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 June 2021

Summary

I am a little of both! First, I am a firm believer that investors who remain patient tend to receive above average investment returns over time. Key words, patience and time.

In my opinion, we have done this quite well for our WSG family. My proof is that about the only clients who leave our investment oversight are those who pass away. Yet, their adult children and their children stay with us. We now have a handful of families where we work with four generations!

So, time and patience combined with a well thought out asset allocation and quantifiably strong performing investment positions works.

The other half of my "a little of both" statement above is my belief that you always sit close to the exit just in case something out of left field starts to develop. This is why I created the WSG Exit Strategy™ many years ago and continue to freshen it up regularly. It has been my experience that sitting through market valuation drops like the Great Recession, which I wrote all about in my best selling book Surviving the Storm, McGraw-Hill 2007, well before it happened, is not a good investment strategy. It just seems to me that if you see the potential for significant downward volatility that you should raise some cash so you can potentially re-enter if that downdraft event actually occurs.

There are people who would rather sit through downdrafts as they are of the mindset that over time and with patience the values of Corporate America will once again rebound up to new all-time highs. I do understand the logic here.

When I first sat down in my Investment Advisor chair in April of 1982, yes, 39 years ago, my Quotron machine flashed that the Dow Jones Industrial Average (DJIA) was trading at 777. I remember like it was yesterday as I thought to myself, that is a LUCKY number, and it has been.

Since that day, the U.S. has had plenty of gut-wrenching, agonizing and traumatic events occur. From 9/11/2001, the Great Recession, wars, market crashes to the pandemic. Just CRAZY!

Yet, as I write this summary on 6/6/2021 (yes, it is a Sunday and this is my hobby, rhymes with nerd), the same DJIA rests near the all-time high at 34,756!

Assume the DJIA only does HALF as well over the next 39 years, the DJIA will rest at 500,000 in 2060!

I believe these long-term patient investors will be rewarded.

As noted, the valuations of Corporate America rest near all-time highs. I have quantified in Sign #7 (Corporate Earnings) below that even with the tremendous increase in corporate earnings for 2021 and 2022 valuations are trading at a premium of 19.47% for 2021 and 11.40% for 2022.

Old market sayings like “trees don’t grow to the sky” and “it’s different this time” pop into my mind. Hence, back to the WSG Exit Strategy. Today I remain close to the exit, not with all positions, but with a thoughtful amount. This mostly because Consumer Spending, Sign #1 below, remains neutral, as is Sign #4, Durable Goods Spending. So, not terrible!

Yet, out in the world I continue to closely watch my “four pins that prick bubbles”:

- White House tax increase on Corporate America could result in a 9% - 11% reduction in profits not to mention what is coming to the people, like you, who read this, i.e. we are all in the tax increase bullseye.

- Inflation outlook noted above, and in Sign #7 below, forces the Federal Reserve to increase interest rates earlier than planned. This could spook the herd bit time.

- The potential for U.S. – China relations to continue unraveling and in so doing damage to economic global growth prospects.

- Corporate America quantifiably trending above normal Fair Market Valuations opens up the possibility of a flash crash to down 15% in a very short period of time.

Tax increases are in play as I write. Inflation is on the rise, see Sign #7 below. Since I wrote last month’s update, U.S. – China relations have deteriorated, a lot. Any one of these alone, let alone with some other out of left field wild card, could result in a 15% - 20% “flash crash” or perhaps worse, a repeat of the 2008 – 2009 Great Recession do-over.

So, I am a little of both, we will likely go to higher valuations over the next decade, yet along the way it seems to me there are points where thinking people "take a rest" by building up a little cash, just in case.

Personally, I would rather miss a touch of upside valuation potential than re-live some of the nasty drawdowns in value that have happened along the way to higher highs.

So, our WSG team remains focused, aware and ready to make thoughtful changes in our asset allocations and investment positions if and when warranted.

As a WSG family member, your responsibility is to work with us to plan now while the valuations of Corporate America remain near all-time highs.

If the thought of your account value dropping 20% makes you a little queasy, you need to freshen up your plan to create a new one.

All plans start with each person's constraints for time, risk and volatility but should also include:

A) No debt where possible
B) Cash reserves at each person's comfort level. At least 6 months of expenses
C) Monthly expenses known
D) Monthly income sources ID'd to cover C above

Today, right now, is the time to think about that sick feeling of being down several 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 financial 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'll update your current plan, or create a new one that will work for you.

