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RETIREMENT STRATEGIES

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June 11, 2020 - Signs of a Changing Economy..."What to look for, where to find it, and what to do when you see trends changing"

From time to time I am asked what sources of information I read each morning to prepare for the business day. When recently asked I replied that I have been looking more at medical research on a COVID-19 therapeutic and vaccine updates. We already know the economic news is terrible, getting less terrible and as you will read in this month's update, likely bottoming out and starting to get better as we see the dawn of 2021.

But, when you finally hear the words "successful treatment", the stabilizing period we are now in should start the trend back to the strongest economy ever on earth, or better. Which brings me back to business news.

Corporate businesspeople are pretty good at sweeping problem news under the rug until there is a best time to release it as news. We saw this in 2007-2009. The economy was so bad that Corporate America could blame any bad news, bad decisions and bad outcomes on the economy and start fresh.

As you might imagine COVID-19 will now present an equally good opportunity to pull up the rug and clean out any bad news. That is one reason the next few quarters of corporate earnings are likely to be extra bad. This is good news. The reason it is good news is much of Corporate America will be starting fresh and much of the news after the house cleaning is going to be good, and in some cases, great. Sign #6 below quantifies this positive outlook.

As we all know our economy is driven by our Sign #1 in The Seven Signs of a Changing Economy™ monthly update, which is Personal Consumption Expenditures (PCE). Per J.P. Morgan's Guide to the Markets from March 31, 2020, PCE is 68.10% of our entire economy. The consumer has been at home and consuming less, but they have also collectively received money that most are ready to get out and spend on "stuff". In fact, per the U.S. Federal Reserve cash balances at present totals $18 trillion, the highest in history.

I love it when I read the savings rate has increased. We all know that is temporary. Americans love to spend and as they slowly roll open the economy, spend they will! That spending increases the earnings for Corporate America and with all the bad decisions cleaned up, the value many companies offer will suggest the price valuations are fair to even low. Yes, this will happen inside of volatility, as is already the case.

From this it is easy to see why the surprise jobs recovery in Sign #4 below should not be a surprise! For sure, many jobs are gone forever. I detailed that in the May update, but there are many new jobs in new industries that will put those who choose to work, back to work. That means more consumer demand and another economic positive into 2021.

It is reasonable to think the earnings of Corporate America in 2021 will be much like 2019. Hence, 2020 is the "black hole" of our economic donut I often refer to. As of today, it

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sure seems like the lows in the valuations of Corporate America from this pandemic sell-off are in as of 3/23/2020. We will have volatility, seems we always do, but the data flow suggests more positive from here.

Many things have happened in a very short period. Two biggies to me are:

1) China is in transition from hero to zero. They have lost global trust. Manufacturing is already leaving in waves. Perhaps worse for China is that 28 years ago they forced the one child policy on their population. Statistically, you need to have 2.1 kids per household to maintain population growth. One child is economic collapse. (See stat above on consumer spending being 68.10% of the economy. It is nearly the same in China.) China has more people over age 80 than under age 10. The most productive age of any population is from age 30 to 40 and that is just two years away from China having less and less of that productive age cohort, due to the one child policy. My guess has always been, and continues to be, China's economy will not grow larger than that of the U.S. in our lifetimes, if ever!

2) Back here in the U.S. every one of us just got forced at least three years into the future of technology! Personally, 90 days ago "Zoom" was a term for going fast. Today I know Zoom to be a website for meetings and social gatherings. Just one little dividend, of many, from COVID19. Mark my words, productivity is going to be off the charts. The U.S. owns the leadership in science, technology, 5G, artificial intelligence, robotics and space, to name just a few. I have quantified this outlook in Sign #7 below.

Of course, it is going to be herky jerky as we all push forward to the new next, but that is what change is. As humans we don't like change, but we got a big one, and I think it will go into the history books as one reason for the biggest leaps forward in productivity ever. Just like electricity, the telephone and the thermos. Okay, the thermos might be stretch, but I would still like to know how it knows to keep hot liquids hot and cold liquids cold. That is high tech! Ha!

Also, we need to remember there will be more 1,000+ down days ahead.

Now is the time to think about that sick feeling of being down several hundred thousand dollars and make sure you have cash levels, asset allocation amounts and investment positions that will not negatively affect your lifestyle package going forward.

