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 July 2017

Summary

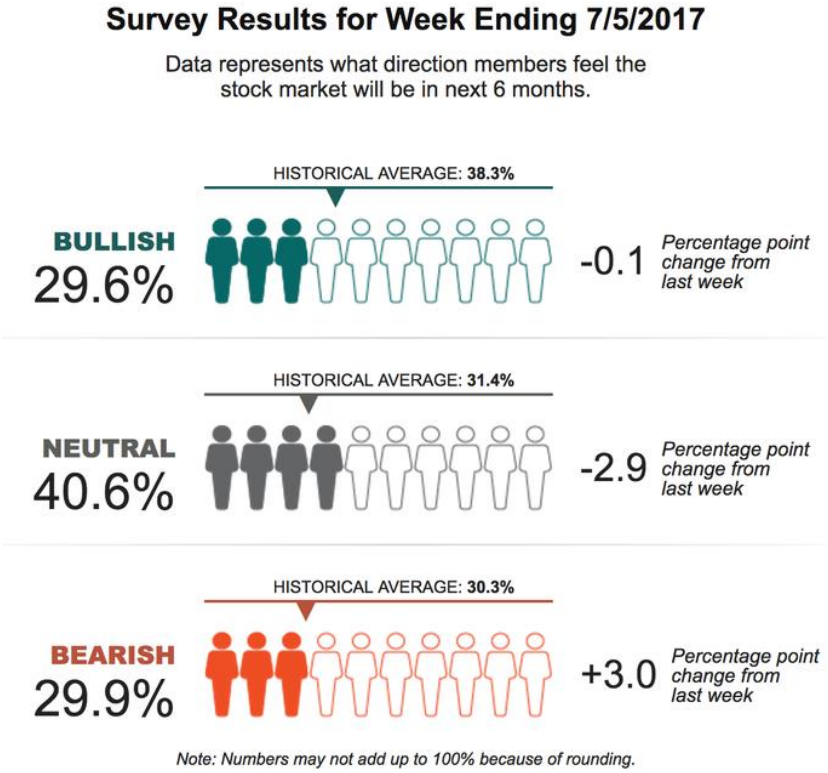
Quick quiz!

Remember way back in January 2016 when the Dow Jones Industrial Average (DJIA) started the year off with "the worst start to a year in the last 83 years?" Remember that this is how last year started. The DJIA was down 14% by February 11, 2016 and then the rebound started.

How many DJIA points have passed since that low point?

As of July 7, 2017, the answer is +5,980.36, or +38.75%!

Yet, as you can see in the chart below from the American Association of Independent Investors (AAII) Sentiment Survey dated 7/5/2017, only 29.60% of investors surveyed remain bullish (positive) on the outlook for investing.



Also, notice the slippage out of neutral was toward bearish (negative), not positive, i.e. more of the neutral folks are leaning negative.

My conclusion is that we very much remain in the "headline risk" stage and not the fundamental economic risk stage or The Corporate America over valuation risk stage.

As you peruse this month's update of The Seven Signs of a Changing Economy™, please notice that:

- We have added 16.2 million new jobs versus the 8.8 million lost during the Great Recession
- U.S. household net worth, as of March 31, 2017, is the highest ever recorded at $95.5 trillion
- Household debt service is the lowest in 37 years
- The Leading Economic Indicators (LEI) we track are 4 times more positive than last year at this time
- New home sales are up +8.90% year over year
- Per the Bureau of Labor Statistics 863,000 new jobs have been created since February 2017
- The companies of Corporate America continue to buy back hundreds of billions of dollars in their own shares
- Inflation and deflation are in check
- Interest rates are, contrary to popular belief, likely not going up again during Janet Yellen's term, which ends January 2018
- The sales, profit margins and earnings of Corporate America all remain at all-time highs
- Valuations, as measured via our "Rule of 20", in Sign #6, remain in the fair and reasonable zone

This is fact-based data, with sources cited, all in this month's update! As a whole, this detail suggests the economic backdrop that Corporate America must operate in is robust and that this current bull market has more than likely not run out of steam.

All of that said, it is summer and a large part of the big money management desks are being run by the junior varsity squad while the varsity team is off to wherever they go for their summer break. Thus, it would be normal to expect some volatile patches as we work our way through the summer doldrums.

As I have been suggesting in "The Weekly Update" that I post to the WSG website every Friday, consider using any volatility to the downside to calmly, logically and patiently add to your investment allocation as we all remain focused on meeting our bigger financial future goals.

Please feel welcome to call, email or drop by the office with any questions, comments or discussion.

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, September 14, 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)
One of my favorite quotes is attributed to the famous essayist George Santayana (12/16/1863 – 9/26/1952). It is "Those who cannot remember the past are condemned to repeat it." I understand this can relate to more serious historical events than consumer spending, but being a keen follower of trends I believe it fits the observation stage well.