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, July 15, 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)
The last few months I have incorporated the data trends into a few of our economic signs. The trends are key and when the data can be observed in sequence, I think it makes it a little easier to identify a positive versus neutral or negative trend. So, let's add this month's data to the last few.

Per J.P. Morgan, 67.6% of our entire economy is Consumer Spending. This is measured via our Sign #1, which is Personal Consumption Expenditures (PCE). So, how is PCE recovering from Covid?

Covid-19 impact hits:

April 2020	-12.30%
May	+8.50%
June	+5.90%
July	+1.10%
August	+.90%

September	+1.10%	
October	+.30%	(Adjusted up from +.20%)
November	-.60%	(Adjusted up from -.70%)
December*	-.90%	
January 2021	+3.10%	(Adjusted down from +2.00%, to +.30%, a huge downward revision. As of 4/30/21, adjusted back up to +3.10%)
February	-1.20%	
March	+3.60%	
April	-.10%	

***Where Sign #1 was reduced from positive to neutral.**

Before we decide what this trend is saying to us, let's consider a few other pieces of data. First, per the St. Louis Federal Reserve, personal current taxes hit the highest level ever recorded in the most recent release (April 2021). So, we know people are going back to work, paying taxes, earning, saving and "sorta" spending.

Second, since the beginning of 2021, gasoline prices have increased from $2.23 per gallon to $3.05 per gallon. This represents a $1.02 per gallon, or +45.74% increase YTD. (Source: www.gasbuddy.com) For perspective, recall that for each penny increase in gasoline the non-discretionary spending by consumers and businesses is reduced by an annualized $1.3 billion. Thus, an annualized reduction in discretionary spending of $132.6 billion, so far, and gasoline prices continue to increase. I suspect Russia and OPEC +1 are very happy with the new administration's energy policy.

Third, the Velocity of Money comes into play here. The velocity of money is a measurement of how fast money changes hands. If we all leave money in cash and don't spend, the velocity of money slows down and depresses our economy. This is what happened around the world when we were locked down and spending much less. To make up for the reduced spending, more money was added to the system and combined with continued low interest rates has spawned a reasonable recovery so far. However, per the St. Louis Federal Reserve the most recent velocity of money measurement is only a fraction above the pandemic low.

My conclusion is that folks are earning and paying taxes but are also getting held back in spending due to higher energy costs and therefore the velocity of money is still stuck in the mud. There are a few other reasons for this detailed in sign #5 below, but as more of our country, and the world, opens up, I suspect this trend for our very important Sign #1, Personal Consumption Expenditures (PCE) will improve. Since that is not in the data flow yet, 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)
Memorial Day is the unofficial kick off to summer. In the money management world, this means the big-time money desk whales rotate to wherever they vacation for a month or two or three until Labor Day, the unofficial end to summer.

All that means to us is that we tend to see lower trading volume in the summer, which oftentimes leads to more volatility. This is normal, so plan for it as we enter June.

However, behind all this are a few trends are intact that tend to favor we long-term investors. One, the money supply continues to be increased into the monetary system. This is measured as M-1 Money Stock and reported by the St. Louis Federal Reserve. This is also a big back story for the velocity of money detailed above in Sign #1. This month the money supply hit another all-time high at $18.935 billion. In simple terms, just know that the more money supply sloshing around the economy, the higher stock prices will go.

Next, Mr. and Mrs. 401(k) remain fearful. Per the American Association of Individual Investors (AAII), only 36.4% are bullish (positive) on the investment outlook for the next six months. In other words, almost 2/3 see a neutral or negative six months. This is important to note, as this group tends to be wrong most of the time!

On the flip side, Corporate America, think thousands of floors of MBA's, CPA's and attorneys all across the nation, are buying back their own company stock at a rate on track to make 2021 the largest buyback year ever. So, the people who get to see the books are "all in" and Mr. and Mrs. 401(k) are fearful. This is good news for the uptrend we are in and 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*

Written by Brittany Jarocki, CFP®

(Positive)
The Leading Economic Index (LEI) rose 1.6% month over month, which is a new all-time high for the index. Keep in mind that this is our look into the future to see if our economy is contracting or expanding six to nine months from now, i.e. December 2021 through March 2022.