Please don't miss this bigger future but do have a plan. A financial plan that you trust. Promise yourself and your future self that you will not waiver. A financial plan where all your effort will be on meeting your goals calmly, logically and patiently over time. If you don't have one of these, call me and we will update your current plan, or create a new one, that will work for you.

Thank you for your trust and confidence! This month's Seven Signs are updated below.

1)	**Indicator:**	*Personal Consumption Expenditure (PCE)*
	Where to find it:	*www.bea.gov*
	What to look for:	*Consumer spending increases or decreases for three consecutive months*

(Positive)
Consumer spending is measured via the Personal Consumption Expenditures (PCE) by the Bureau of Economic Analysis (BEA). It is Sign #1 in our monthly update of The Seven Signs of a Changing Economy for a reason. Per J.P. Morgan's Guide to the Markets 3/31/2020 update, PCE represents over 68% of our entire U.S. economy. In other words, PCE is the tail that wags our economic dog. This is why you really want to know what consumers are doing with their money. We are all consumers and the good news is we are waking up from the COVID-19 required lock down.

Observe people consuming around you and you tend to know what the economy will be doing long before the PCE is reported!!!

There is pent up consumer demand. Our economy is on the launch pad. .....4.....3....2...1.....Launch = OPEN!

Meanwhile the ordering online bonanza has not stopped. People buying from home is hitting new highs on most any metric you would like to look at. I consider our house normal, and therefore assume our spending pattern is like millions of others, i.e. what you have been reading about the doom and gloom may be, well, I will be nice, not all true.

I will suggest we need to watch airlines. They will lead any hot spots, or a second wave, of COVID-19 by several weeks. It may also be interesting to watch states still closed squirm as their citizens watch the rest of the population going back to the next normal on their TV. It won't take long for the sushi to hit the fan in those states when they see the rest of the kids out playing and they remain stuck at home. We will see.

Consumer confidence just came in at 86.6% slightly above the average during the great recession. I suspect we will see an equally strong economic recovery this time.

Economists had projected home sales for April would be down -23.40%. They only missed by the Grand Canyon amount, as usual, as home sales for April just reported at +.60%. Buying a home online must be a new adventure! We have real clients who have done it!

This all tells us the consumer is still there and thus the economy that Corporate America must operate in is likely better than your news source wants it to be. Remember, they need bad news to sell you stuff. If the news is good you won't read as much, or for as long.

Too bad for the negative news people, the Transportation Security Administration (TSA) reported on 6/1/20 a 20.49% increase in travelers going through checkpoints versus the prior week. A week is certainly not a trend, but after the shortest and steepest economic contraction in the history of our country it is reasonable to think this sudden burst in travel signifies solid footing for the economy to push toward the next normal.

Sign #1 is positive!

2)	**Indicator:**	*Institutional Money Flow*
	Where to find it:	*www.wordenbrothers.com or www.barrons.com/convictionoftraders*
	What to look for:	*Increasing or decreasing prices on high volume of large block trades*

(Positive)
Money flow is sign #2 of our monthly update for a reason. For those who may not know, I decided to create The Seven Signs as a collective after observing each of the seven inputs individually over a few decades. Each economic sign was consistently correct in predicting what was around the corner and collectively they had an incredibly accurate peek around the corner to suggest what economic backdrop Corporate America would be operating in six to twelve months into the future.

However, it turns out not one thing being predicted by anyone, or anywhere, works during a pandemic and subsequent closure of earth for a few months.

However, one subset of The Seven Signs has been quietly telling us louder and louder each day what is supporting the valuations of Corporate America. Even as the economic news continues to be going from just terrible to less terrible, money supply has been doing positive work.

The investment markets happen to be more like Wayne Gretzky, "The Great One" in hockey. When Gretzky was asked why he was so much better than his peer group he replied, "I skate to where the puck is going to be, not to where it has been". In the capital markets, "money flows" to where it is going to be treated best, not to where it was treated best.

In The Seven Signs we track money flow each month via our independent source The Lipper Fund Flow report.

You can view software programs that report trading volume and money flow and is fact-based. Both measure and quantify that big institutional money flow, think trillions, as it always leaves a footprint. Always!

When you see your news source reporting things like "the price of XYZ is up, or down, because of this, that, and the other thing", it is just gobbledy gook! XYZ is up in price, or down, because money is flowing toward, or away, from where it will be treated best going forward. PERIOD!

