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 October 2019

Summary

If you watch your preferred news source from time to time, as we all do, it might surprise you to see that all of The Seven Signs of a Changing Economy™ remain positive this month. In Sign #1 below, you may want to focus on the well-oiled locomotive pulling this economic train higher, Personal Consumption Expenditures (PCE).

PCE grew at a healthy +.40% for the most recent month and is annualizing at +1.80% year over year (YOY). This is great in two ways. First, the U.S. consumer is the driver of our overall economy and they are buying a ton of "stuff". Second, the U.S. Federal Reserve uses the annualized PCE as their measuring stick for inflation. Many are under the impression the Fed tracks inflation via the Consumer Price Index (CPI), but that would be inaccurate.

The Fed has publicly stated for years that the goal is to keep the inflation rate at 2%, or less, while expanding all the goods and services, the national GDP. Based on the fact that PCE is 1.80% after the most recent Fed interest rate cut, that we have some rather odd outside influences, like the China trade riff, the European economy slowing toward recession, led by Germany, and the heat increasing around the next Presidential election on 11/3/2020, it seems very probable the Fed will once again reduce short term interest rates again at their next meeting.

Normally, that would suggest our economy will continue to grow. Thus, the economic backdrop that Corporate America must operate in is expected to be ideal.

At the same time Corporate America is doing great! As measured by the S&P 500, corporate revenue, profits and cash reserves have never been higher. This quarter, 3Q2019, is "the" quarter where we lap the effects of last year's corporate tax cut. Those tax cuts were responsible for a +20% jump in the profits of

Corporate America. A tough comparison to beat, but so far, the companies that have reported earnings are about +1% higher year over year.

Better yet, next quarter is estimating earnings growth of +7-8%. In Sign #6 below, I have outlined where current market values for the S&P 500 are versus fair market value. We remain right at the 25-year average of 16.22 x earnings. Not too hot, not too cold, just right.

This is all fabulous detail. Yet, most people out in the world continue to see the glass not only half full, but half full with a hole in the bottom. Why? Because there are scary news headlines and pretty much everyone you see, anywhere you go, has one of those "original communicators" from Star Trek staring back at them. Yes, the cell phone! Full of all the scary headlines the masses have become addicted to!

When fearful and scared, we humans, at least those with savings, tend to hoard cash. The outlook is scary enough that investing for their bigger financial future is off their decision tree. As of October 4, 2019, per the U.S. Federal Reserve website, the folks are $14 trillion scared as that is where the liquid reserves for our country now rest.

Should they become, say $10 trillion scared, expect the valuations of Corporate America to increase, perhaps substantially. If they get $18 trillion scared, it is likely valuations will be reduced.

It is possible to have a good economic backdrop like today, solid corporate structure, revenues, profits, etc. just like now and still have the values of Corporate America go down. I saw this with my own eyes between 1Q2000 and 3Q2002.

The catalyst back then was the dot.com bubble. There are many possibilities, or combinations of possibility, that could be a like catalyst going forward. The one I happen to be concerned with is our Presidential race into November 2020.

The mud-slinging is just warming up and we all know this one will go down in the history books as the nastiest, most contentious and divisive ever! Not to worry. Each person in our WSG family has received a copy of my three key updates referred to as "The Three Trap Doors™". Read them here:

1) The Exit Strategy, emailed 1/31/2018
2) The Weekly Update, "What's Next" emailed 4/26/2019
3) The Weekly Update, "The Wicked Witch is Dead…Revisited", emailed 6/14/2019

The Three Trap Doors are in my pending file and I personally look at key data points every single day! Nothing has happened yet, but we are using the calm to review each client's Wealth Vision Future Planning Report (call, or email, me if you are not familiar with this report), each asset allocation and investment

positions. The goal is to continue to reduce risk and reduce volatility while not being fully invested yet still achieving S&P 500 returns. I know it sounds Herculean, but we have been doing it.

In the process, we will now be looking to move some of the rather pleasant 2019 gains to more secure choices, reviewing how to exit pre-tax accounts like 401(k)'s, IRAs and Profit Sharing Plans in the most tax efficient way, i.e. "tax the rich" is the new D.C. theme, and making certain that each client relationship has an appropriate allocation of our "shock absorber" investments.

Of course, where we see lemons, i.e. reductions in a position's value, we will look to make lemonade. Losses realized now can be used to offset capital gains distributions we expect pre-year end.

There you go, you are now up-to-date on the current thinking process and actions of Jim Lunney and the WSG as of October 9, 2019.

Enjoy the Seven Signs and 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, November 7, 2019.