To visualize the trend, here are the past 13 months readings:

Covid-19 impact hits in:

April 2020	-4.40%
May	+2.80%
June	+2.00%
July	+1.40%
August	+1.20%
September	+.70%
October	+.70%
November	+.60%
December	+.30%
January 2021	+.50%
February	-.10% (Revised 3/2021 from +.20%)
March	+1.30%
April	+1.60%

The past two months have shown strong increases as we move into the summer months and our world begins to re-open with vaccinations prompting more travel, dining, sports games, etc.

Last month all ten of the inputs that make up the LEI were positive. This month only two components have moved from positive to neutral – average weekly manufacturing hours, and manufacturers new orders both held steady. I have a feeling that this is due to supply constraints, not demand constraints, i.e. can't find laborers who want to work and parts to manufacturer goods are backordered. There are no negative indicators again this month, which is rare.

Finally, the Chemical Activity Barometer rose yet again in May. This is +18.6% on a year over year basis. As we know, everything chemical happens first, and this continues to move in a positive direction.

Based on the past two months of data Sign #3 had been deemed neutral and was awaiting this month's data to push it back up to positive. With the strong readings last month and this month, Sign #3 is back 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)
Before we get to new jobs creation, let's look at another key jobs data point, initial claims for unemployment benefits. Initial claims hit a pandemic peak on

4/25/2020 at 5,033,250 (Source: St. Louis Federal Reserve). Each month since we have seen reductions. This month came in at a pandemic low of 406,000. As a comparison or benchmark, the cycle low was on 2/15/2020 at 209,250.

This month the U.S. economy created 559,000 new jobs. This was below forecast, but in an odd way this is a great jobs creation number. Why? Because it is not so good that the Federal Reserve will be motivated to raise interest rates right away yet warm enough to keep the steady eddie growth going north.

In my opinion, part of the reason for the reduced initial claims for unemployment benefits and new jobs creation is because more than 20 state governments have now declined federal bonus checks to those in the states making more by staying home than going to work. Finally!

As our country continues to re-open, there are workers who will lose the federal benefits to sit at home. Thus, it is reasonable to think more jobs will be created going forward, fewer initial claims and even more people working, earning, paying taxes and spending on "stuff" as measured in PCE, Sign #1, above.

Sign #4 is 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)
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.

This month new orders decreased -1.30%. Shipments have been up eleven of the last twelve months and come in at +.60% and inventories increased +.50%.

Like the data flow in Sign #1 and #3 posted above, this month Sign #5 was positive, but again a noisy data trend for new orders. Observe below:

Covid-19 impact hits:

April 2020	-13.50%
May	+15.70%
June	+7.70%
July	+11.20%
August	+.40%
September	+1.90%
October	+1.30%
November	+.90%

December	+.20%
January 2021	+3.40%
February	-1.10%
March	+.50%
April	-1.30%

Question: The Institute for Supply Managers (ISM) Index soared this month to the highest level in 38 years. In a normal world it would be almost impossible to have Durable Goods Spending drop with that backdrop of an increasing ISM. So, what gives?

Well, for starters, if the product is not available for sale, it is hard to buy. Think cars. Cars are a large input to Durable Goods and new orders for autos dropped 6.2% as production lines were slowed due to the microchip shortage.

If we take transportation out of this month's data flow, new orders were up +1.10%. In addition, the report stated new orders, excluding aircraft, increased +2.3%. These are new orders from capital expenditures made by Corporate America. This is a great sign to see, as clearly Corporate America is re-opening, re-engaging and spending money to do it.

I need another month to be confident this dataflow is a positive trend, so Sign #5 looks good, but remains neutral this month.

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)
Last month under Sign #6 I detailed how great the results, i.e. profits, were for Corporate America. Since last month earnings have gotten even better than projected.

With 92% of the S&P 500 companies having reported earnings, they are on track to be up 50% year over year (YOY). This is more than double the 24% increase expected at the beginning of the 1Q2021 earning season.

I have recently seen a research report by our Broker/Dealer, LPL Financial, that stated 2Q2021 earnings are estimated to be up an additional 60%. Equally positive, is that Yardini Research is now estimating 2022 full year earnings for Corporate America, as measured by the S&P 500 to be $212.12 (Source: Yardini Research 6/2/2021)

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 1Q2021 “second estimate” released May 27, 2021 of +2.10%.