So, on February 19, 2020, our prior all-time high in Corporate America Valuations, the herd was spooked. They were fearful of what was next, as in no one living has had a pandemic experience. In that fear they decided to sell ownership in Corporate America and go to cash. Per the U.S. Federal Reserve, cash reserves as measured by any instrument that is cash, or will mature to cash in 30 days, rested at a cool $18 TRILLION as of May 29, 2020.

$18 TRILLION is not a rainy-day fund.....it is a rainy decade fund!

According to Charlie McElligott over at Nomura Securities, $380 million worth of buying started in March of 2020 to buy back shares that had been "sold short". Selling short just means some people reverse the order of normal investing. They sell first and then complete the transaction by buying it back later. They sell it first as they think it is going down in value and once it has, they buy it back.

In March that group flipped to the buy side with a ton of buying power, i.e. a big footprint, and then as the upward price trend strengthened even more money started to flow back in. This is the time of year when retirement plans get funded and more seasonal "automatic investments" start flowing in.

Now we are starting to see pieces of that $18 TRILLION starting to become less fearful and dripping back into what is next for Corporate America, i.e. RECOVERY.

Yes, many small and medium size businesses will go BK and that is sad. The unpleasant facts are they don't change hands on the major exchanges and therefore have little to no effect on the valuations of Corporate America as a whole. The ma and pa retail of last year may still have ma and pa working, it just might happen to be in a big box store.

In my 22 years as an investment advisor I have never seen, and cannot find, any data that reports even close to this much money in our economy looking for what is next. I believe the money flow will slowly figure out that the S&P 500 dividend yield of over 3%, versus a 10-year U.S. Treasury paying .82%, is a more correct choice. And that is where the money is flowing. The footprint is as big as it gets!

Believe it, or not, there are values for investors. We have been, and continue to, thoughtfully investing inside our asset allocation model.

How high is high, for the valuations of Corporate America? No one knows the future, yet I have seen two smart and experience investment veterans suggesting a DJIA of 40,000 this year is possible. As I write this on 6/11/2020 the DJIA rests at 25,598, so 40,000 is "up there". We will see.

Sign #2 is positive.

3)	**Indicator:**	*Leading Economic Indicators (LEI)*
	Where to find it:	*www.businesscycle.com or www.newyorkfed.org/research/global-economy/globalindicators.html*
	What to look for:	*Trends up or down for three to four months*

(Positive)
Sign #3 detail is very important, as it is our peek around the corner to see what economic backdrop Corporate America will be operating in six to nine months in the future.

Last month I detailed how the 30-day reduction had wiped out four years of solid economic growth…and that it would get worse, and it did. In this month's release, the Conference Board, the creator of the Leading Economic Index (LEI), adjusted last month's -6.70% down to -7.40%.

The good news in the most recent LEI report was that the LEI "increased" to being down -4.40% versus last month. Obviously, this suggests two key points. First, the worst appears to be in and behind us and second, the unbelievable swiftness of the contraction is likely to be followed by an equally swift expansion.

Of the ten components that make up the LEI, four were positive this month. Two of the four are, in my opinion, "fluffy", but the other two are heavyweights. The two heavyweights that came in positive were:

- Manufacturers' new orders for consumer goods and materials
- Manufacturers' new orders for non-defense capital goods

These two positive inputs strongly suggest the bottom is in and our economy is coming out of the black hole of our economic donut rather quickly.

The Chemical Activity Barometer (CAB), which is sourced by the American Chemical Council, was a complete wipe out last month at -14.80% year over year reduction. This month, per Kevin Swift, Chief Economist at ACC, "The May CAB reading is consistent with a recession, but given the small, unadjusted decline of only -.03%, one that may bottom out."

I agree and Sign #3 has bottomed out, bouncing up and that is positive!

4)	**Indicator:**	*Employment rate and after-tax personal income*
	Where to find it:	*www.bls.gov*
	What to look for:	*A flattening, then downward trend in non-farm employment with a flattening to decreasing after-tax income would be a negative indicator. The appropriate trend would, of course, be a positive trend indication*

(Positive)

As we left April 2020, the flood of Americans seeking unemployment benefits remained extremely high. Total filings since the crisis began was right at 30 million.

