

August 6th, 2020

August will mark the 6th month point (half a year!) since the coronavirus significantly changed our world. Have you adjusted? In *From John Bird's Desk*, our President and CEO highlights the quarantine fatigue that is hitting the nation and why Wall Street seems evermore divergent from Main Street. As we dive further into the *Economy and Markets*, our CIO, Jason Ware, reminds us that Wall Street cares more about “whether things are *getting better or worse* as opposed to the *absolutes of good and bad*.” In *Planners' Corner*, Senior Wealth Advisors Liz Bernhard and Dani Gregory address the question, “Should I refinance?” And in *Albion Community*, we say goodbye to an Albion legend, Eleanor Sasaki who retired in July after 20 years.

From John Bird's Desk

Every Monday my schedule pops up with an “event” which is not actually an event; it's a reminder of how many weeks ago we had a coronavirus inspired mad dash to transition to remote working. Of course, we were not alone. Across the country and globe individuals, families, communities, and businesses have to a greater or lesser degree adjusted their routines to reflect our current reality.

Today we are beginning week eighteen. It feels normal now. The extraordinary becomes the ordinary. The capacity to adapt is remarkable. Yet it is anything but normal. Fiscal and monetary policy kicked into high gear to keep the economy, companies, families, and individuals afloat to buy us time. Social distancing: Avoiding large gatherings, keeping at least six feet away from others, wearing a mask, and of course washing our hands constantly, is being exercised – to greater and lesser degrees – to attempt to keep infection rates low and also buy us time.

Time for what? To develop therapies to treat those afflicted and develop an effective vaccine to keep us from becoming afflicted in the first place. Progress on vaccines is nothing short of extraordinary. The avenues of scientific exploration and the speed at which learning is happening is unprecedented.

And yet, understandably, we are impatient. Enough already of the pandemic. The new normal is not normal and we want to get out, socialize, get back to work, and return to our pre-pandemic lives. We are finished with it.

Unfortunately, the virus doesn't know or care that we've had enough. The virus is doing what all successful viruses do – transmitting in any way possible to new hosts to further its own replication. It will keep doing so as long as there are potential new hosts at hand. And we stop it by eliminating potential new hosts – through social distancing in the near-term and a vaccine longer-term.

Through this the financial markets have been far more resilient than a quick review of the headlines would suggest. With record unemployment, a clear recession, expanding Covid-19 case counts, and horrible federal deficits how can this be? Not to mention the social unrest our nation is experiencing.

Three factors account for current financial market strength.

Market participants tend to be forward looking. What are the trends? What will next month, next quarter, and next year look like? What the market sees is no reduction in human innovation across a range of products and services coupled with the consumer's desire to take advantage of these new products and services. The market is pricing in its best estimate of the future, not the circumstances of today.

Federal support, through monetary and fiscal policy, has been massive and unprecedented. The Treasury and Federal Reserve have pumped trillions of dollars into the system to support the bond markets, becoming the buyer of last resort for all manner of debt securities from U.S Treasury bonds to corporate debt. Congress has provided fiscal support through a variety of stimulus measures from the PPP to improved unemployment insurance.

And finally, with interest rates near or even below zero, where else is an investor to put funds? Lack of good alternatives has helped fuel equity markets.

We are all engaged in our new normal while efforts are being made every minute of every day to crack the coronavirus puzzle and get us back to our old normal. While we cannot know with certainty where the financial markets will be next week, next month, or next quarter we do know the innovation engine is alive and well – both in an effort to mitigate the coronavirus and in creating new products and services to allow us to coexist with it. That said, I'm sure we all look forward to returning to the old normal. I know I do.

Economy & Markets

In our last quarterly letter we discussed how quickly things can change. The world went from a good economy to recession in a matter of weeks, driven by a global pandemic that nobody predicted. The dark days in February, March and April left us with many more questions than answers. These were not minor questions, but rather some of the most important, consequential questions in modern times. What is the novel coronavirus? How quickly will it spread? How deadly is it? How will we fight it? What will its impact be on society? Our health? The economy? Our jobs? Livelihoods? Investments? What could possibly be done to get us through

this? These were all profound unknowns. Given the gravity of the situation and the abyss that we were staring into, financial markets became unhinged. We all have vivid memories of the tumult in stocks that began in February running through the lows on March 23rd. It was the fastest bear market on record as the S&P 500 fell over -35% in little more than three weeks. The economy looked to be falling apart as well. Perhaps worse yet, it felt like our health care system – the very infrastructure we rely on to keep us strong – was also cracking. These were truly unprecedented stretches that tested our collective mettle.