For example, when I first became registered as an investment representative in 1982, the Personal Consumption Expenditures (PCE) were $1.9 trillion for the year. As of June 30, 2017, the PCE is annualized at $12 trillion, so up about 6 times.

Also noteworthy is that the current $12 trillion in PCE is up +50% since the Great Recession ended in 2009 at $8 trillion PCE. (Source: Bureau of Economic Analysis (BEA) dated 6/30/2017)

From this historical perspective, I did have a to smile as I read from an internet news page how disappointing the PCE report for this month was at only +.10%. There was no mention that the PCE has been up in ten of the last twelve months, or that the prior two months combined were +.80%, i.e. really good growth.

"The facts" that support our spiraling up of the economy are actually pretty easy to find and to think through. For example:

- During the Great Recession, our economy lost -8.8 million jobs. Since 2010, we have added +16.2 million jobs (Source: JP Morgan Guide to the Markets 3/31/2017)
- We know this to be realistic, as personal current taxes collected are at an all-time high at on annualized $1.997 trillion as of 6/30/2017 (Source: BEA)
- The U.S. household net worth, as of March 31, 2017, is the highest ever recorded on earth at $95.5 trillion!
- Household debt service is the lowest since records started in 1980, i.e. in 37 years! (Source: FactSet)

More people working means more tax revenue to our U.S. government, money left over to save, pay down debit and spend on "stuff".

Personal Consumption Expenditures represent 68.8% or the U.S. economy. (Source: JP Morgan Guide to the Markets March 31, 2017). Thus, you might say PCE is the bullseye of our economy and it is continuing to grow and therefore Sign #1 remains positive.

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

(Positive)
As you will read below in Sign #6, (S&P 500 earnings per share), there is a great deal of focus put on the value of Corporate America versus what they earn. I would agree that the prices versus earnings (P/E ratio, a measure of risk) is an important data point, or it wouldn't be one of The Seven Signs of a Changing Economy ™. That said, it is Sign #6 versus Sign #2, which in order of importance implies Sign #2, Money Flow, is more important to us.

Valuations matter, just not as much as what people are doing with their investment capital. For the last month, (5/31/2017 – 6/28/2017) the inflows to U.S. equity funds, per the Lipper Fund Flow Report dated 6/28/2017, was +$7.713.

This is a rather puny number. In reality, U.S. exchange traded funds (ETF's) have remained popular. U.S. ETF's saw a record +$314.8 billion in inflows over the past twelve months through April 2017! Source: lipperusfundflows.com.

Key point: An index like the S&P 500 is what we call "market capital weighted". When money pours into an index like the S&P 500, a larger company, say Apple, Inc., will get a larger percentage of the money flow. Not necessarily because it is a good value, but because it is a large percentage of the index, and the index fund must, by prospectus, match the index!

We have seen this movie before. Make no mistake – there will come a day when those large cap valuations once again become "stupid" and those current buyers will become "sellers" of market cap weighted ETF's and the trend will reverse.

For now, the valuations remain fair, the money is flowing into Corporate America, hedge funds caught "short" (explained in many prior issues) are buying back in quantity and Corporate America continues to buy back their own stock at the rate of hundreds of billions of dollars per year.

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*

(Positive)
I will quote from The Conference Board Leading Economic Index (LEI) report dated June 22, 2017, so that you can read what "positive" sounds like.

"In the six-month period ending May 2017, the LEI increased 2.3 percent (about a 4.7 percent annual rate), faster than the growth of 1.1 percent (about 2.3) percent annual rate) during the previous six months."

To me, that reads that the outlook for our economy six to nine months down the road (December 2017 through March 2018) is strong and getting stronger, so positive!

In addition, consider this year over year as a comparison:

Period: January – May 2016 LEI +.50%
Period: January – May 2017 LEI +2.2%

As a trend follower, I will quantify here that means about 4 times stronger year over year (YOY).

Note to self: that is very positive.

For the last few 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 to 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. However, basically flat versus last month.

It is realistic to expect a little slow down from these two great future planning tools going forward.

One would have to think the inputs can only remain "white hot" for so long!

Sign #3 remains white hot 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)
Since October 2010 jobs creation has been positive every single month. That is 81 consecutive months of positive jobs growth. As noted above in Sign #1, Personal Consumption Expenditures, 16.2 million jobs have been created against the 8.8 million lost during the Great Recession.

This month 222,000 new jobs were created. Of that total, 102,000 were created by that pesky telephone survey done by the Bureau of Economic Analysis (BEA). The survey is the "birth/death" model, but it doesn't measure people being born or passing. It is a call to a business to ask how many people were hired or fired. If there is no answer, as in they folded, the survey assumes all people on that inquiry are still employed or automatically re-employed. Sounds a little fishy to me!