The Friday, June 5, 2020, job report was a shocker, but in a good way. The labor market delivered a pleasant surprise, as the U.S. economy added 2.5 million "net" new jobs in May. The almost always negative economist community had estimated jobs lost at 7.5 million.

Bloomberg news reported economists' expectations at an unemployment rate of 19%, versus actual, of 13.30%. I understand this question gets old, just like lazy economists' unbelievably off estimates on, well, everything they estimate, but how do economists who blow an estimate by 40% to hundreds of percentage points keep their jobs! Exclamation point versus question mark, as it is yet another rhetorical question!

This month's jobs report provides quantifiable and solid evidence that the jobs market has bottomed, is recovering stronger and faster than predicted and should have our economy bouncing back sooner versus later.

We all understand that Covid-19 flare ups are happening, will be dealt with locally and with only a little luck needed, should not cause our economy to have a mass shutdown again.

Sign #4 is very positive!

5)	**Indicator:**	*Durable goods spending*
	Where to find it:	*www.census.gov/indicator/www/m3*
	What to look for:	*An increasing or decreasing trend, especially a trend of four to five months out of six would be a positive or negative sign*

(Data lags by one month so still Covid-19 impacted)

These long shelf-life items like non-perishable, non-fashion items are usually the first to show signs of a slowing economy. Remember, these are items we can do without, if need be.

Before we jump into this month's detail, it is important to remind everyone this data point lags by one month. So, the numbers I am about to share were released on May 28, 2020 (most current) for the prior month, April 2020. We all know April was most impacted by the economy shutting down and, like Sign #4 above, starts to show renewed life in May 2020.

New orders decreased -17.2%. Not good! I don't like to play the "yeah, but" game so I will just share an observation I had when I read this release. New orders "excluding transportation" decreased -7.4%. I have observed so many new car tags in the last few weeks that I will venture to guess that next month we will see new orders significantly above both of these!

Shipments decreased -17.7% and inventories increased +.2%. In addition, I follow but don't always note here, that unfilled orders decreased -2.10%.

What does all this mean? Easy! You don't need much shipping if there are reduced new orders, so that makes sense. But inventories did not go up in a meaningful amount. This would suggest there was plenty of demand coming out of "the back room" or inventories would have spiked. They didn't.

Also, unfilled orders decreased only -2.10% in a -17.20% reduction of new orders world. This suggests our manufacturing plants were working like crazy to get ready for what we likely see over the summer months, and that is new orders coming in at "levels rarely seen" sung to the tune of "pent up demand"!

Sign #5 is impacted, but positive!

6)	**Indicator:**	*S&P 500 Earnings per Share growth*
	Where to find it:	*www.standardandpoors.com*
	What to look for:	*Two quarters of S&P 500 earnings per-share growth, up being a positive trend and down being a negative trend*

(Positive)
It does seem odd to think that 90 days ago is ancient history, but in a Covid-19 world it is, at least economically, for sure! Way back then in March of 2020 I wrote here in Sign #6 that the earnings of Corporate America were "lapping" the +20% in earnings we realized from the corporate tax cuts in 1Q2019.

Recall those crazy economists and their really poor estimating skills, were suggesting 1Q2020 EPS would be -4.50%. In reality, the S&P 500 companies tallied a +1%. That is +1% to a +20% 1Q2019 gap up from the tax cuts.

And then the party wrecker, Covid-19, hit! The facts are Covid-19 is/was not nice to us in many ways. It will become rearview mirror "soon" and will prove to be a steppingstone from heaven to the biggest and fastest technology pushed productivity rejuvenation since, well, maybe ever! Time and patience required.

This puts us in the "black hole" of our donut economy. Nonetheless, let's make an effort to calculate where the Fair Market Value (FMV) of Corporate America is at this point, but for 2021 – past the black hole!

Yardini Research had S&P 500 earnings for full-year 2021 at 164.12 per share as of 6/3/2020. Let's run our FMV using the "Rule of 20" estimate.

To use "The Rule of 20" you just subtract the inflation rate from 20. I will use the same inflation rate the BEA used in calculating the Gross Domestic Product (GDP) "second estimate" for 1Q2020 released May 27, 2020 of 1.61%.

The result becomes your multiplier and is multiplied by the respective year's earnings per share to calculate the Fair Market Value (FMV).

