THE WEALTH STRATEGIES GROUP
Independent Unbiased 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 2017

Summary

Interesting times we are living in right now!

The data flow out of D.C. ranges over many subjects and ranges of intensity. As a Social Scientist, my observation remains the same as it has been for my 34 years as an Investment Executive. Please remember, I am only speaking about the economic backdrop and investment market opportunities, as I am far from qualified to address other very important topics.

That said, it has been my experience that Consumer Spending, Sign #1 of The Seven Signs of a Changing Economy™, which represents nearly 70% of our $19 trillion-dollar economy, is paramount to the happenings in D.C. Historically, D.C. is just noisy when compared to the reality that 92 million American millennials are starting to get jobs, buy houses and cars, getting married, having kids and buying a dog or cat. All are expensive!

This largest in American history cohort is just starting up the same predictable spending pattern as the 88 million baby boomers before them started back in the early 1980's.

This month's update of The Seven Signs of a Changing Economy™ quantifies this and suggests the economic backdrop from which Corporate America will operate in after 2017 is positive, wide in scope and gaining momentum!

However, we all believe there will be a day not too far off where an event, a news item or a wild tweet could cause the valuation of Corporate America to separate from the positive economic backdrop for a period of time. So, in advance of this inevitable separation, I have created a scorecard, so to speak, of what we might expect and how we might prudently act at different levels of price reduction. I have named this tool "The Retracement Reality™".

The Retracement Reality™

I continue to believe this market will have a correction, i.e. a reduction in value of 15%-20%, when the first bomb is dropped to remove the “Islamic Terrorist State”, as noted in President Trump’s State of the Union Address.

That should prove to be an opportunistic entry point, if and when it happens. However, if it happens it will be a yet another scary time.

Scary times tend to cause investors to freeze in their tracks like a deer in the headlights. So, to help put that thought, and opportunity, in perspective, as well as any other scary events that could knock the market valuations downward, I have created what I will now call The Retracement Reality™.

It is simply a regularly updated estimate of key valuation points of Corporate America, as measured by the S&P 500. These valuation points are meant to represent the valuations at which point one should become more alert as to further downside possibilities unfolding, i.e. a change in the current trend from up to down.

The table I have created below is suggesting that a:

10% reduction from the last high is "normal"
15% reduction is a notice to be on alert
20% reduction is the first point of a possible trend change and action might be needed to preserve capital.

The Retracement Reality™

As of 3/2/2017	S&P 500 =	2,395.98
	-10% =	2,156.38
	-15% =	2,036.56
	-20% =	1,916.78

60% retracement of gain from last base is a “normal” retracement in an upward trend

Value as of 3/2/2017	2,395.98
Last base 5/10/2016	2,049.846
Gain	346.12
	X .60
	207.67
3/2/2017	2,395.98
	-207.67

60% retracement since beginning of advance puts the S&P 500 at: 2,188.31, or -8.67%

This is, as stated above, an analysis to gauge where we are compared to other pullbacks that have occurred. It is not meant to suggest that action of any kind should or will be taken, as there is a complex matrix of data flow taken into consideration prior to that level of change.

The decision tree is also unique to each person. The clients of The Wealth Strategies Group are a diverse group with varied constraints for time, risk and volatility. That is why I present this analysis as a guideline that can be used to increase investor alertness to the idea that a possible trend change may be in progress.

I will update this as needed going forward and share it with you in The Weekly Update, our monthly issue of The Seven Signs of a Changing Economy™ and on the WSG monthly update conference call, as 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, April 6, 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)
This daisy chain of quantifiable factual data that I am going to share with you is worth sticking with me here. So, it flows like this:

- ✓ The most recent Personal Consumption Expenditures (CPE) was reported by the Bureau of Economic Analysis (BEA) as -.3%, on a "chained dollar" basis. Chained dollar just means that it is adjusted for inflation. As a reference point, PCE was +.2% on a "current dollar" basis. Inflation is real and for that reason, I prefer to use "chained dollars" when I refer to PCE.

  Key point: Even using the chained dollar PCE result of -.3%, this is only the second month in 32 months that PCE has contracted. In addition, these PCE numbers are regularly adjusted and it wouldn't surprise me at all to see this month's number adjusted toward positive next month, and here is why.

- ✓ For the same month (most recent is January 2017) retail sales were +.4% and +.8% excluding autos. It appears auto sales had a dip in January. Car sales in January tend to be slow, as half the country is covered in snow and too cold to consider buying a car. These retail sales numbers make it clear that consumers are spending with gusto across all categories!

