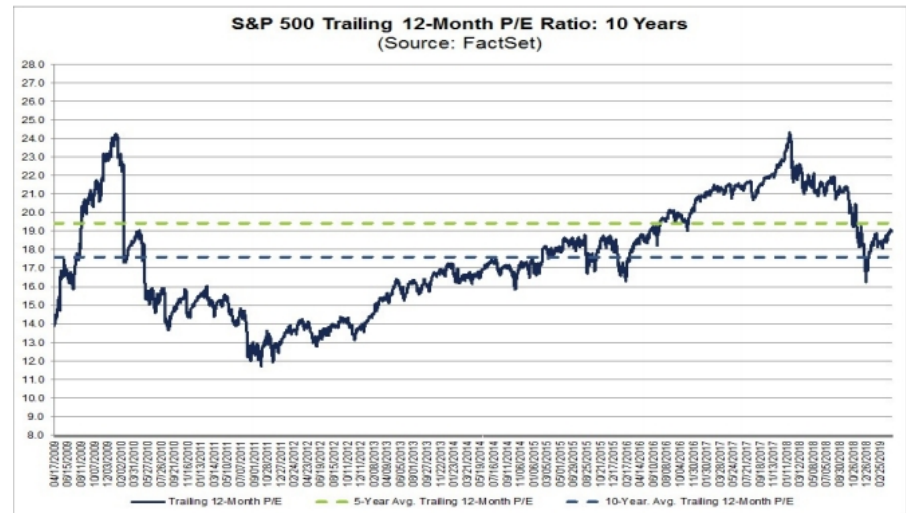
Recent U.S. economic data continues to show a solid, well-balanced economy. That said a “slowdown” in 2019 is possible after the near 3% real GDP growth experienced in 2018, fueled primarily by a large tax cut. As we’ve stated previously, any boost here will probably be short-lived. The trend in this 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, though weaker as of late, with the most recent data showing a pace below the Fed’s 2% target. Additional measures like CPI and “5-year, 5-year forward” data also reflect steady, yet marginally slowing 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. And this view has been especially borne out in recent data.

## UNITED STATES 10 YEAR TREASURY YIELD



## TRAILING 12M P/E RATIO: 10 YEAR



Probably the biggest change since last quarter has been the Fed and interest rates. The “Fed pivot” we began discussing earlier this year – this idea that in rather sudden fashion the Fed went from an almost auto-tightening stance to being quite dovish – has taken shape at a quicker pace than we anticipated. This has helped send bond yields lower, especially at the short-end of the curve. Putting it as succinctly as possible – the Fed now stands ready to support the economic expansion as needed and seems more attune to the potential “downside risks” present in the economy. Indeed, interest rates remain low, particularly in real terms, which should be a positive for both stocks and the economy.

In the time since we called the market “cheap” at the end of 2018 stocks have embarked on an impressive rally recently hitting new highs. Given this run it’s much harder to argue that they remain cheap, but we do reason that they are not “expensive” either. To wit, as of this writing the S&P 500 trades at ~16.2x expected earnings in 2020. This is right around the 5-year mean, and just above its 10-year (~15x). And when you consider that bond yields and inflation have fallen yet again, this furthers the case that stocks are not expensive in today’s environment.