It is probably not fair to suggest all 102,000 jobs created by the B/D model are bogus, but it would be equally unfair to assume that survey added 102,000 new jobs.

However, a few other data points that support the stronger growth of new jobs number is the upward revision of the April 2017 job creation of 47,000. Also, the 4-week moving average of initial claims for unemployment is back to the lowest levels since the mid-1970's at 243,000. Anything below 300,000 new claims is considered positive.

In addition, "new" home sales are up +8.90% versus last year. That represents 610,000 "new" homes built and sold. That employs a ton of people, from the people who make the little plunger in your new sinks to the people putting up the white picket fence.

Once again, the anecdotal evidence highly suggests the job creation data is real and strong. Additional data continues to suggest it would be even better if the talent pool being drawn from were a bit more talented and more highly educated. Nonetheless, Sign #4 remains 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 were down -1.10% this month, shipments were down -.80% and inventories increased +.20%.

This is the second month in a row that new orders have contracted. Knowing these are items people can do without, if they don't have the money to buy it does beg the question, "is the consumer tapped out or just at the beach?"

Well, for the same period:
2013 = +4.10%
2014 = +7.17%
2015 = - .50%
2016 = +4.10%
2017 = +2.10%

Conclusion: I don't know!

I do know two months of contraction on "stuff" we can do without for a period of time is not alarming, but as noted in the detail box above: "a decreasing trend, especially a trend of four to five months out of six would be a negative sign."

Two contraction months is at most interesting, but not notable. Sign #5 remains in a positive trend.

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 mentioned above in Sign #2, Money Flow, Corporate America continues to invest via the buying of their own shares, and in a big way! In the first 90 days of 2017, they bought back $533 billion dollars' worth. Just FYI, I counted the quarterly flow and this was the eleventh biggest buyback quarter in history! Perhaps a bigger point to ponder is that since the great recession Corporate America has bought back an estimated $3.2 trillion dollars' worth of shares.

When a company buys back their own shares it is the equivalent of making the pizza smaller. With a smaller pizza and the same, or growing revenue, each piece of pizza (a share of stock) becomes more valuable. Why? Same numerator, smaller denominator.

Example:	Company earns:	$100
	Shares outstanding:	10
	Earnings per share:	$10

They then buy back 3 shares:

Company earns:	$100
Shares outstanding:	7
Earnings per share:	$14.28

Hmm…they buy back 30% of the shares and the earnings per share on the outstanding shares goes up +42.80%. I like this!

In addition, FactSet now estimates 2017 full-year S&P 500 earnings will grow +10% versus 2016. Yardini and Associates estimates full-year 2017 S&P 500 earnings per share at $138.97. Let's once again plug this into our Fair Market Value (FMV) estimate model the "Rule of 20".

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 1Q2017 Gross Domestic Product for 2017, released June 29, 2017, of +1.94.

20 – 1.94= 18.06

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 = 138.97
- 138.97 x 18.06 = 2,509.79

As of 7/7/2017 the S&P 500 trades at 2,432.54 (3.14% below 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. Then 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 17.50. The 90-day T-bill as of 7/7/2017 is 1.05%

17.50 +1.05 = 18.55, 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 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)
Inflation and deflation matter a great deal to our economy. We want moderate inflation as it reflects growth in our economy. We don't want deflation, as that represents a shrinking, or contracting economy, which has historically lead to a recession or depression. The reason it is called a depression is because it is depressing, so we want growth, but not too much, or too fast.

This month the prices that producers paid for their input components at the manufacturers' level, referred to as the Producer Price Index (PPI), were +2.10% annualized. This is reasonable, and up from January's +1.70%. Steady growth.

The prices we pay at the household level, referred to as the Consumer Price Index (CPI), were +1.90% annualized. Again, steady, not too hot, not too cold, just right.

Like last year, all the goods and services we produce in our country, referred to as the Gross National Product (GDP) bounced up as more data was collected:

1Q "2016" GDP		1Q "2017" GDP	
Advanced estimate:	+.50%	Advanced estimate:	+.70%
Second estimate:	+.80%	Second estimate:	+1.20%
Final:	+1.80%	Final:	+1.40%

These are “annualized” numbers for our country’s output of goods and services. As noted above, we do not want to see any further reduction in the GDP as we move through 2Q2017! It is for that reason that I will once again go against prior reports and suggest the Federal Reserve will not raise interest rates again in 2017.

Not only that, Fed Chair Janet Yellen’s term expires at the end of January 2018. She will leave the angst of increasing interest rates to her likely successor, Kevin Warsh.

Growth is growth and inflation remains in check, 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 $138.97 turns the 2,509.79 2017 FMV into 1,111.76and even worse if earnings were to drop below the example of $138.97/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 economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.
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•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.