- 20 – 1.61 = 18.39
- 2021 S&P 500 earnings estimate = $164.12
- 2021 S&P 500 Fair Market Value estimate =$164.12 x 18.39 = 3,018.17

As of 6/5/2020, the S&P 500 trades at 3,193.93, or a +5.82% premium to FMV.

A research piece I recently read was titled "Daily Wealth" by Dr. Steve Sjuggerud. In this issue, Dr. Sjuggerud presented research that added the price/earnings (P/E) ratio to the 90-day T-bill.

This is a tool that accounts for the cost associated with borrowing money, i.e. it accounts for the impact of low interest rates on a company's ability to earn profits. The research quantifiably showed that when the total is above 22, we are in the danger zone. Below 20 represents quantifiable value.

Based on this, I did some quick math to see the 2021 projected price/earnings (P/E) ratio is 19.46 +.16 = 19.62, below 20 and also a mile below Dr. Sjuggerud's 22 level "danger" zone.

Sign #6 is positive.

7)	**Indicator:**	*Inflation/deflation numbers*

Where to find it:	*www.bls.gov/ppi/ or www.bls.gov/cpi/*
What to look for:	*An interruption to the consistent but modest increase in the cost we all pay for goods and services*

(Positive)
The Producer Price Index (PPI), which measures the inflation rate at the manufacturing level, reported in at -.30% annualized for this month. Covid-19 impacted!

The Consumer Price Index (CPI), which measures the inflation rate at the household level, reported in at +.30% annualized this month. Covid-19 impacted!

The "second estimate" of our Gross Domestic Product (GDP) for 1Q2020 was reported as -5.06% annual growth rate of all the goods and services we produce as a country. (Source: Bureau of Economic Analysis (BEA)). Covid-19 impacted!

As I write here each time the GDP is released, the released is "real". This simply means it is adjusted for the effect of inflation. In this 1Q2020 "second estimate" report, the Bureau of Economic Analysis (BEA) used a deflator of 1.61%.

Meanwhile, over at their sister government agency, the Bureau of Labor Statistics (BLS), the inflation rate was reported as a much lower -.76%.

Rick Davis, over at The Consumer Metrics Institute, likes to point out, had the BEA used the inflation rate from the BLS of -.76%, the GDP would be reported at -2.77%.

As detailed above in Sign #6, we are crossing through the "black hole" of our Covid-19 donut economy. As bad as a -5.06% contraction sounds, it is over 40% better than the predicted -7.18%!

As we travel from the pre-Covid-19 best economy to ever exist on earth, via most any metric you choose to compare, through the contraction black hole, it is my guess that we will see better economic growth than pre-Covid-19!

How can this be? Many reasons, but here are a few keys:

- Liquid money in people's bank accounts are the highest ever recorded at $18 trillion. This will start moving "soon". (Source: U.S. Federal Reserve)
- Productivity! 90 days ago, the thought of millions of Americans working from home (think no traffic time waste/better lifestyle package) was a "like that will never happen".
- Productivity = Corporate cost reduction = increased profits.

It is reasonable to think that the shares of Corporate America are not overvalued as detailed via the "Rule of 20" above in Sign #6, but perhaps undervalued based on this new next. Maybe that is a reason the valuations of Corporate America just keep going up, "for no reason". Hmmm…maybe.

Sign #7 is positive.

**The Rule of 20 is in this calculation implying, and using, a price/earnings ratio, which is the valuation ratio of a company's current share price compared to its per-share earnings. Thus, 18x the expected Earnings per Share. Both EPS and the multiple of 18 could drop. The earnings could be reduced due to the consumers spending less. The multiplier of 18 could drop to, say 8 for example, if investors were to get scared and become risk adverse. All of a sudden 8 x $164.12 turns the 3,018.17 2020 FMV into 1,312.96 and even worse if earnings were to drop below the example of $164.17/share! This is the multiplier risk and earnings risk I personally worry about. It may never occur, but what an unfortunate event it would be if it did and we had not prepared for it as a possibility. Thus, I am glad we have!*

We will continue to monitor and interpret the reports and data and continue to bring value to you. If you have friends, family or co-workers who you think we should be sharing our outlook, strategies and processes with we would be honored to receive the referral. Just forward my e-mail to your e-mail list. It is very timely information and in the volatile investment environment a second opinion may be greatly appreciated. As always, your thoughts, comments and discussion are welcome. Please call us at 800-283-8850 or email to Lindsey@successfin.com.

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