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

- 20 – 2.10 = 17.90
- 2021 S&P 500 earnings estimate $197.80 (Source: Yardini Research, 6/2/2021)
- 2021 S&P 500 Fair Market Value estimate $197.80 x 17.90 = S&P 500 (FMV) 3,540.62

As of 6/4/2021, the S&P 500 trades at 4,229.89, or a 19.47% 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 seven months forward to 2022 earnings. Let’s also look at FMV for a year out in 2022.

- 20 – 2.10 = 17.90
- 2021 S&P 500 earnings estimate $212.12 (Source: Yardini Research, 6/2/2021)
- 2022 S&P 500 Fair Market Value estimate $212.12 x 17.90 = 3,796.95

As of 6/4/2021, the S&P 500 trades at 4,229.89 or a 11.40% 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 21.38 + .02 (the yield on a 90-day T-bill) = 21.40.

So, based on 2021, in the “fair to buy zone”.

Based on 2022, the P/E ratio is 19.93 + .02(the yield on the 90-day T-bill) = 19.95 and slightly below the 20, representing reasonable value.

This clearly sums up what I have been saying for several years during this uptrend, Corporate America can be both underpriced and expensive at the same time.

For example, tech companies can add billions in revenue by simply adding to or upgrading code that makes their customers' products better in the process. Expect tech to be volatile, but also profitable over "time" – key word!

Sign #6 remains positive but pricey.

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 +6.70% annualized for this month, up 108% over last month. As energy prices increase, it is likely we will continue to 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, +6.70% is not! These costs will very likely start to be passed on to consumers in the coming months, i.e. inflation!

On 5/13/2021, the Consumer Price Index (CPI), which measures the inflation rate at the household level, reported in at +4.20% annualized (highest since 2008) for this month. CPI has increased +1,400% from .3% in April 2020. That is a large percentage increase, and the shot over the bow of inflation entering the households of America that I have been writing to you about, talking with you about and investing in front of since last summer. (I remember because a few folks thought I must be crazy! Ha!)

These are very large increases, especially for producer inputs above. These are well ahead of expectations. As noted above, at the WSG we have been reallocating our clients' asset allocation to be in front of the inflation I saw coming since last summer (summer 2020). Just to re-emphasize, in an inflationary environment you want to own real assets and the shares of Corporate America are real assets. The profits they provide are a good inflation protector. Corporate America does fine, we however, are about to see our home operating costs increase.

All the goods and services we create in our economy are measured and reported as our Gross Domestic Product (GDP). As you would guess, with all the trillions our government has fire hosed into our economy to fight off the Covid meltdown, the GDP is booming! In the first quarter of 2021 our economy grew +6.5% and at 4.3% after accounting for inflation, i.e. "real" GDP growth. Our economy is now the largest ever at $22.061 trillion.

This Sign #7, inflation/deflation measurement, is meant to warn us if the economy is contracting (deflation) or expanding (inflation) and by how much.

As you can clearly see in this data the economy is expanding, which is better than deflation, which leads to depressions. But like many things in life, too much of a good thing can turn it into a bad thing.

I don't think we need to change the outlook from positive to negative on Sign #7. Instead, we all need to be VERY aware of what higher inflation means to us as investors and invest in front of the inflation wave, and we are.

It is important for you to know the year over year (YOY) numbers jump sharply due to the impact of rolling off April 2020's sharp deflation decline. The reason the Federal Reserve has not increased interest rates in light of these number is they know this is YOY and that the increase is being compared to a terrible 2020. So, "transitory" as they see it.

The Federal Reserve does not use PPI or CPI above as their inflation measuring stick. They prefer to measure inflation from our Sign #1 above, Personal Consumption Expenditure (PCE). At an annualized -.30% this month, clearly there is a separation between PCE, in contraction, and PPI and CPI continuing higher. Transitory or not, we will be watching all inputs and applying common sense along with decades of investment wisdom into our structure, strategy and processes with our asset allocations and investment positions.

Sign #7 remains 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, 17.90x the expected Earnings per Share. Both EPS and the multiple of 17.90 could drop. The earnings could be reduced due to the consumers spending less. The multiplier of 17.90 could drop to, say 8 for example, if investors were to get scared and become risk adverse. All of a sudden 8 x $197.80 turns the 3,540.62 2021 FMV into 1,582.40and even worse if earnings were to drop below the example of $197.80/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!

•Government bonds and Treasury bills are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.
•The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.
•The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.