THE WEALTH STRATEGIES GROUP
Independent Objective Financial Advice

The Seven Signs of a Changing Economy™

"What to look for, where to find it and what to do when you see trends changing!"
As of March 2021

Summary

Before we look forward from this month's update of The Seven Signs of a Changing Economy™ I would like you to please take a moment to pause, and look back, to what we now know was a very important bottom in market values during a wicked start of the year sell off way back in the first two months of 2016.

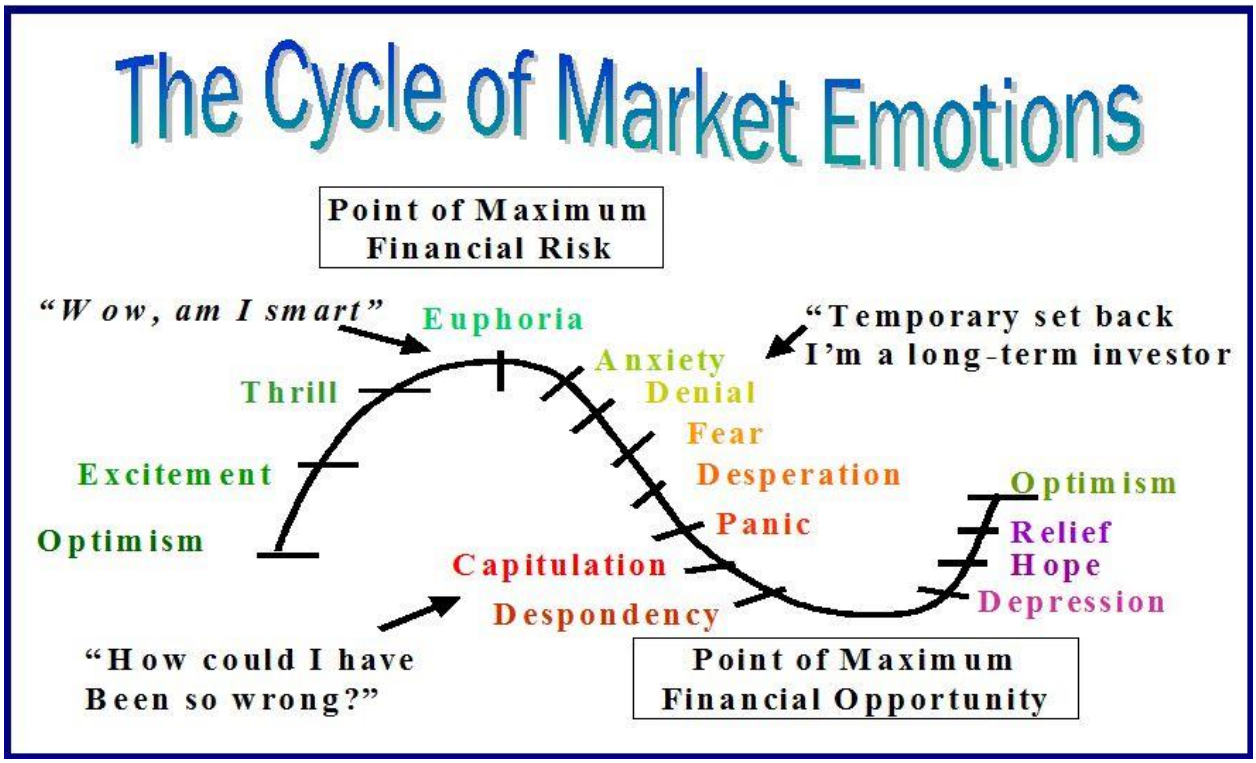
Perhaps you remember the headlines back then: "The worst start to any year in 80 years". I share with you The Weekly Update I wrote at, as it turns out, the exact bottom of that rout.

The Weekly Update 3/4/2016

Pass the Tums Please!

Outside of The Seven Signs of a Changing Economy there are a few less quantitative pieces of "interesting" data. Last week I noted one I like to observe known as "The Hemline Theory".

Another that is always interesting to me is "The Cycle of Investing Emotions". At first it may appear as funny and a joke, but after over three decades in the Certified Financial Planner™ Professional chair I can tell you I don't think it's funny, or a joke. I would argue it is painfully real. Have a look at this graphic and think back to your emotions over, say…the last year. Where would you place your emotions on this chart?