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)
As you will read in Sign #5 below, manufacturing is a "cousin" of durable goods spending. I have often referred to durable goods spending as the "canary in the coal mine". This is because durable goods are items we need to buy but can delay the purchase of for months, if need be.

If durable spending slows, you know the consumer is hurting. The detail is very important because it will back up into Sign #1, Personal Consumption Expenditures, over a several month period. And, Sign #1 is number one for a reason: Personal Consumption Expenditures (PCE) represent 68% of the entire U.S. economy. This is the tail that wags the U.S. economy dog! (Source: JP Morgan Guide to the Markets, 9/30/2019)

The most recent month's data for PCE was +.40%! This is the second highest increase this year and is up 1.80% year over year. Ideal!

Now, back to that "cousin" of durable goods. The valuation of Corporate America dropped when The Institute for Supply Management's (ISM) Purchasing Managers Index (PMI) fell to 47.6 in September 2019, the lowest level since June 2009. I understand, any report below 50% represents contraction. Any contraction on the surface appears scary.

However, manufacturing represents 12% of our overall U.S. Gross Domestic Product (GDP). So, what we have is 12% of our economy is in a slight contraction for one month, i.e. not a trend, while 68% of our economy is expanding at 1.8% annualized YOY!

Those who sold out of their ownership of Corporate America on the one-month data point of manufacturing contraction, clearly don't understand that the consumers are spending like crazy. Conclusion: 68% of our economy expanding is highly likely to pull up manufacturing all by itself. The trend in PCE continues up, the manufacturing contraction is at this point, just a one-month data point and 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)
Two interesting observations that tend to impact money flow are:

1) The Fear & Greed Index was 27 out of 100 on October 3, 2019. 1 is extreme fear and 100 is extreme Greed. On July 3, 2019 the Fear & Greed Index inked at 61.
2) The American Association of Individual Investors (AAII) Bull/Bear (positive investment outlook vs. negative investment outlook) 21.40% bullish investors on October 2, 2019. Meaning 78.6% investors were neutral or negative. It was about 39.2% neutral and 39.4% negative on the investment outlook. On July 3, 2019 the bullish outlook was 33.32%.

Note to self, the constant between the two was August of this year. It was a volatile month with the valuations of Corporate America being "ping ponged" up and down between scary, twisted and generally inaccurate news items. After all the dust settled on a volatile month, investors were, per the data above, fearful and bearish, i.e. negative on the investment outlook. Yet, the values of Corporate America were slightly higher on the last trading day of August than the first, as measured by the S&P 500.

Here is a positive in all of this, after hundreds of billions of dollars selling out of stock mutual funds and ETFs the last month saw the negative flow slow to only $1.3 billion.

Conclusion, Mr. and Mrs. 401(k) have been scared and selling, Corporate America has been buying, valuations are reasonable (see Sign #6 below) and the selling by Mr. and Mrs. 401(k) appears to be close to exhausted, i.e. they are close to out! Thus, Sign #2 is set up to be very positive as we close out this decade in about 880 days! This set up is not only positive, I suggest we investors view any dip in price as a buying opportunity!

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)
This sign is our peek around the corner six to nine months in the future. The Conference Board is the creator of The Leading Economic Index (LEI) and they have ten inputs they track to report the LEI. The ten are meant to represent the U.S. economy as a whole. In my opinion, three of the ten are more forward looking, as they reflect manufacturing that needs to increase, or decrease, to meet new order demand.

The three are manufacturers' new orders for consumer goods and materials, which was positive this month, suggesting the consumer spending in Sign #1 is strong and real. Manufacturer's new orders for non-defense capital goods, excluding aircraft, was unchanged. Industrial Supply Managers (ISM) New Orders Index was a negative contributor.

It seems fair to conclude this data is suggesting what the other signs updated in this report are, i.e. the consumer is spending like crazy and manufacturers are modestly investing in new equipment. This is heavy equipment and machinery used to manufacture other goods. The ISM New Orders Index measures how long it takes to get the supplies to fill orders. This negative report suggests demand is weak as supplies are being delivered quickly. When demand for inputs is slow to deliver this index goes up, meaning a large demand for products out in the economy.

Overall, LEI remained unchanged for the most recent month, which is for August 2019. The index is a +1.10% annualized rate. The data suggests the tariff riff with China is causing Corporate America to be cautious with capital expenditures.

The LEI remains positive but is clearly indicating gains in our economy into the second quarter of 2020 will be slower.