Fast forward many months and the balance between questions and answers has shifted some. What was once all questions with virtually no answers gradually improved into (still) numerous questions but with significant progress toward finding and implementing solutions. In other words, a once pitch-black cold landscape began to feel the sun's warm light peaking over the horizon. This new dawn set off a strong rally in stocks as the market began to look toward the future, instead of being mired down in the daily heap of awful, sometimes unspeakable headlines. What it saw was a reopening of commerce (albeit in a measured way); a Federal Reserve providing trillions in support; a mass mobilization of fiscal spending from Congress not seen since WWII; and perhaps most important a global scientific community – both in the public and private sectors – working around the clock to battle this virus.

In addition, there is this pesky little quirk ever present in investing that goes something like this: markets care more about whether things are *getting better or worse* as opposed to the *absolutes of good and bad*. In the first quarter, things were clearly getting worse. In the second quarter however, while we are certainly not out of the woods yet, things unquestionably got better. This, along with the colossal

monetary and fiscal policy support fueled what appears to be a new bull market with stocks gaining approximately +20% in the April thru June period (up even more off the 3/23 lows). As quickly as it went, it came back. History teaches us that this fairly symmetrical pattern – fast downs, followed by fast ups – is not atypical. Another truth in financial markets are its highly adaptive qualities. That is, a sudden shock from complacency is acutely felt. But overtime a crisis' ability to shock wears off as people become desensitized to developments. It shapes our new normal. Investor expectations are recast. We recalibrate our world view. This adaptivity resets the bar allowing for incoming information to eventually best our now more muted outlook. From these ashes new upcycles are often born.

Where we go from here over the *short run* depends on developments across several fronts, most importantly the virus. It appears that the national appetite for another mass economic shutdown is low. Consequently, the economy should have seen its nadir back in April. So too does it seem clear that the Fed is now on a steady course regarding monetary policy. Zero interest rates and extreme accommodation will be around for the foreseeable future. Meanwhile Congress, while bogged down in the muck of politics, has already made a massive down payment on America's future to the tune of ~15% of GDP with the 'CARES Act' and other spending programs rendering them unlikely to suddenly stop providing support before we cross the goal line (though the size / potency of future packages may be lessened). Besides, the Beltway never passes on a chance to spend more money. It is our view that the severity of this predicament absolutely requires that they call on such tendencies.

That leaves our battle against the virus. Some regions have done a better job than others at managing the spread of

infection. China and Europe versus Brazil and the U.S. spring to mind as contrasting strategies with equally contrasting results. Indeed, after briefly flattening the curve here at home we have since allowed cases to jump to new highs this summer. Though, as I write this, the rising trendline may be hitting exhaustion. Likely the result of a growing inclination toward "universal masking" and fresh restrictions in the new epicenters of spread. Only time compounded by our shared actions will reveal where this all goes from here. But the goal is the same for everybody – buy time until we reach an effective vaccine. The news here has been good ... almost a little *too good*. It seems that just about every card we flip over in the deck has been promising. Be it in the remarkable developments made in innovative mRNA vaccine platforms among companies such as Moderna and Pfizer; adenovirus vector platforms championed by AstraZeneca and Oxford, or Johnson & Johnson; live attenuated virus approaches like at the University of Melbourne; or even Novavax's profusion protein made using its proprietary nanoparticle DNA technology grown inside insect cell cultures, the data here has been favorable. And with twenty-three SARS-CoV-2 vaccines currently in human trials (plus dozens more in the pre-clinical phase) the odds of one or more hitting are quite good. There are many shots on goal, some of which are now entering Phase 3 large scale efficacy trials, and we are encouraged by some of the smartest minds in the world together working to solve this problem. Faster than we ever have before. It is the great race to save humanity from a pandemic of likes not seen in over 100 years. Our work is not done. But we believe science and the human spirit will ultimately prevail.

So, what are the specific portfolio implications from all the above? Two things primarily. First, as is core to our philosophy it is critical to both focus on and finetune the asset allocation. The appropriate mix of stocks, bonds and cash for your goals and risk profile. This is something we constantly

endeavor with you to get right. The fruits of this work often pay most handsomely in challenging market environments. Second, the composition of your investments matter. Know that the securities contained within your portfolio(s) are of high quality and well vetted. These are great American businesses, thoughtfully diversified, that we believe will endure over the longer run. We are proud of how these companies – owned both through direct investment into their stocks and / or via the ETFs that own them – have conducted themselves in what’s been arguably the most difficult environment not just for stocks, but life in general over the past eight decades. We are hopeful that the coming months and years look bright. The economy should heal over time. Interest rates and inflation are low. Valuation is OK, primarily a function of those prior two variables but also endorsed by a recovery that’s likely to find its legs before long. We will beat this virus. Our plan is to continue to find and own great businesses on your behalf along this journey. We value your trust in us more than you know.