- ✓ Consumer Confidence hit a 15-year high this month, per a market watch report dated 2/28/17 by Jeffery Bartosh where he cited a Conference Board survey that stated "Americans are the most confident in the U.S. economy in 15 years, buoyed by the strongest job market in years".

- ✓ Holiday sales are now official. As predicted here last September, they were the largest ever, beating even the National Retail Federation prediction. I will now predict that 2017 holiday sales will once again surprise to the upside and be the largest ever recorded on earth!

- ✓ Business Inventories now sit at a 35-day supply! I am a Social Scientist and when I see a statistic that says inventories are at 35-day supply, the first thing I think of is: "How could a recession possibly start if there is only a 35-day supply to feed our $19 trillion economy?" Answer: "It can't!"

- ✓ Personal Taxes: As of January 1, 2017, personal taxes are right at the all-time high of $2.054 trillion, suggesting people who want jobs have them, are earning income, paying taxes and spending their discretionary dollars.

Conclusion: This key economic data point that represents 68.7% of the U.S. economy (Source: JP Morgan Guide to the Markets 12/31/2016) remains positive as is the data that feeds into it for months, and possibly years to come!

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)

As the Dow Jones Industrial Average hits all-time highs, there is clearly a lack of celebrating in the streets!

The American Association of Individual Investors (AAII) reported as of 2/28/2017, the sixth straight week of bullish sentiment below 40%. If you go to the AAII website, you can pull up past reports and also see this is the 112th straight week where the bullish sentiment is under 50% bullish.

The conclusion here is that Mr. & Mrs. Normal 401(k) investor continue to be out of investment markets, as they have been for the last 14,458.69 Dow point move! (Source CNN Finance 3/9/2009 DJIA at 6,547.05 vs. 3/3/2017 at 21,005.74 = +14,458.69 points.) They continue to sit on household cash and cash related accounts of $9 trillion! (Source: U.S. Federal Reserve)

This is GREAT NEWS! Valuations of Corporate America are not extreme and investor optimism and participation are near all-time lows. This is a set up for higher highs as the $9 trillion continues to gain confidence.

Those three drives I have been referring to as pushing values higher for the last several years also remain in place. They are:

- ✓ $1 trillion in hedge funds and asset managers caught “short” and must now “buy back” to square their positions.
- ✓ The currency carry trade, especially with Japan, is still active and huge, i.e., trillions flowing to the U.S. currency and buying Corporate America.
- ✓ Corporate America buying back their own shares at the trillions of collective dollar level.

Sign #2 is positive and the data flow continues to suggest it will remain positive for months to come.

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 Index (LEI) is a tool used by economists to peek around the corner and see what the U.S. economy could be doing six to nine months in the future, i.e., September to November 2017.

This month the LEI reported a +.6% increase. This is on top of last month's +.5% increase. Note to self: This is really strong economic growth being suggested.

In addition, this month's report had eight of the ten components used to calculate the LEI as positive, one neutral and one in slight contraction. This data strongly suggests our economy should accelerate in the months ahead.

Last month I shared detail around The Chemical Activity Barometer (CAB). Last month this key indicator was trending up strongly and once again this month came in at an all-time high!

The Chemical Activity Barometer is a leading economic indicator derived from a composite index of chemical industry activity. The chemical industry has been found to consistently lead the U.S. economy's business cycle given its early position in the supply chain, and this barometer can be used to determine turning points and likely trends in the wider economy. Month-to-month movements can be volatile so a three-month moving average of the barometer is what we track. This provides a more consistent and illustrative picture of national economic trends.

Applying the CAB back to 1919, it has been shown to provide a lead of two to fourteen months, with an average lead of eight months at cycle peaks as determined by the National Bureau of Economic Research.

Once again this month, the LEI and the CAB point toward stronger economic growth for the companies of Corporate America to operate in, suggesting, as detailed below in Sign #6, earnings of Corporate America are headed higher.

Sign #3 is rarely this 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)
This month is one of those where the jobs data is released after I write The Seven Signs of a Changing Economy™. As I write this on 3/5/17, the jobs creation report will not be released until 3/10/17, and after our monthly conference call on 3/9/17.

In absence of this data I will default to the 4-week moving average of initial claims for unemployment as my barometer for jobs growth. Initial claims for unemployment remain near the 40-year low. Clearly, the labor market is getting tight. As I have suggested here before ad nauseam, if you have a high school education, you're not high on drugs, show up on time and say "please" and "thank you" you are hired!

Over the last four weeks, initial claims for unemployment have averaged 234,250 as of 2/25/2017, (Source: St. Louis Federal Reserve Bank) which is about 40,000 below the levels of six months prior. Thus, not signaling a recession.

