ALBION FINANCIAL GROUP

Guiding Clients To A Lifetime of Good Decisions

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INTRODUCTION

2022 was a landmark year for Albion. Now we begin our forty-first year of operation and the following letter has some thoughts we would like to share with you. Our final quarter letter for 2022 contains John Bird's perspective on the year's challenges, accomplishments, and Albion's ongoing commitment. Also read Jason Ware's assessment of the past year's market activity, his recession expectations for the US economy in 2023, and Albion's ongoing investment strategy. Finally, find Patrick Lundergan's summary of how inflation has adjusted contribution limits, gifting limits, and tax brackets in 2023.

FROM JOHN BIRD'S DESK

Another year is in the books and we hope you all found peace and joy over the last twelve months. One of our key objectives is to consistently improve the value we provide and at year end we look back at what we've done and ahead to where we hope to go. It's a process of continuous improvement some of which is readily visible – such as the new portfolio management software we installed two years ago that allows us to be more precise in our portfolio implementation and more comprehensive in our reports – to less obvious steps including our commitment to continuing education in all things financial advising and investment management across the entire team.

Albion's work on behalf of clients and our commitment

to continuous improvement landed us in the number three spot on CNBC's list of best Registered Investment Advisors and the number one spot for firms west of the Mississippi. Yet 2022 will also be remembered as the first year since 2008 where the S&P 500 will close out the period with a double-digit loss.

While we value the recognition inherent in our CNBC ranking we view it as a validation of our efforts toward continuous improvement rather than an end unto itself. Ours is more of an "If you build it they will come" approach. While CNBC does not share the specific criteria they use in their ranking they do highlight several important categories; A firm's regulatory and compliance record (where any blemish is immediately disqualifying), the number of Certified Financial Planners, the number of investment advisors registered with the firm, and the total number of employees. What we glean out of this is that in addition to a clean record they are looking to see where we put our resources. Do we invest in marketing and distribution or do we invest in a team of investment professionals and financial advisors in an effort to deliver value? We have always chosen the latter path.

They also ask about firm longevity. According to the Bureau of Labor Statistics only 25% of businesses survive fifteen or more years. This year we celebrated our 40th anniversary and know well It takes consistency, dedication, and an unwavering focus on providing value to make it in the business world. CNBC apparently recognizes this and weighs their analysis toward those firms that have withstood the test of time.

They started their search with an initial list of 39,818 Registered Investment Advisors from the Securities and Exchange Commission database which was reduced to 904 firms meeting CNBC's criteria. That we rose to the top – exceeding several firms we know and respect from around the country – suggests we are thinking about how to add value in the right way.

We will continue to evolve Albion to improve what we do for each of you every year. If that results in additional third-party recognitions in the coming years that'll be nice. However it won't impact why we do what we do. The true measure of our success is our ability to meet and hopefully exceed your expectations.

Speaking of expectations we've all seen 2022 has been a down year for most all asset classes both financial and non-financial. As noted above it's the first year since 2008 where the equity markets have experienced a double-digit negative return. This was further compounded by bond markets which due to inflation concerns experienced declines in line with the stock markets.

It is easy and even trite to say that the pain of bear markets is the price one pays to benefit from long-term equity returns. Easy and trite, yes. But also accurate. The markets have delivered strong double digit returns for four of the last five years with the laggard year, 2018, off less than 5%. Even in the face of this years' down market a diversified portfolio remains the best way to achieve long-term financial goals.

This is the seventh bear market I've experienced since we started Albion forty years ago. Every one of them has been financially painful and anxiety provoking. Yet every one of them has eventually ended with financial markets responding to underlying economic expansion and pressing markets higher. This time will be no different.

Good investments in solid companies weather these storms and that is the focus of our investment team. Clear candor regarding one's financial situation and how to take steps to improve it remains the focus of our wealth advisors. We believe in the importance of good ideas coupled with solid execution to make an economy thrive and clearly see the millions of people who get up each day looking for ways to create value better, faster and cheaper. It is this depth of energy and creativity that makes us confident in what the future holds.

We hope 2023 brings you peace and success in all your ventures.

ECONOMY & MARKETS by Jason Ware

Last quarter we shared our recession call.