I have my standard $1.00 bet that you did not reply "Thrill" or "Euphoria" did you?! I talk with many clients each day. I know who is scared, fearful, upset and happy! Based on that "social scientist" type of research I would suggest the last 60 days have seen an almost stealth transition from capitulation to complete and total despondency!!!

I would suggest despondency is that quiet period where investors think all investment advisors are stupid. A period where emails and phone calls go unanswered while the investor quietly asks themselves, as the chart says, "How could I have been so wrong?"

Well, GOOD NEWS! As the chart suggests that is the "Point of Maximum Financial Opportunity"! In my opinion, WE ARE THERE!!

No one knows the future and of course this period could drag out for a longer period of time or change. However, I have lived through this cycle…well, let's call it "too many times"!

I feel this is the time to be adding to your quality investment allocation positions and pursuing your bigger future!

End of 2016 Weekly Update:

If you took advantage of that March 4, 2016 "point of maximum financial opportunity", as many of our WSG family did, you should be proud. Well done!

The point is not to boast, it is the opposite! The point here is to revisit "The Cycle of Market Emotions". Here we sit at all-time highs. Yet, to me something just feels a little "off".

As you will read below, all four of the signs that went to neutral from positive last month just did a "hockey stop" and 180-degree turn to the upside. This is rare! As in, I have never seen it happen. But, then again, I have not lived through a world that shut down and then opened in a rather herky jerky kind of way. For now, I will assume this is what data flow does under these circumstances.

As you will read in this month's update, the data flow suggests "game on"! And yet, as I said above, something feels "off". It would be great if I could identify what that means and tell you with confidence what it is, how it came to be and exactly how we would plan your bigger financial future around it, but I don't have that gift at the moment. But I have a brain and therefore some thoughts on this that I will share.

If you are a client, you know I am not a political person. You know this because I share it with the WSG family whenever it comes up. So, please don't misunderstand: the comments that follow are not intended to be political judgement or opinions around the Green New Deal (GND). Instead, they are just honest, boots on the ground, observations of what might be part of the "off", I am dealing with.

During the Presidential campaign, President Biden promised several things. Many involved undoing the prior administration's deregulations and tax cuts. We were promised higher taxes on high incomes, a wealth tax and lots of regulation under the Green New Deal.

It has been less than 60 days since Inauguration Day and in one of the shortest timelines in history, much of the promise has been completed via Executive Order. Thus, there is the re-regulation in play, but has not yet hit. Taxes are increasing, but not yet. Many new regulations have been initiated and are working their way into various systems.

Many unknowns are on the horizon. No one knows what to expect for sure, but we do know Corporate America is smart, really smart, and will deal with it in a positive way. Unknowns mean we likely experience volatility and dealing with this change in a positive way means higher highs in the valuations in Corporate America. How much time is between the two, I do not know, maybe none?!

That said, it may be a good idea to observe the chart I opened with, get a solid understanding for your comfort level inside the volatility oscillator and then update me on any changes you feel are needed as we update your constraints for time, risk and volatility.

This month's Seven Signs are updated below. As always, I have added some unique insight with my comments. Just scroll down to view these now.

Your thoughts, comments and discussion are welcome. Please call me at 303-933-2107 or e-mail me at Jlunney@wealthstratgroup.com.

Respectfully,

James O. Lunney, CFP®
CERTIFIED FINANCIAL PLANNER™ Professional

The Wealth Strategies Group was founded by James O. Lunney under the guiding principle that comprehensive wealth counseling combined with independent investment advice will provide high net worth clients with complete trust in our competence, execution and integrity.

P.S. Please join me for our monthly conference call on The Seven Signs of a Changing Economy. You have the option of calling in or listening live for free from your computer. To call in, simply dial **516-387-1595**. There is no access code needed. To listen live from your computer, go to our website, www.wealthstratgroup.com, and click on the **"LISTEN LIVE"** button on the home page. You will be sent directly to our page on the Blog Talk Radio website and you can click on the link there. Instead of having a live Q & A session at the end of the call, you can now e-mail your question to me prior to the call at JLunney@wealthstratgroup.com and I will address them after my commentary on The Seven Signs of Economic Change.

