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 November 2017

Summary

If you chose to, you could read The Seven Signs of a Changing Economy™ going back several years to when McGraw-Hill released my first book worldwide September 2007, right before the 2008 economic meltdown I wrote about in Surviving the Storm, Investment Strategies That Help You Maximize Profit and Control Risk During the Coming Economic Winter.

Interestingly, few people were interested in that negative and detailed prediction!

Then the "Great Recession" happened and it was a little late for most investors to react!

Since about 2010, and 15,000 Dow Jones Industrial Average (DJIA) points below where we are today, I have been writing about how the same economic indicators that suggest a weak economy have been suggesting a strong economy ahead. This backdrop usually sets the stage for increasing sales and profits for the companies in Corporate America, which then leads to higher valuations of same.

Like before, few wanted to hear about this rosy outlook as they were too scared to ever invest again after the "Great Recession"!

So where are we today? Well I will quote Jason Goepfert of SentimentTrader.com:

As of Friday, 10/20/2017…

- The market closed at a record daily high ***every day*** last week.
- It has closed at a record weekly high ***every week*** for the last six weeks.

- It has closed at a record monthly high ***every month*** for the last seven months.

Per Jason, "That combination has never been seen before in market history,"

Gee, who would have seen that coming! You, if you are reading these updates! That is what I have been suggesting would happen for years!!!

Now, here is "the thing" and there is always a "thing"!

The trees don't grow to the sky. I anticipate a correction in this upward trend! That is a given. The difference this time is Mr. and Mrs. 401(k) will be quick to sell as they still, deep in their hearts, believe there is another shoe to drop!!.

They will sell into the downdraft.

At The Wealth Strategies Group, we will not!

We will consider allocating cash and get ready for what comes right after that, which I believe will be a serious bounce up and a continuation of the current trend.

I refer to this stage of the market advance as the "FOMO" stage. What is FOMO, you ask? It is an acronym for "Fear of Missing Out"!

Legendary investor and money manager, John Templeton is often referenced for his famous quote that bull markets:

"Are born on pessimism, grown on skepticism, mature on optimism and die on euphoria."

FOMO is my reference to the euphoric stage. It is the stage where your taxi cab driver tells you he is going to quit his job so he has more time for day trading, or like the E-Trade commercials of 2008 where the teenager in a tie-dyed t-shirt is presented as making so much money trading stock that he has his own Rolls Royce limousine.

The signs will be there. In fact, I saw my first one this weekend. A local news station reported on a class of junior high students who were "learning about money" by competing against each other "trading" in their play stock account with play money. The student with the highest balance at the end of the quarter would be declared the winner.

Am I the only one who sees this as a very, very bad learning module around money and investing? 90 days to get the largest return teaches maximum risk taking and most people can't decide where to vacation next year in 90 days. This is "a sign" of a peak. Imagine any school putting this learning module in place back in, say, 2009 when the kids' parents were losing their homes and

blowing up their 401(k). Just saying, wait for it, there will be many more signs like this one to come!

The Seven Signs below are all positive once again this month! So, good they will usher in the FOMO stage starting about now.

That will bring the last of the Mr. and Mrs. 401(k) investors back into owning the shares of Corporate America and that is the point we will have our first look at reducing our clients' exposure to the companies of Corporate America.

Timing? Not sure, but perhaps before the really ugly mid-term elections that arrive in 2018, and not perhaps for a few years from now. That is exactly why we will continue to thoughtfully prepare for what is next. Here at The Wealth Strategies Group, we have in place and ready to go, the structure, systems and strategies to take action if and when it is needed.

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 **347-826-7481**. 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, December 7, 2017.

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*

(Positive)
The Federal Reserve Bank of St. Louis releases the amount of "personal current taxes" collected each month. Please note the word personal, i.e. taxes paid by folks like you and me. I think you would agree that most of us pay tax on income. From that reality, it is fair to suggest that if the taxes collected, as reported by the St. Louis Fed, are at an all-time high then household taxable income must also be at an all-time high, correct?!