"*Our current appraisal of the economic information suggests that a recession in 2023 is probable.*"

While disheartening (and infrequent) for us to declare, our preferred data to gauge such things – to the extent anyone can – still suggests that a slump is imminent. To be clear, we're talking about the *US economy* not the stock market. The latter is already in decline. Has been throughout the year (you've probably noticed!). But the former is not. The contemporary bear market has been plagued by *tumbling valuations* ("multiple compression"), not deteriorating economic or corporate fundamentals. At least, not yet. For now, our unfavorable view on the economy in 2023 remains in place. The Fed has overplayed their hand. Stay tuned.

2022 was an eventful year…some of it good; much of it was not. At the outset stocks were at or near all-time highs. Inflation persisted on a pandemic-driven cyclical upswing. The Fed was beginning to demonstrate less patience for its "transitory" explanation. Concomitantly, Vladimir Putin was preparing for war on Ukraine's east border. Most military and political analysts did not expect him to attack. By the end of February, he had. The human suffering and physical destruction it caused continues as of this writing. Commodities markets responded forcefully making an already bad inflation situation worse. Gas and food prices soared. The Fed worried that inflation may become imbedded in the minds of American consumers making it harder to contain. A couple of weeks later, in March, they began raising interest rates off from zero. Today, Fed funds rate sits at ~4.37% representing the most aggressive pitch in monetary policy since the Volcker era. Powell & Co. are likely not done (though we reason they're close). In addition to rates, the Fed commenced quantitative tightening, or "QT" where they allow their balance sheet to shrink. Economists estimate this has added another half-percent or so of financial tightening into the system. *Sigh* it's been a lot over a *very* short stretch.

Meanwhile, the economy has held up. Despite the mild and brief dip in real GDP from January through June, the business cycle's foundation has been sturdy. Most notably the labor market added >4.3M new jobs through November while consumer spending remained buoyant. This potency found its way, as it often does, into corporate profits. Indeed, when all is said and done earnings for S&P 500 companies will hit a new (annual) *record* of ~$220 / share in 2022. None of these particulars smacks of recession. In fact, such a juxtaposition would be historically unprecedented – a truth ignored by those who claim we're *already* in an economic downturn. Hogwash.

And what of inflation? While we're still detached from any reasonable definition of "price stability" trends are moving in the right direction. Peak price pressures have passed, the goods side of the equation is firmly undergoing disinflation (potentially on its way to *deflation*), core services appear to be plateauing, and shelter costs are finally decelerating as housing enters a welcome cool down. This stuff (particularly shelter) operates with noted lags, so it will take time to show up in official inflation statistics. However the path seems clear. Other more forward-looking indicators of inflationary forces like the money supply, real liquidity, asset prices (i.e., "wealth effects"), shipping costs as well as other supply chain related matters (unclogging), not to mention a slowing macro, portend well for a continued lessening of inflation in the quarters ahead.

All told, the effects of higher interest rates (yields), elevated inflation, deep geopolitical uncertainties, and a braking economy have persuaded investors to rethink the earnings multiples (P/E) they're willing to pay – especially on "growth" stocks like the variety often found in technology and consumer discretionary sectors. The result of this "rerating" of equities has pushed down considerably the share prices of both individual stocks and the broader indices. No place was

safe, including bonds which in the aggregate experienced the worst losses in modern history (the flip side, now there's some yield out there!). Cryptocurrencies were not spared with standard-bearer Bitcoin down -75% and a host of other coins worse off, if not wiped out entirely, as the days of "easy money" vanished. Deepening cryptos troubles was a growing mistrust culminating with the spectacular blowup of FTX. Buyer beware.

Like we said, it was an eventful year. But it's old news now. Water under the proverbial bridge. Where we go from here is what everybody, including you dear reader, are interested in.

Coincidentally, 'tis the season for Wall Street prognostications. And as verified by the twenty-five "top" predictions peddled by the Street's largest investment houses, the Grinch has certainly descended onto Broad & Wall. To wit, only three of said forecasts expect stocks to beat cash in the coming year. Ouch. The crowd is in an exceedingly dreary mood, often signifying a good time for enterprising long-term investors to move contrariwise. Fortunately, we (you) are just such investors. This, plus our *structurally* bullish view on stocks ("good companies") over the long run, means that we retain a fully invested posture in our portfolios. You've often heard us say that *time* in the market is paramount to *timing* the market. It's an unwavering principle that guides us through trying times. And history has shown repeatedly that it – reinforced by general optimism – to be a winning strategy.