The call is always on the first Thursday of each month at 1:00 p.m. MST/3:00 p.m. EST, unless otherwise noted. Please mark your calendar to join me for the next call on Thursday, 4/8/2021.

We encourage you to invite people from your family, work and social circle to join in the call. Just forward my e-mail notification to your e-mail list. It is very timely information and in the volatile investment environment a second opinion may be greatly appreciated in these uncertain times.

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*

(Neutral)
Let's start right where we left off last month by reviewing the trend of Personal Consumption Expenditures (PCE). This is important, as PCE represents 68% of our entire U.S. economy (Source: JP Morgan Guide to the Markets 12/31/2020). Here was the trend last month with the most recent month's data as the last input.

Covid-19 impact hits: April 2020 -12.30%

May	+8.50%
June	+5.90%
July	+1.10%
August	+ .90%
September	+1.10%
October	+ .20%
November	- .70%
December	- .60%

Trends matter and this one doesn't look good and then we get January 2021 (most recent data): January 2021 +2.00%

If you're like me, you're asking yourself, "where did that come from?" Here are my two observations:

1) Inside the PCE Retail Sales jumped +5.30%, which is huge. Economists missed this by a cool 440%, as they estimated a gain of +1.20%. As the Covid-19 vaccinations roll out and government officials slowly reopen our country, we may have witnessed a "hockey stop" on this negative trend.

2) Per Morgan Stanley, personal savings rates have jumped from 9.5% to 25.7% quarter over quarter. Pretty obvious from the data flow above that people were saving and not spending as much during the lockdown.

As the virus ultimately fades away (estimates are in the next 12 months) people do have money and will most likely be playing catch up on all those purchases, travel and outings.

I am leaving Sign #1 neutral for now, but as we reopen the country it is very possible that this key sign came just moments from going negative due to this "hockey stop" and 180-degree turnaround. Let's hope for that!

Sign #1 remains neutral.

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)
This month saw the most money flowing into equity funds since March 2020, per Refinitiv.com, Lipper U.S. fund flows dated 2/24/2021. The money flowing in resembles much of what I wrote about several times last year where I referred to the coming "FOMO", i.e. Fear Of Missing Out!

We are officially at FOMO!

At the core of any investment price change is money. Money flowing in increases the valuations and the opposite is also true, money flowing out reduces valuations. Where is all this money coming from? Simply do a quick online search for “St. Louis Federal Reserve M-1 money stock”.

A chart will appear that very clearly shows liquid cash in our economy, think money available to buy stuff and invest. You will see money supply increasing from $4 trillion in April 2020 to $18 trillion as of February 23, 2021. That represents an incredible 350% increase of money looking for a home that might return more than close to zero percent.

Much of it is finding its way to investments in Corporate America, per the fund flows above. It has caused Mr. and Mrs. 401(k) to increase their positive outlook (bullish) from 37.7% on 1/27/2021 to 45.90% on 2/24/2021 per the American Association of Individual Investors Sentiment Survey.

Much of this newly invested money is “hot” money, as we call it. It is more from “traders”, aka renters of Corporate America looking for a quick profit versus “owners”, aka long-term investors in great American companies. This hot money bouncing in and out can result in volatility.

As I write this update on 3/6/2021, five companies out of 500 in the S&P 500, represent 15% of the index.

These are large technology companies and if you are interested in them, just search “FAANGs” and they will pop right up.

The point here is that when just a few companies represent 15% of the entire S&P 500, as these five do, hot money “flowing out” can cause the entire index representing 500 great companies to go down.

This has the ability to “spook the herd”, as I call it.

In my opinion, it is just a matter of time until this happens. So, we must start to come to terms with the difference between volatility and risk. Volatility is short-term in nature and the price we pay to be long-term owners of the great companies in Corporate America.

Risk is changing your bigger financial future plans in the middle of a fear driven volatile sell-off, so check your investment plan’s constraints for time, risk and volatility.

Sign #2 remains 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*

(Neutral)
This very important "peek around the corner" to see what economic backdrop Corporate America will be operating in six to nine months in the future (September 2021 – December 2021) went neutral last month. The data flow was still reporting positive, last month was +.30%, but was trending a slow-glide path down from +2.80% in May 2020.