This month, the personal current taxes collected are, in fact, at an all-time high of $2.067 trillion, the highest ever recorded. Guess what happens right after you make more money? If you are normal, you might gain more confidence about making some purchases you were putting off over the last few years. Per the Conference Board, the most recent consumer confidence report just hit its highest reading since December 2000. Note to self: That was right before the "Tech Wreck" of March 2000 through October 2003. As a side bar, if you are feeling nostalgic and would like to read the piece I wrote titled "The Wicked Witch is Dead", compliance timestamped October 2002, I called the bottom of the Tech Wreck to the week, not bad! Just call or email me and I will share a copy with you.

So, back to the stats, income up, as proven by increased government tax rolls, increased disposable income leads to increased consumer confidence and yes, another all-time high in Personal Consumption Expenditures (PCE), Sign #1! We now sit at an annualized $13.531 trillion!

That's just a warm up! As printed here in March 2017, and I quote myself, "2017 will be the largest holiday shopping season on planet earth – EVER!" On November 2, 2017 Tonya Garcia wrote in MarketWatch "Adobe forecasts 'online' sales for the holiday season totaling "$107.4 billion, up +13.80% year over year and outpacing 'in-store' retail estimated to be up 10%."

A middle-class tax break will only make this #1 driver of our economy even stronger. Sign #1 is about to do something I didn't think was possible and that is get even more positive than it has been. This is seriously positive!

2)	**Indicator:**	*Institutional Money Flow*
	Where to find it:	*www.wordenbrothers.com or*

What to look for:	*www.barrons.com/convictionoftraders* *Increasing or decreasing prices on high volume of large block trades*

(Positive)
That didn't take long! In the September 2017, just 60 days ago, The American Association of Individual Investors (AAII) survey of members (think Mr. and Mrs. 401(k) investor), reported only 25% were positive (bullish) on the direction of the investment market valuations over the next six months. Said a different way, 75% were negative or confused (neutral).

And then, "nothing happened", and, all of a sudden, the AAII survey dated 11/1/2017 reported 45.10% were positive (bullish), 26.40% were confused (neutral) and 28.60% were negative (bearish). Said a different way, only 55% were negative or confused. This is an 80% increase in the percentage of Mr. and Mrs. 401(k) investors who now see the market valuations six months in the future as positive!

The causal effect is that for only the third month since December 2015 there was a positive inflow to equity funds. It was an inflow of +$12.90 billion. Nice, but only a fraction of the nearly $10 trillion sitting on the sidelines in cash accounts like short CD's, short government bonds and demand deposits.

You have read here, ad nauseam, that until now Mr. and Mrs. 401(k) were petrified, literally, of investing in the companies of Corporate America. The force driving values up for over 16,000 Dow Jones Industrial Average (DJIA) points since the bottom during the Great Recession in March 2009 was:

1) The "stubborn $1 trillion", i.e. short sellers who had to buy shares and cover or go to jail.
2) The currency carry trade, i.e. Japanese yen down versus the U.S. dollar adds many leveraged percentage points of return plus market appreciation here.
3) The companies of Corporate America buying back their own shares, to the tune of hundreds of billions of dollars.

These three drivers, in my observation, have peaked, are slowing down and in doing so, set the stage for the next leg up. The stage I call "FOMO"! Yes, now per the AAII stat above combined with the money flow from Mr. and Mrs. 401(k) investor now flowing towards Corporate America and out of the $10 trillion in cash on the side lines are officially starting the Fear of Missing Out (FOMO) stage.

Stunning to me that these historically smart people waited +16,000 points up on the DJIA to see the "coast as clear". In my opinion, this will do two things:

1) Push the DJIA over 30,000 – sooner vs. later

2) Start the clock ticking to the next sell off, which could be as soon as the mid-term elections on November 6, 2018.

No one knows the future, including me, so I will watch carefully and act thoughtfully but FOMO lights the fuse to the next "event".

Sign #2 remains powerfully 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)
The Leading Economic Indicators (LEI) were created by the Conference Board as a forward-looking tool to estimate what the economic backdrop Corporate America will be operating in six to nine months down the road will look like, i.e. positive, neutral or negative.

As noted in the box above, I choose to reduce the effects of month to month changes by looking more at three to four month trends. So, one or even two months, up or down, really means very little.

That said, The Conference Board's (LEI) for the most recent month fell -.2% month over month. This snaps a 12-month string of advances and falls short of both analysts' expectation for a +.10% gain and the prior month's +.40% reading.