Yet, the long run is but a collection of short runs strung into perpetuity. What that funny sounding phrase really means is that we must also respect near-term conditions and *adjust* accordingly to capture opportunities. This also helps us stay the course to compound those returns over time. At that snarled intersection of discrete timelines and market variables sits how we manage portfolios: aware of imminent risks, mindful of opportunities, all while thinking and acting long-term and in accordance with your broader financial plan. We will press on in this effort and thank you for your trust in us. Happy New Year!

PLANNER'S CORNER

We're all searching for silver linings as we approach the end of a turbulent 2022 and wade into an uncertain 2023. Market turmoil aside, Americans continue to struggle with stubbornly high inflation, which is eating into their purchasing power and affecting their ability to maintain good savings and spending habits. For those willing to plan and adjust, there are opportunities to be had.

Higher inflation has meant a record year regarding the increase in annual workplace plan contribution limits, IRA contribution limits, gifting limits, income phaseouts for credits and deductions, and cost of living adjustments. While most people are familiar with front-page changes like the 8.7% increase in Social Security payments, other adjustments are also worth noting. Of course, everyone's situation is unique; whether you take advantage of the following changes should be based on conversations with your financial advisor and CPA.

Below are some highlights of the changes we can expect to see in 2023, followed by commentary on the new 2023 income tax brackets.

Adjustments to Retirement Account Contributions for 2023:

- The contribution limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan will increase to $22,500.

- The limit on annual contributions to an IRA will increase from $6,000 to $6,500. The IRA catch-up contribution limit for individuals age 50 and over is not subject to an annual cost-of-living adjustment and remains $1,000.
- The catch-up contribution limit for employees age 50 and over who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan will increase to $7,500.
- The catch-up contribution limit for employees age 50 and over participating in SIMPLE plans will increase to $3,500, up from $3,000.
- The amount individuals can contribute to their SIMPLE retirement accounts will increase to $15,500.

Adjustments to the Required Minimum Distribution (RMD) Age:

- The Secure Act 2.0 changed the age when required minimum distributions (RMDs) must begin.
  - RMD age in 2023 will be 73
  - RMD age in 2033 will be 75

Adjustments to Gifting and Estate Tax Limits for 2023:

- The annual gift tax exclusion is now $17,000 per gift per recipient, up from $16,000.
- The estate and gift tax basic exclusion is now $12,920,000, up from $12,060,000.

Adjustments to Important Income Phaseout Ranges:

- The phaseout ranges for deducting contributions to a traditional IRA will increase.

  - Single = $73,000 to $83,000
  - Married Filing Jointly = $116,000 to $136,000
  - Married Filing Separately = $0 to $10,000
  - Non-active participant married to active participant = $218,000 to $228,000

- The income phaseout range for people making contributions to a Roth IRA will increase for taxpayers filing as single, head of household, and married filing jointly.

  - Single = $138,000 to $153,000
  - Married Filing Jointly = $218,000 to $228,000

Adjustments to Income Tax Brackets in 2023:

Another boon of inflation is increasing and widening marginal tax brackets. When tax brackets adjust for inflation (aka tax indexing), it helps reduce the effect of "bracket creep," which occurs when inflation pushes income into a higher marginal tax bracket, increasing taxes without any increase in purchasing power.

Tax indexing increases the income needed to enter a new marginal bracket and widens the taxable amount in the said tax bracket. The "width" of a tax bracket refers to the income range subject to that tax bracket, while the "increase" occurs when more income is required to enter a specific bracket.

For example:

- In 2022, the 24% bracket for a married couple filing jointly was $178,151 to $340,100 and covered $161,949 of taxable income. The 2023 24% bracket for the same couple is $190,750 to $364,200 and covers $173,450 of taxable income.
- Also, the start of the 24% bracket moved from $178,151 to $190,750. In summation, we now have a 24% bracket that is 7% higher and 7% wider.

As a result, those on a fixed income or an income that doesn't keep pace with inflation should be able to manage their top tax bracket better. Others with multiple accounts with different tax characteristics might consider small shifts in withdrawal strategy to take advantage of these changes.

ALBION COMMUNITY UPDATE

Albion Gives Back

This past year Albion entered into a new volunteering arrangement with the Utah Food Bank's "Mobile Food Pantry" and Woodrow Wilson Elementary School. Each month members of the team volunteer their time to distribute food to students and families who are in need.

We also want you to know that a portion of our annual charitable contributions were made on your behalf to the Utah Food Bank and the Crossroads Urban Center.

Paperless Reports

Did you know that you can receive and access all of your quarterly reports online? If you no longer wish to receive paper copies of your Albion quarterly reports in the mail, please contact your advisor.

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/

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