Planners’ Corner

Should I refinance?

Mortgage rates are at historic lows. According to Bankrate, the national benchmark rate for a 30-year fixed refinance mortgage is 3.250% and a 15-year fixed refinance mortgage is 2.77% (it is worth noting that rates for refinancing tend to be a bit higher than for purchases). Many clients are wondering if they should refinance and it seems like the answer should be, “yes,” however, not unlike many financial planning questions we address, the real answer is, “it depends.”

The two major drivers for refinancing are lowering your monthly payment and reducing the term of your loan.

Refinancing at a lower rate will reduce your monthly payment. But, it may not reduce the total payment you make over the life of your loan. One of the most determinate variables in the refinancing equation is how long you’ve had your current mortgage.

For example, we had a client looking to refinance a few months ago. They were 10 years into a 30-year fixed mortgage at 4.375% and were looking to refinance into a new 30-year fixed loan at 3.5%. Sounds like a good move, right? Well, it depends on the goal. Their monthly payment would drop by \$400, but they would actually end up paying an additional \$15,000 over the life of the loan. Why? Because more of the monthly payment goes towards interest in the early years of a mortgage. When you refinance, you restart the interest clock. In our client’s example, if they continued paying on their current loan at 4.375%, they would pay a total of \$128,000 in interest over the life of the loan. If they refinanced at 3.5%, they would end up paying \$143,000 in interest. For simplicity sake we are not accounting for closing costs, but they do have an impact on the refinancing decision as well.

Based on our calculations, the client would have to refinance at 2.9%, more than one percent lower than their current rate, to come out ahead on total payments.

Refinancing at a lower rate while keeping your monthly payments the same is one way to shorten the term of your loan which can be a good option if the goal is to have the loan paid off in a certain amount time (i.e., retirement).

So, should you refinance? Again, the answer is, “it depends.” How long have you been paying on your current mortgage? If you haven’t had your current mortgage for very

long, a refinance is likely more compelling. How much lower will the rate be? Do you want to shorten the term of your loan? And, what is more important to you, current monthly savings or total payments over the life of the loan?

We have helped many clients work through refinancing decisions. Please reach out if you have questions about your current mortgage or other loans. We are happy to help you determine the best decision for your individual circumstance.

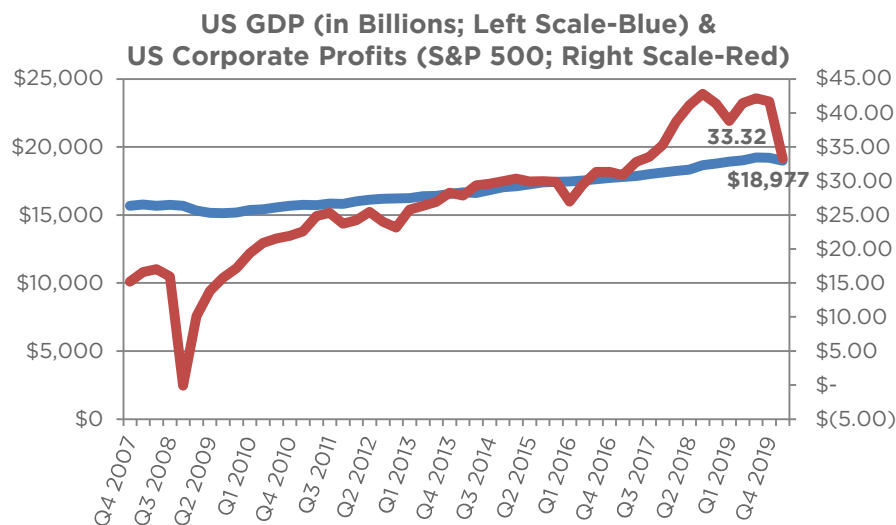
Albion Community

We are celebrating the career of Eleanor, our team member of 20 years. Eleanor retired in July, after staying on board 3 extra months to help our team and clients navigate the changes brought on by the onset of the pandemic. Our team celebrates the legacy that Eleanor leaves behind. We will always hear Eleanor encouraging us to take care of each other and our clients, to focus on our goals even though that may

mean addressing something that we are uncomfortable with, to triple check our work, and to continue enjoying each other by remembering that the fellowship that lunchtime provides is a very important part of every day for the Albion family. It is not often that you find someone who continues to push you to be better. We are so lucky to have had Eleanor for 20 years in the office, and for a lifetime as part of our Albion family. Dontatsu is a Japanese word that roughly translated means the “best of the best”. Eleanor truly is dontatsu.

As many of you know, Eleanor worked closely with Sarah Bird for many years. Sarah will now be working with Albion’s newest team member, Kari Moon Brown. Make sure to read our next quarter letter to learn more about Kari’s background and the expertise she brings to the Albion team.