Part of the decline can be attributed to hurricane-related impacts with labor markets and residential construction cited as the primary sources of weakness. However, the Conference Board noted that the majority of LEI components continued to contribute positively, and they see this month's decline as a "one-off" reading with the overall index trend pointing at +4.0%, a level that has historically been associated with a low chance of recession in the next 12-18 months.

For the last several months I have also been highlighting here the Chemical Activity Barometer (CAB), since all things chemical tend to happen before many other activities in our economy. It is also one of the first to show a weakening economy. Since 1919, it has shown to provide a lead time of two to fourteen months, with an average lead time of eight months, before a recession starts. This month the CAB reported in at 119. This is higher than before the "Great Recession", highest level ever recorded and is +6% year over year.

I believe the economy will continue doing well into the spring and summer 2018. A strong economic backdrop for Corporate America to operate in would normally

imply increasing profits and thus increasing valuation of Corporate America, as measured by the S&P 500. Sign #3 is very 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)
Let's start with a quick look back.

In July, 209,000 new jobs were created. For an economy that is near full employment that is good. Since the Great Recession, we were looking for +300,000 new jobs per month, but all of the jobs lost have been replaced plus many more. Specifically, 8.8 million jobs were lost during the economic storm and since it ended March 9, 2009, 17.1 million jobs have been created. So, nearly full employment. (Source: Guide to the Markets, J.P. Morgan Asset Management 9/30/2017)

The part of the July jobs creation number of 209,000 that was not great was that pesky birth/death model adjustment. Remember, the birth/death model is not a measure of lives but a telephone survey of businesses to see who is hiring and how many. The issue is that if a business went out of business, i.e. they don't respond, the survey assumes all employees are now "employed" elsewhere. Hmmm…sounds like a margin for error! So, July reflected 158,000 of the 209,000 jobs were added via the birth/death phone survey. Only 51,000 real, measurable jobs created.

For August, 156,000 new jobs were created, but again 103,000 were those very questionable birth/death survey calls. Thus, perhaps only 53,000 real new jobs created. This suggests it is possible that we are now at a wall, where have a mismatch between jobs available, i.e. openings, and unfilled jobs. This highly suggests there is a job "skill set" requirement that many in the talent pool are not qualified to fill.

September's data was, in my opinion, not reliable, as it was clearly affected by the hurricanes in the southeastern U.S. There were -33,000 jobs lost. The birth/death survey took away -49,000 so the net result was a pathetic +16,000 new jobs created, i.e. hurricane affected.

After this quick "look back" the most recent jobs creation for October 2017 inks at +216,000. A respectable number, "but" that questionable birth/death model for jobs creation added 216,000 of the 261,000 new jobs and suggests only 45,000 jobs were really created!

Sign #4, jobs creation has been super positive and is also a great thing for so many people who want to work and create value. However, this data flow continues to quantify what I have been writing here for a few years and that is the detail suggests a very large skills mismatch between unfilled jobs and the available labor pool to fill them. If you are a realist, you knew this was coming. Even McDonalds is automating the front counter versus paying $15.00/hour plus healthcare, etc.

Sign #4, Jobs Creation, has been so positive for so long, my ongoing concern is that it somehow collapses in on itself, causing labor costs and inflation to trend higher, which would be a party wrecker for sure!

For that reason, I will continue to stay focused on this still very positive sign of a changing economy.

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*

(Positive)
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. New orders increased +2.20% this month, shipments, up four of the last five months, increased +1%, and inventories were +.60%.

This data flow is positive, but the important data point few tend to notice is unfilled orders. To me, unfilled orders means we have so many orders we can't keep up, sung to the tune of, "that's on back order". And how much is currently on back order, you ask. That would be $1.135 billion. I am not sure about you, but to me $1.135 billion on back order strikes me as "a lot" as we are now just 14 days away from the start of the largest holiday shopping season that will soon be reported as the largest ever on planet earth.

As a social scientist, I observe this data in real time as I go about my life. I see cranes over "every" town I have visited in the last three months and there were many and on two different continents! If you were to poke around www.bigcharts.com, you might see shipping and trucking companies that we all know the names of trading at all-time highs supported by all-time highs in their respective revenues and earnings per share!

If you are more independent, objective and data driven, as I am, you could search: Texas Manufacturing Outlook Survey. I suggest this state and survey only because you would expect the hurricane activity would have a negative impact. Not correct.

