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Guiding Clients
To A Lifetime of
Good Decisions

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INTRODUCTION

The final quarter of 2022 has arrived. We always look forward to the joyous moments of gratitude and cheer that are part of this season, but we also recognize this period as 'crunch time' and there is still much work to be done.

The letter ahead provides some historical context from John Bird about bear markets and how this one will impact borrowing. Then, Jason Ware addresses the potential of a recession next year and how we are poised to endure it. And our Planners Corner this quarter lists some common year-end tasks we perform. Finally, our Community segment highlights October as Cybersecurity Awareness Month and invites you to our November Conference Call.

FROM JOHN BIRD'S DESK

On September 16th Albion celebrated its 40th anniversary at a wonderful event at the Utah Museum of Natural History. To those of you who attended – thank you! And to those who couldn't make it know you were missed. We have tremendous gratitude to our clients, friends, and the Albion team. You have all contributed to our success.

In breaking news we were just informed that Albion has once again made CNBC's Top 100 Registered Investment Advisor list; a select group of companies culled from the 38,818 firms in the Securities and Exchange Commission database. And this year we are in the number three spot! While the true measure of our success hinges on you being satisfied with the

value we provide it's nice to receive such positive external validation from an independent and objective source. Thank you Albion Team for your insight, thoughtfulness and caring!

We are now in a bear market, the sixth since we started the firm. On average the five previous bear markets saw a peak to trough drop of 38.6% and lasted 333 days. In the 21 bear markets since 1928 the average decline was 37.13% and the average length was 344 days*. This suggests that while the forty years Albion has been shepherding our clients' funds feels like an unprecedented and unique period of history it turns out that, at least in terms of severity and duration of bear markets, it has been remarkably ordinary.

As of this writing the current bear market has dropped the S&P 500 24% and is in its 267th day. Of course averages are just that. They may reflect correlation but they do not reflect causation. There is no clear way to predict the depth or duration of a bear; though we do know in each and every case so far bear markets have been followed by strong positive runs. In fact if we look at bear markets in the context of decade after decade of rising stock prices we see that despite the setbacks markets have rewarded investors with a long-term rate of return north of 9% per year.

The current selloff is driven by a variety of factors including rising interest rates, continued crimps in the supply chain, and the challenge of Russia's invasion of Ukraine which has wreaked havoc in energy, commodity, and grain markets.

We are all aware of efforts by the Federal Reserve to quell inflation with particular focus on the impact higher rates have on a variety of lending tools. Mortgages are of particular concern to individuals and families. About a year ago a 30-year mortgage carried a rate of less than 3%. Today the same product carries a rate north of 6%. One year ago a $2,000 monthly mortgage payment would support a $475,000 loan. Today, at 6%, that same payment would support a $333,000 loan. This will of course reduce what buyers are willing and able to pay and we have seen the first data points indicating that home prices are trending lower which is a solid indication that the steps the Fed has taken to quell inflation are working.

While based on recent history a mortgage rate north of

6% is high let's put it in context. In 1982 - when Albion started - a 30-year mortgage carried a 16% interest rate and the same $2,000 payment would have supported mortgage debt of $149,000. Difficult as it may be for us to fathom from today's perch, people did borrow and buy at those rates. The economy in fact was just beginning a multidecade period of growth assisted in part by the then Fed Chair Paul Volcker who raised rates sufficiently to crush inflation that had persisted throughout the 1970's.

There is and will continue to be debate about whether the Federal Reserve has been too slow or too fast in responding to the current inflationary pressure. What we know is they take the threat of inflation seriously and will do whatever they feel is required, even if it means pushing the economy into a recession, to knock down the inflation beast as quickly as possible. When Volcker took a similar course the economy tipped into recession. However with the benefit of hindsight we know he did the right thing and taming inflation was an essential prerequisite to the prosperity that followed.

"...every period of poor market performance has been followed by a sustained period of outperformance and there is nothing to indicate the cycle is broken."

I am beyond the point in my professional development when I might have attempted to predict the magnitude and duration of a market sell-off. What I can offer is the observation that to date every period of poor market performance has been followed by a sustained period of outperformance and there is nothing to indicate the cycle is broken. I have also observed that it is nigh impossible to "sell at the top and buy at the bottom". No one has ever been able to manage this feat with anything close to consistency. Instead we work to get the allocation right, own durable companies, and accept that to earn long-term equity returns we must also experience difficult down market periods.

As we approach year-end we wish you all a healthy and peaceful holiday season.