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)
The U.S. labor market continues to do well despite a very shallow pool of qualified applicants, i.e. for the most part anyone who wants a job can get a job. For the most recent month, September 2019, 136,000 new jobs were created. This month it is actually better, as the "birth/death" model removed 71,000 jobs. If not for that adjustment, the new jobs created would have been closer to 207,000 new jobs. In a word, "outstanding".

If you are not aware of the birth/death model, it is a survey of businesses conducted by the census arm of the Bureau of Labor Statistics (BLS). The birth/death is not people, but companies created, dissolved, expanding or contracting employees.

This contraction suggests 71,000 people were released or companies representing 71,000 employees were dissolved. One issue I have with the B/D model is that if a survey target doesn't respond, they are considered out of business and that the employees got new jobs elsewhere, i.e. a good amount of

subjectivity bordering on complete fiction. Nonetheless, 136,000, or 207,000, new jobs created is great. This puts the unemployment rate at 3.5%, a fifty-year low! An unemployment rate below 4% is considered "full employment", which this month it is for the first time in fifty years. Very rare!

This dovetails into Sign #1 (PCE) in the sense that the spiral up continues. More people working means more taxes to the Treasury, more savings, more spending and pretty much more of all things good.

So far, the tight labor market has not started to contribute to the inflation fears I see in various news sources, thus Sign #4 remains positive.

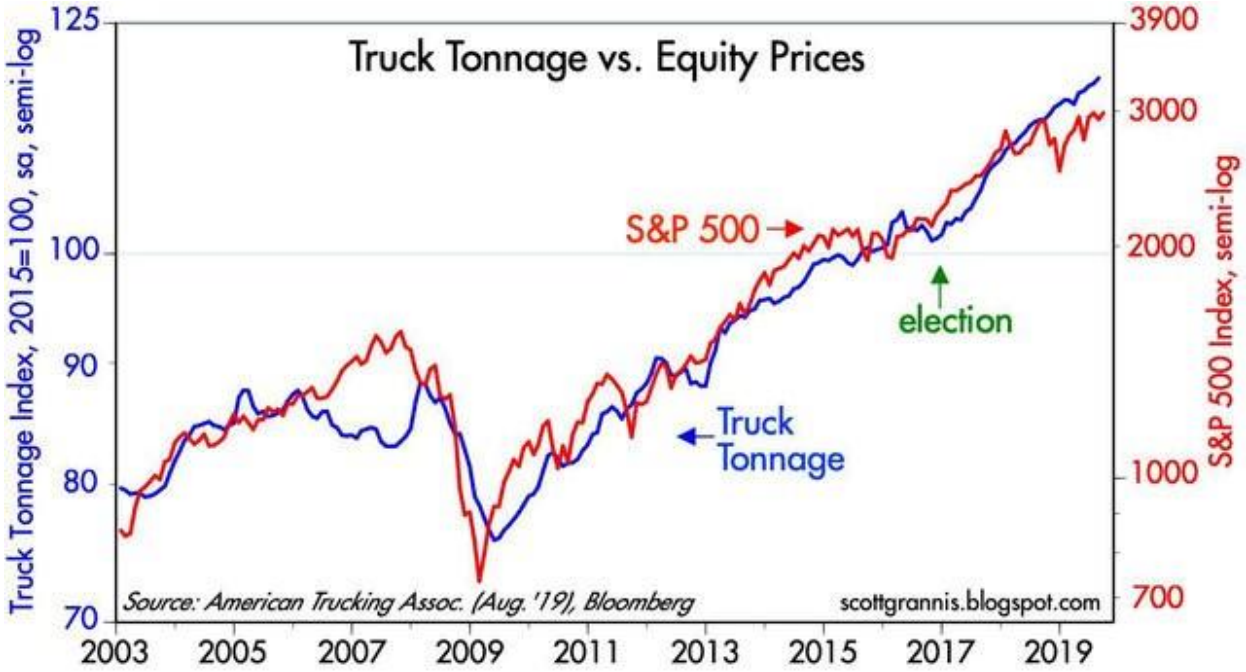
5)	**Indicator:**	*Durable goods spending*
	Where to find it:	*www.census.gov/indicator/www/m3*
	What to look for:	*An increasing or decreasing trend, especially a trend of four to five months out of six would be a positive or negative sign*

(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 for durable goods increased .20%, following two monthly increases. Shipments, up three of the last four months, increased .10%. Inventories increased .20%, which is completely normal in the summer months as new orders are manufactured for future delivery to retail stores and warehouses.