- Texas Production Index rose to highest reading since 2014

- Texas manufacturing activity also increased with "new" orders at a 10-year high, up +31.91%
- Texas factory capacity utilization hit the highest level in a decade
- Texas factory shipments also well above average at +20.90%

If you look around as you go through day to day normal activities in your life, you can't help but notice that even non-essentials are flying off the shelves.

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)
As I write this update, there are about 56 days left in 2017. It is about now that the calendar starts to make the 2017 earnings per share for Corporate America more and more irrelevant as most analysts start looking for what to expect in 2018.

As noted in the last two monthly updates the energy sector has seen their earnings "roar" back up as crude oil is hitting a two-year high. Other sectors continue to grow as estimated and FactSet now estimates 2018 S&P 500 earnings will grow nearly +9% year over year (YOY).

At present the S&P 500 EPS estimate for full-year 2017 is $145.55, and 2018 full-year S&P earnings are estimated at $159.09.

In our effort to determine what this means, let's plug full-year 2017 earnings into our "Rule of 20" Fair Market Value (FMV) estimate model.

To use the "Rule of 20" you should subtract the inflation rate from 20. I will use the same inflation rate the BEA used in calculating the "advance estimate" 3Q2017 released October 26, 2017, of 2.16%.

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

- 2017 S&P 500 earnings estimate = $145.55
- 145.55 x 17.84 = 2,596.61 (S&P 500 2017 FMV estimate)

- 2018 S&P 500 earnings estimate = $159.09
- 159.09 x 17.84 = 2,838.17 (S&P 500 2018 FMV estimate)

As of 11/3/2017, the S&P 500 trades at 2,587.84 (at 2017 FMV and a 9.67% discount to 2018 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 of the two was under 20, the markets were trending up. When the total is above 22, we are in the danger zone. Based on this, I did some quick math to see the forward price earnings ratio calculated above is 17.77 for 2017 and 16.27 for 2018. The 90-day T-bill as of 11/3/2017 is 1.18%.

For 2017 17.77 + 1.18 = 18.95 and for 2018 16.27 + 1.18 = 17.45, both are below the average of 20 and very much below Dr. Sjuggerud’s 22 level danger zone. This is interesting detail, so I thought I would share it again this month.

Sign #6 remains 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)
All of the goods and services we produce in the U.S. are measured via the U.S. Gross Domestic Product or GDP. The government agency who collects and reports this data is the Bureau of Economic Analysis (BEA). The BEA reports GDP as “real” since they back out any GDP growth related to inflation.

In the October 26, 2017 advance estimate of 3Q2017 GDP, the BEA used an inflation rate of 2.16 to report 3Q2017 GDP growing at an annualized +3.00%. This is solid economic growth and puts our combined total output of goods and services at $19.495 trillion, the highest ever recorded on planet earth.

This is a solid economy and one, based on the prior six signs, is clearly spiraling up. This is exactly the economic backdrop Corporate America needs for it to grow revenues and profits, which in turn support the current company share valuation and that also continues to push them higher (see Sign #6 above on 2018 FMV estimate).

Inflation is key here! It is key as the historic goal is to grow the economy at +4% per year net after inflation. What we don’t want to see is inflation above 3-4%. At present the Consumer Price Index (CPI), which measures inflation at the household level is running at +2.10% annualized as of October 2017.

The Producer Price Index (PPI), which measures inflation at the manufacturers’ input level is running at +2.20% annualized as of October 2017.

Post World War II, the three drivers of inflation are labor costs (see Sign #4 above) which are headed higher, energy costs, which are at a two-year high, and

consumer spending (PCE), (see Sign #1 above), which is growing at +2.13% per year seasonally adjusted as of October 2017.

If you love to have something to keep you up at night, focus on these three. Combined, they make inflation go up and increasing inflation will result in increasing interest rates. Interest rates eat into the profits of Corporate America and if profits stagnate or start to decline, the market valuation of Corporate America, as measured by the S&P 500, will begin to reverse, i.e. the S&P 500 will go down!

I don't write this to scare you, I simply want you to know I know and that with our WSG team we have systems, processes and strategies to thoughtfully act as needed in our best efforts to grow and to protect the assets our clients have entrusted to our oversight.

At this point, Sign #7 is very 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 $145.55 turns the 2,596.61 2017 FMV into 1,164.40 and even worse if earnings were to drop below the example of $145.55/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!

stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.