*Data from Yardini Research

ECONOMY & MARKETS by Jason Ware

In our last quarterly missive, we asked a key question: *will we soon go into recession?* It's central because as we then noted, *"beyond the obvious economic importance of that inquiry, as it pertains to equities history instructs that if we do prices probably have further protracted downside ahead. But if not, if we avoid recession, then the worst of the bear's roar may be behind us."* We further reasoned that *"it's thus practical to ask – what will determine if we hit or elude recession? Well, in a word … the Fed (OK, two words)."*

This quarter's memo begins with that brief review because by summer's end the answer to that question seems clear. Cutting to the chase, our current appraisal of the economic information suggests that a recession in 2023 is *probable*. Admittedly, that's not something you often hear us say. Throughout the ten-year period post-GFC and up to the pandemic we regularly remained sanguine in the face of both equity volatility and the periodic recession scares peddled by economists, Wall Street, and pundits alike. Even during the darkest days of the Covid lockdown we argued that science (vaccines) and economic policy (both monetary and fiscal) would ultimately deliver us from that void, and sooner than most believed. But here we are today forecasting a slump. We take no joy in such prognostication.

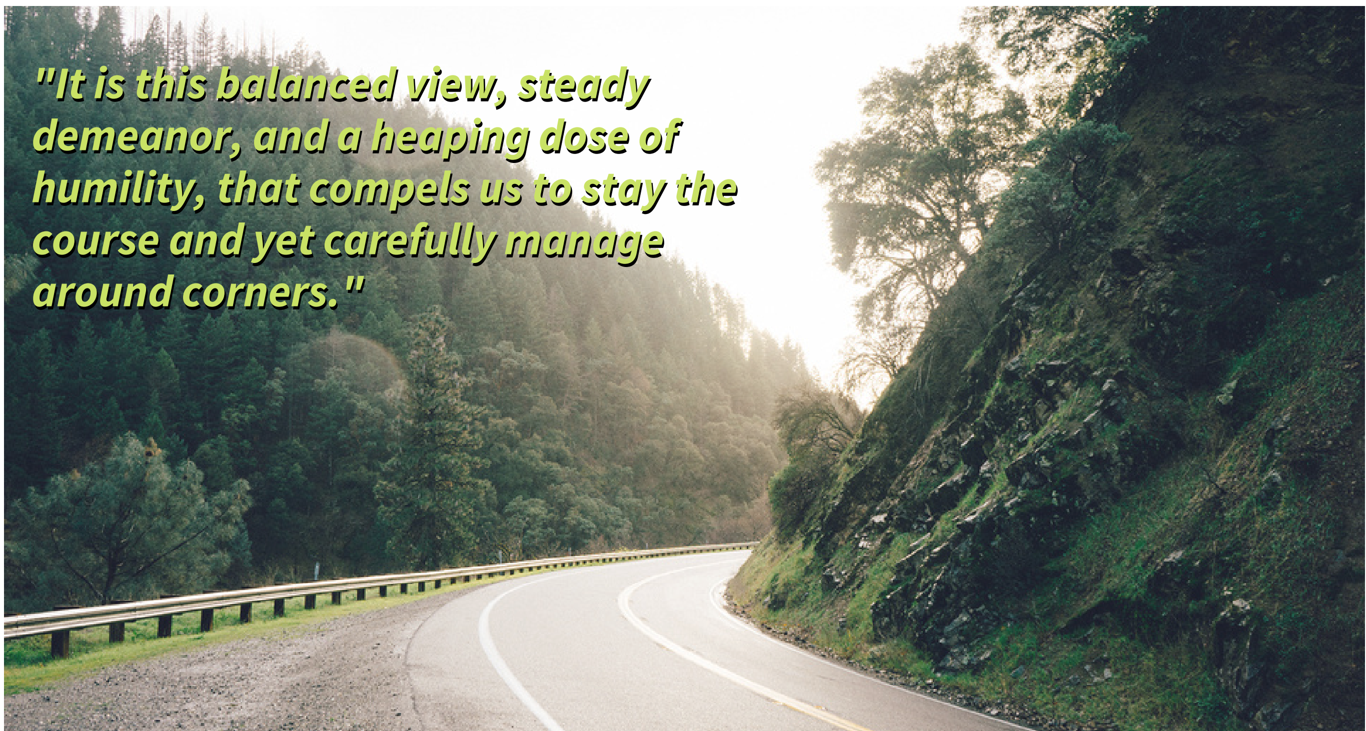
Some context.

The American economy has been through the wringer in just over two short years. A novel virus shut down

commerce resulting in a quick twenty-two million jobs lost and thousands of businesses closing their doors (some permanently). Our health, livelihood, and money were all on the line. Life seemed about as uncertain as it's ever been. However within a few months' time we were suddenly talking about "a return to normal" and an economic revival thanks to remarkable medical innovation and sweeping financial support from the federal government. Both were profoundly needed and did their job – save lives and rescue the economy from the abyss. But it also produced a whipsaw effect, from one extreme (on the edge of depression) to the other (biggest boom in annual GDP growth in 37 years), in a short time span. Consequently, what we've simplified as "economic weirdness" ensued in the post-pandemic era. From lofty and erratically shifting aggregate demand to an unusually tight labor market; across supply chain dislocations and high inflation, the evolving economic climate experienced unparalleled quirkiness. Add a brutal war in Ukraine into the mix, and 2022 has surely had its share of tremors tossing things off balance.