As noted above in Sign #1, manufacturing is in a very slight contraction. This data is for August, i.e. summers are slow, and I will suggest the next few months will start to more realistically reflect the anticipated demand for the holiday shopping season. I sense the slight manufacturing reduction is directly related to Corporate America's cautious buying as a result of the tariff angst. Equally odd, Chinese manufacturing, the other side of the tariff angst, reported Chinese manufacturing activity increased to 51.40%. (Source: Markit Research) Odd, as we consume about 93% of our GDP and export about 7%. China exports about 80% and consumes about 20%. Per the Markit Research report, new Chinese domestic orders increased to the most in 18 months, even as new export orders continued to decline. I say odd, only because the Chinese have been known to omit some data in their reporting, i.e. the lie of omission. We will see.

Looking forward, I would suggest a key future indicator is Truck Tonnage being shipped. Per the American Trucking Association (ATA) trucking represents 70.20% of tonnage carried by all modes of domestic freight. Per the chart below from ATA and Scott Grannis, trucking has consistently led the valuations of Corporate America. Guess what? Summer is over, and they are moving a ton of stuff to shelve and warehouses all over this country in preparation for the largest holiday shopping season on planet earth, which I predicted here last January.

Last key point, as you observe the chart below, the consumption of all that stuff people are buying like crazy represents 68% of our economy. That matters!! (Source: JP Morgan Guide to the Markets 9/30/2019)



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)
3Q2019 concluded a week ago, so only 14 of the S&P 500 companies have reported results. 12 of these 14 companies reported positive earnings that were "surprise earnings", or higher than expected/forecast.

Per Yardini and Associates, full-year 2019 S&P 500 earnings per share are estimated to be $164.30. As of 10/4/2019, the S&P 500 trades at 2,952.01. So, 2,952.01 divided by 164.30 per share equals a multiple of 17.96.

Let's now quantify, measure and use the earnings of Corporate America to get a Fair Market Value (FMV) of same using estimated 2019 earnings per share.

Using Yardini Research's forward earnings of $164.30 per S&P 500 share for our 2019 (as of 10/4/2019) Fair Market Value (FMV) estimate, using "The Rule of 20".

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) “final estimate” for 2Q2019 released September 25, 2019 of 2.60%

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

- 20 – 2.60 = 17.40
- 2019 S&P 500 earnings estimate - $164.30
- 2019 S&P 500 earnings estimate = $164.30 x 17.40 = 2,858.82 S&P 500 Fair Market Value (FMV)

As of 10/4/2019, the S&P 500 trades at 2,952.01, or about 3.25% premium 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.

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 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 forward price/earnings (P/E) ratio is 17.96 as of 10/4/2019 (S&P 500 as of this writing on 10/4/2019 is 2,952.01) divided by Yardini and Associates’ 2019 estimate of S&P 500 earnings of $164.30. The 90-day T-bill as of 10/4/2019 is 1.56%.

Thus, 17.96 + 1.56 = 19.52, well inside the “value” range of 20 and very much below Dr. Sjuggerud’s 22 level “danger” zone.

Sign #6 is positive again this month.

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 input level, reported in at 1.90% annualized for this month. “In check!”

The Consumer Price Index (CPI), which measures the inflation rate at the household level reported in at 1.70% annualized for this month. “In check!”

The “final estimate” of our Gross Domestic Product (GDP) for 2Q2019 was reported at +2.01% annual growth rate of all the goods and services we produce as a country. (Source: Bureau of Economic Analysis (BEA))

As I write here each time the GDP growth is released, the release is “real”. This simply means it is adjusted for the effect of inflation. In this 2Q2019 “Final Estimate” report, the Bureau of Economic Analysis (BEA) used a deflator of 2.60%.

Meanwhile, over at their sister government agency, The Bureau of Labor Statistics (BLS) the inflation rate was reported as 1.83%. If the BEA had used the BLS inflation rate as their deflator, the 2Q2019 GDP would have been reported as +2.80%.

Slice up the details as you choose. At the end of the exercise you will still have the $21.3 trillion U.S. economy growing. Be it at a 1.83% clip or a 2.82% clip, growth is growth and growth is good. Even better is growth with little inflation.

Every good story has an antagonist the hero must overcome to remain the hero. This economic story has our hero as the consumer and for now there are a few antagonists, i.e. China trade, effects of seasonality on manufacturing, lapping last year’s +20% jump in the earnings of Corporate America, but for now our hero appears ready to stand tall and overcome them.

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 $164.30 turns the 10/4/2019 FMV into 1,314.40 and even worse if earnings were to drop below the example of $164.30/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!

successful.

•Stock investing involves risk including potential loss of principal

•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.