UNITED STATES GDP ANNUAL GROWTH RATE



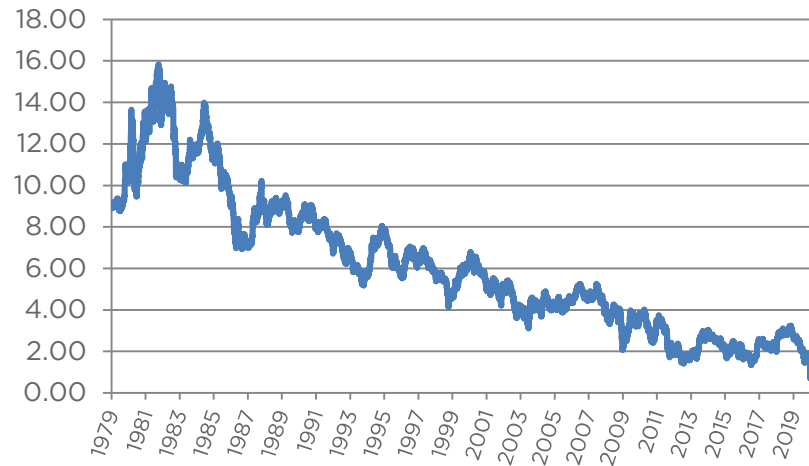
UNITED STATES INFLATION RATE



Where the economy and earnings go over the short run depends on developments across several fronts, most importantly the virus. It appears that the national appetite for another mass economic shutdown is low. Consequently, the economy should have seen its nadir back in April. So too does it seem clear that the Fed is now on a steady course regarding monetary policy. Zero interest rates and extreme accommodation will be around for the foreseeable future. Meanwhile Congress, while bogged down in the muck of politics, has already made a massive down payment on America's future to the tune of -15% of GDP with the 'CARES Act' and other spending programs rendering them unlikely to suddenly stop providing support before we cross the goal line (though the size / potency of future packages may be lessened). Besides, the Beltway never passes on a chance to spend more money. It is our view that the severity of this predicament absolutely requires that they call on such tendencies. All told, the economy remains weak and fragile. Nevertheless, slow re-openings are happening across the country and we do expect it will heal over time.

Using the Fed's preferred measure core inflation is low with the most recent data showing a pace well below the Fed's 2% target. Additional measures like CPI and "5-year, 5-year forward" data also reflect meager expected price growth. We stated in our last quarterly letter that "inflation is a lagging indicator," and "given the recession due to COVID-19, our best guess is that inflation will fall further over the coming months." This has proven correct with the most recent readings. The Fed is clearly concerned about this disinflation as evidenced by their recent actions regarding monetary policy. Our expectation continues to be that over the next couple of quarters core inflation will present in or around 1%. However, when looking out over the arc of several quarters we believe there's reason to anticipate a pick-up in inflation given the massive growth in money supply (primarily M2). This, of course, presumes we get an economic recovery as the result of a successful vaccine.

UNITED STATES 10 YEAR TREASURY YIELD



Forward 12M P/E RATIO: 10 YEAR



Rates remain at or near historically low levels given extraordinary Fed policy in response to the pandemic-driven recession. In addition, the “flight to safety” trade in global financial markets as a result of coronavirus has pushed yields down across the spectrum. The Fed appears committed to keep rates at zero for the foreseeable future. Jerome Powell recently commented that they “are not even thinking about thinking about raising rates.” That’s rather strong and direct commentary from a central banker. Meanwhile, the Fed has implemented other measures with their support programs and various credit facilities, and is contemplating news ones – like ‘yield curve control’ – in order to keep rates low. On net, we do not expect interest rates to rise toward anything even remotely considered normal or elevated for likely many years.

Recession makes it hard to say with accuracy where the current market P/E sits because 2020 earnings are in such disarray. Using known earnings (trailing four quarters), the Q2 rally in stocks puts the S&P 500 at ~20x profits. But this view is imperfect. Mainly because earnings will come in significantly lower throughout the balance of 2020, thereby elevating that P/E relative to current stock prices. But stocks are forward-looking assets, which means they are likely looking past gloomy 2020 earnings and instead into 2021. Our present assumption is that 2021 earnings should return to growth, with the caveat that it’ll depend on the virus and thus the economy. If correct, this stabilizes the P/E ratio and allows us to plot it against other data points – like inflation and interest rates – our preferred method of valuation. Both figures are very low due to pandemic conditions. Put differently, the market at ~20x earnings is not cheap (on a nominal basis), but it’s also arguably not expensive either because when rates and inflation are low P/E multiples should be higher when compared to the “averages”.