Enter the Fed. Interest rates routinely act as a center of gravity in asset pricing. It's hard to believe that just *seven short months ago* Fed Funds was at 0%, the 10-year US Treasury bond carried a ~1.7% yield, and the 3-month T-bill was at ~0.30%. It seems totally anachronistic to recall a world where Jerome Powell was pumping liquidity into the system and professing "transitory" inflation. Yet here we are. Nowadays central bankers are determined to crush that same inflation. When presented with a choice between being this generation's Paul Volcker (inflation fighter) or Arthur Burns (inflation appeaser), contemporary Powell clearly prefers the former. Even if it means creating a recession to accomplish this objective. To wit, since March the Fed has raised rates the equivalent of *twelve times* (using standard +0.25% increments). And based on their own outlook, as well as that of the oft prescient fed funds futures market, it is conceivable that the equivalent of an *additional five hikes* will occur by year's end.

All told, it's the fastest and steepest pitch in restrictive monetary policy since the early-1980s, an *incredible*



amount of tightening. As a result, bond yields have risen dramatically (as bond *prices* fall), mortgage rates have shot up, the US dollar has strengthened to twenty-year highs, and an already “normalizing” (decelerating) economy has braked further. Despite this, inflation has proven sticky (so far, but we judge that relief is coming). All these forces have assembled to fashion a broad bear market in equities.

In addition to the sharp impact on financial assets, as we called out last quarter the Fed’s heavy-handed approach was the single most important force likely to produce a turn in the business cycle … if conducted haphazardly. Unfortunately, as the dog days of summer wore on our most trusted bevy of leading indicators foretold that the Fed had done just that – gone too far. Overtightened. The dreaded “Fed policy error” now appeared increasingly likely. The yield curve inverted, upstream housing data cracked, consumer confidence plummeted, LEI went negative, and more. Recession became our base case. It still is as of this writing.

OK, but what does this all mean?

Bad news first. Stocks likely will remain shaky for the time being, any rallies may be short-leashed (for now), and a downside market bias could persist. The bears are in control. But don’t get too negative. The good news is that there have been fourteen bear markets since the end of WWII…twenty-three since the 1920s…and the common thread connecting them all is the fact that *they eventually end*. That’s right, 100% of the time the selling exhausts itself, contraction turns to expansion, and corporate profits resume their gradual upward march taking equity prices – trading at a discount – with them. We trust that this too will be the path for *this* bear market and upcoming downturn. In the stock market summers are long, and winters are short. History has recurrently rewarded patience and long-term optimism. Hence, we retain this core temperament on behalf of your portfolios staying fully invested to participate in the new bull market when it arrives while respecting hazardous short run conditions (as concluded by our internal economic dashboard). Sensible asset allocation does most of the heavy lifting, though we further endeavor to smooth the ride by *tilting* equity portfolios *incrementally* more defensive when we see opportunities to do so. You may have noticed this measured process is underway.

Rest assured we are mindful of the near-term risks while remaining grounded in long run thinking. It is this balanced view, steady demeanor, and a heaping dose of humility, that compels us to stay the course and yet carefully manage around corners. Toward this end, we continue to favor smart diversification, logical factor selection, and ownership in quality companies / investments that stand the test of time. We appreciate your confidence in us and endure in our work to provide thorough and seasoned resources in managing your wealth. Many thanks.

PLANNER'S CORNER

It is officially fall in Utah with cooler temperatures and changing leaves. It is this time of year that we start thinking about end of year planning. Here are some of the more common items we expect to help clients complete before year-end:

- Charitable contributions
- Funding of some retirement accounts
- Required minimum distributions from IRAs, Inherited IRAs and retirement accounts
- Required trust distributions
- Fourth quarter estimated state and federal tax payments (due Jan 17th, 2023)
- Roth IRA conversion opportunity
- We will review realized gains and losses for tax year 2022. If you have substantial gains or losses that

occurred outside of the accounts managed by Albion, please let us know.

December can be a busy month so please contact us by Friday, December 9th if we can assist you with any of these items.

ALBION COMMUNITY UPDATE

November 15th Conference Call:

We hope you and your family will join our conference call on November 15th at 9AM Mountain Time. Our panelists will be discussing financial planning matters and the state of the economy and markets, but we hope you will participate by submitting questions in advance and/or asking questions live during the call. Please expect an email later this month with a Zoom link and more details.

Beware of Phishing & Fraud

Fraud is on the rise. Scammers are getting smarter. We have recently seen an increase in attempted phishing scams via text message, email and phone. In order to safeguard your identity and protect your finances, never click unsolicited links or respond to suspicious texts, emails or calls.

We want to make it easy for you to learn more about cybersecurity and increase awareness about staying safe online. For more information please visit our website:

https://albionfinancial.com/learning-center/cybersecurity/

Also, keep your eyes out for a communication in the next few weeks with more information on how to spot phishing emails and what to do if you get one.