Like Sign #1 (PCE) above, this Sign saw a "hockey stop" and turn up for the positive. The Conference Board, who created the Leading Economic Index (LEI) reported the most recent release as +.50%. It is reasonable to think of this reversal in the downward trend as an early sign that we are beginning to exit the patch of Covid induced economic weakness and could now be a set up for re-acceleration.

All things chemical happen in the economy before all else is reported, as they are key demand inputs for all other areas of our economy. The Chemical Activity Barometer (CAB) rose 1% in February 2021 following a +1.80% increase in January. On a year over year basis the CAB was +1.30%.

This is a good and positive sign. The CAB has now increased for 10 months in a row and suggests a solid economy with the potential to expand. For now, Sign #3 will remain "neutral". The peek around the corner LEI was always suggesting growth, but at a lower and lower rate causing the drop from positive to neutral. We will now need to see two more months of positive and growing LEI to change the key input to 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*

(Neutral)
As we reviewed last month's jobs creation it was so terrible (we created only 37,000 new jobs in November and December 2020) that Sign #4 was reduced from positive to neutral.

Like Sign #1 (PCE) and Sign #3 (LEI) above, we have experienced another "hockey stop" and 180-degree turnaround in jobs creation. As the economy is starting to reopen the private sector created 465,000 new jobs! Public employment happened to shed 90,000, so the net gain in new jobs was a very solid +379,000.

As noted above, this is 10x more jobs created in one month than last November and December combined. We are not out of the woods just yet as there are still

an estimated four million fewer jobs than we had going into the pandemic shutdown last February. However, tt is pretty obvious at this time that reopening will pick up steam as vaccinations and herd immunity solidify. This reopening, I believe, will result in more jobs creation reports like this one.

On an equally positive note, the St. Louis Federal Reserve 4-week moving average of initial claims for unemployment dropped from 847,000 last month to 730,000, down from the pandemic peak of 5,033,250 on 4/25/2020. This is outstanding progress.

No, I don't believe the "books are being cooked"! Yes, I do believe we are reopening and can expect more reports like this one. Hockey stop or no hockey stop, people need jobs to earn money, pay the bills and to go buy more stuff, PCE above, and keep our economy spiraling up.

Sign #4 remains neutral, but we need two more reports as respectable as this one and we will be back to 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*

(Neutral)
Like Signs #1 (PCE), Sign #3 (LEI) and Sign #4 (Jobs) above, our "canary in the coal mine", this Sign #5 representing Durable Goods Spending went to neutral last month. And, like #1, #3 and #4 also did a "hockey stop" and 180-degree turn.

Durable Goods are long shelf-life items like non-perishable, non-fashion items that generally show the first sign of a slowing economy, as these are items we can do without if we don't have the money. Think new clothes or underwear.

Last month Durable Goods remained positive, but barely at a +.2%. That was the fourth month of reduction as each month eroded from September's +1.90%. Then, BLAMO! The most recent month shoots up +3.40%. This is the largest increase in six months and bounces back to levels pre-pandemic.

Inside the overall +3.40% the data is even better as business spending was up for the ninth consecutive month. Both businesses and consumers are all of a sudden buying everything in sight. As the lockdowns unlock one doesn't need too much imagination to think this multi-month eroding trend has been backstopped and should start to gain month over month for many months going forward.

That said, Sign #5 also needs a few more growing months of data before it will suggest an all-clear "positive"! Let's hope by June.

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)
There is only one wat to cut through the "weirdness" of the market psychology to determine if what we are buying is at a Fair Market Value (FMV) price, or not. The tool that has treated our WSG family the best in this FMV category is the old business school rule of thumb, "The Rule of 20".

Let's plug into our Fair Market Value (FMV) calculator using "The Rule of 20" to get both FMV and the price to earnings, or P/E, ratio (a measure of risk).

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) for the 4Q2020 "second estimate" released February 25, 2021 of +1.60%.