Perhaps most importantly is that our unemployment rate is at a nine-year low. I would suggest sooner, rather than later, the jobs creation number will start to drop. Not because there are no jobs or hiring, but instead because there are no qualified prospects to hire. Smells like inflation brewing.

My guess, and it is only and educated guess, is that our economy created 286,000 new jobs. We will know the actual number when released at 8:00 a.m. on 3/10/17 by the Bureau of Labor Statistics.

Sign #4 is rarely this 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*

(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 +1.80%, Shipments decreased -.10% and inventories were virtually unchanged.

The key to this data point is the New Orders number and this month's +1.80% is a rather large and positive uptick. Last month was for December, as this data lags about 4-6 weeks, and reported -.40%. December is normally negative, as noted last month, since December is the holiday selling month not the buy and ship month. So, this month's strong new orders suggests those empty shelves are being re-stocked!

This detail is strongly supported by the Institute of Supply Management (ISM) January activity, which hit the highest level in over two years.
The Philadelphia Federal Reserve Bank reporting manufacturing in the region jumped from 23.6 in January 2017 to 43.3 in February 2017. This is not only a gap jump up, but represents a 33-year high. As a side note, the MarketWatch economic consensus was for a reading of 20. Another 100%+ miss by the economists! Again, how do these people keep their jobs? No need to answer, it's a rhetorical question!

Lastly, per MarketWatch, 33 of 36 major industries tracked in the U.S. are expanding, which obviously signals a very robust economy.

Sign #5 continues to suggest the consumers are buying, which requires more New Orders. When combined with the peek around the corner in Sign #3 above, i.e. the LEI and the CAB, we should be experiencing a booming economic backdrop to invest in for 2017.

Sign #5 remains 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 noted here last month, the masking of corporate earnings caused by the implosion of the Energy Sector in 2016 has been lifted as the Energy Sector has recovered.

As of February 24, 2017, 92% of the companies of Corporate America, as tracked by the S&P 500, have reported results for Q4 2016. Good news! 66% beat their earnings estimates.

The overall growth rate in earnings for 4Q 2016 was +4.90%. This may not sound like a lot, but the fourth quarter will mark the first time the S&P 500 Index has seen year-over-year growth in earnings for two consecutive quarters since Q4 2014 and Q1 2015. As you have already read in Sign #5, the economic backdrop is in position, wide in scope and gaining momentum! FactSet now estimates 2017 S&P 500 earnings to be $132.63, up +12.24% versus 2016. WOW!

Let's plug full year 2017 earnings estimates 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 final U.S. Gross Domestic Product for 2016, released December 21, 2016, of +1.39%.

20 – 1.39 = 18.61

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

- 2017 S&P 500 earnings estimate = 132.63
- $132.63 x 18.61 = 2,468.24

As of 3/3/2017 S&P 500 trades at 2,383.12 (a 3.57%) discount 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 rate. 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 17.97. The 90-day T-bill as of 3/01/2017 is .63%.

17.97 + .63 = 18.60, which is well 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 is powerfully 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)
I have no reason to twist any of the data in these historically correct economic Signs of Change. But, perhaps there is some bad data in the current Gross Domestic Product (GDP) data flow.

Example: We left the third quarter of 2016 on September 30, 2016 with the final annualized Gross Domestic Product (GDP) at 3.50%. We now have the final 2016 GDP as of December 31, 2016 at 1.85%. Is it really possible for a $19 trillion dollar economy to slow down by 1.65% in 90 days, i.e. nearly a 50% reduction?!?

Yes, there was a change in leadership in D.C. in the middle of the quarter. However, all Seven Signs of a Changing Economy™ continued to gain upward momentum. Not one straggler. This month we see momentum growing, not contracting. So what gives?!!

Just an observation, but my guess is, and it's only a guess, the economic data flow was perhaps represented as a bit more positive in hopes of a different outcome to the election. Knowing voters tend to vote with their pocketbooks, it is not out of the realm of possibilities that a more aggressive slant was taken. That

guessed, all Signs point to stronger, wider and better growth for the balance of 2017.

As for inflation at the Consumer Price Index (CPI) level, the 12-month change remains in check for now at +1.50% per year. Input costs at the Producer Price Level (PPI) bounced up to +2.50%. This PPI bounce is not great to see. Last year at this time it was +1.40%. Thus, consumers will see at least some price increases going forward as a result of those higher input costs upstream.

For now, 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, 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 $132.63 turns the 2383.12 2017 FMV into 1061.04 and even worse if earnings were to drop below the example of $132.63/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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•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.