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

- 20 – 1.60 = 18.40
- 2021 S&P 500 earnings estimate $173.63 (Source: Yardini Research, 3/3/2021)
- 2021 S&P 500 Fair Market Value estimate - $173.63 x 18.40 = S&P 500 (FMV) 3,194.79

As of 3/5/2021, the S&P 500 trades at 3,841.94, or a 20.26% premium to 2021 FMV.

With Corporate America hitting all-time highs for profits and interest rates hitting close to zero, it is normal for investors to look just nine months forward to 2022 earnings. Let's also look at FMV for a year out in 2022.

- 20 – 1.60 = 18.40
- 2022 S&P 500 earnings estimate - $203.00 (Source: Yardini Research, 3/3/2021)
- 2022 S&P 500 Fair Market Value estimate = $203.00 x 18.40 = 3,735.52

As of 3/5/2021, the S&P 500 trades at 3,841.94 or a 2.85% premium to 2022 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. 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 22.12 + .04 (the yield on the 90-day T-bill) = 22.16

So, based on 2021, overvalued.

Based on 2022, the (P/E) ratio is 18.92 +.04 (the yield on the 90-day T-bill) = 18.96 and below the 20 value opportunity level.

My conclusion is that short term this suggests volatility, but one to two years out there is value in the ownership of Corporate America.

Sign #6 remains positive as earnings are likely to surprise on the upside, but valuations are no longer in the "bargain bin"!

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 +1.30% annualized for this month. As energy prices increase, it is likely we will see input costs go up. That said, any increase of up to 2% is not only reasonable but expected at this stage in our economy. In fact, input costs have increased +31.9% since April 2020. These costs will very likely start to be passed on to consumers in the coming months.

The Consumer Price Index (CPI), which measures the inflation rate at the household level, reported in at +2.00% annualized for this month. Up 42.85% over last month's. CPI has increased +566% from .3% in April 2020. That is a large percentage increase, and the first shot over the bow of inflation entering the households of America. I don't think it will cause late 1970's or early 1980's inflation, which was the second highest inflation rate since the Civil War, but more like 3-5% annualized inflation.

The "second estimate" of our Gross Domestic Product (GDP) for 4Q2020 was reported as +4.10% annual growth of all the goods and services we produce as a country. (Source: Congressional Budget Office)

On the surface, this is a very good rebound out of the 2020 black hole in our economic donut. Peel back the onion skin and we see the "cause" was over $3 trillion in government spending and $14 trillion in new money supply placed into

circulation by the Federal Reserve. Current headlines just reported another $1.9 trillion stimulus package is in place!

Our government has borrowed and printed these incredible amounts of money to stabilize our economy. This is great in the moment, but remember, "we the people" and Corporate America will pay higher taxes to somehow pay this debt down. Higher taxes mean less money in consumers' pockets to buy stuff (See PCE Sign #1 above) and less profit to Corporate America, which is arguably overvalued per the quantification in Sign #6, S&P 500 earnings per share above.

In plain English, what these data points just told us is that manufacturers have seen a +333% increase in their input costs since 1/1/2021. Just one barrel of oil is up +314.25% since April 2020, i.e. one year ago.

At our household level, CPI is up 566%. Yes, these are big percentage increases on a small / lower number. Just a note to self, follow the trend and the trend is going up with momentum building.

Watch food prices! Food represents 14% of the total CPI. If food prices are going up, so is inflation at your house!

Here is what we might expect to see next: Next month, April 2021 the lower PPI and CPI readings of 2020 will become the basis for the year over year comparison. 2020 dropped precipitously due to the pandemic. The laws of mathematical calculation will be forced to calculate inflation, versus the prior year, creating a much higher and increasing inflation rate. Add this statistical quirk to the about to be pandemic free roll out of pent up demand and it could make inflation look even worse than it might be.

We are planning accordingly. Each client in our WSG family has been seeing for months now, that we are thoughtfully allocating away from what has treated us well, to what we strongly believe will be treating us well next in our client asset allocations and investment positions.

Sign #7 remains positive but could be reduced to neutral if we see the inflation rate pick up as we expect it could.

*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 $173.63 turns the 3,194.79 2021 FMV into 1,389.04 and even worse if earnings were to drop below the example of $173.63/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!

The opinions voiced in this material are for general information only and are not intended to provide specific advice for every client.

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