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 October 2016

Summary

Shortly after I started in the financial services industry, I, like many new people to the industry, started to read various sources of research in order to gain a better understanding of where we were in the economic and investment cycle. For the first decade or so, I assumed the research I read was the key to successful investing. During that period, I observed that many highly educated, historically correct and very highly paid analysts were, in many projections, 100% wrong!

Somewhere in my past I remembered making a mental note of the phrase, "Who do you listen to and why?" So I decided to start a research analyst tracking report, which I still use today, to track who was wrong, right and consistently right.

Over the next few years I used this quantification matrix to drill down into the source data. I started to "listen less to the experts" and instead started to "listen to the data". In particular, I started listening to the data sources that proved generally correct in suggesting where we are in the economic cycle and how companies and industries were doing inside of the economic cycle.

The data sources that proved consistently correct over the next decade came to be what I now call The Seven Signs of a Changing Economy™.

It was the change from positive to negative inside these seven data points that motivated me in August 2006 to write my first book, Surviving the Storm, McGraw-Hill 2007, to warn those who would listen. As you would guess, those who would listen were few. It turns out, most humans don't see much past the windshield and were frozen as they watched most of what I suggested cause them to lose great wealth.

Much like today, it turns out. If you look back over the last several years, and thousands of Dow Jones points, these data points I call the Signs of Change have been suggesting a better economy and investment cycle ahead. But, the crowd again remains, for the most part, frozen to act. Still haunted by the string of losses from the Great Recession.

So, again the question bubbles up… "Who do you listen to and why?" As for me, in the category of economic outlook and investment cycle, the answer is "no one". Instead, I choose to listen to the facts! This data stream has been generally correct for almost thirty years. Good economy, bad economy, good performing markets and poor performing markets.

It is for these reasons I suggest you also ask yourself, "Who do you listen to and why?"

Of course, I still read multiple research reports, news items and special newsletter reports. But, as I read them, I now compare and contrast what they report against my economic and market compass, The Seven Signs of a Changing Economy™.

I have updated "The Signs" every month since "Surviving the Storm" was released worldwide in 2007. In addition, The Weekly Update has provided weekly updates every week for the last nine years.

So, knowing the accuracy of this detail, you will be happy to know all Seven Signs of economic change are positive again this month. Perhaps more importantly is that each of these signs of a changing economy has been in a positive trend for over two years. It is good to know that as important as each of these data points is, the order they are in (one through seven), and the trend of the data of each is also very important to how we thoughtfully oversee the assets entrusted to our oversight.

The economic back drop from which the companies of Corporate America must operate is quite good and so are the trends of the data. The Personal Consumption Expenditures, which represent almost 68% of our entire economy continues to grow, as detailed and commented on in Sign #1 below.

It is quite clear from Sign #2, Money Flow, that average investors, versus institutional investors, remain fearful of investing. The average investor continues to have net outflows of ownership in Corporate America and into fixed income investments, i.e. bonds. Once again, I will suggest that if you currently own fixed income investments, like bonds, be sure to do your homework and understand that when interest rates trend up, the value of your investment trends down. I recently had a person tell me they weren't worried about this because they had "short duration" investments. Duration is the average time to maturity of all coupons and principal payments in a portfolio and represents the sensitivity of a bond price to a change in interest rates. Thus, a good rule of thumb to remember is if interest rates go up 1%, the value of your investment could drop by approximately the amount of the investment's duration.

When I write this update for November 2016, we will have elected a new President in the United States. Our leadership is very important on many fronts and to key issues around the world. However, it is what companies earn inside

the currently positive economic back drop that matters to how these companies are valued. At this time, the values remain fairly priced and are right at the twenty-year average, per J.P. Morgan Guide to the Markets, dated 9/30/2016. This valuation detail is presented in Sign #6 below and it is key to know, should we hit volatility in prices for any reason, least of which might be a change in leadership in D.C.

Looking beyond the positive trends in this data, I would invite you to put on your social scientist hat as you go through your daily activities of life. Make note of what you see and how it could be affecting the future of our economy. What I have recently seen are a lot of young ladies between the ages of 21 and 36 who are pregnant, have children, or both. Kids are expensive! The millennials, ages 16-36, are a much larger generation than the baby boomers, 92 million millennials versus 77 million baby boomers. This generation is moving out of their parents' basements, renting apartments, buying cars, getting married, buying houses, having babies and buying pets. This will continue for decades, as the tail-end of this millennial generation is only age 16.

This group of people, the largest to ever be on planet earth, will drive almost all aspects of our economic system higher as well as some areas yet to be invested!

It could prove wise to prudently and thoughtfully create an investment strategy, system and process to help you and your family benefit from this multi-decade change in our country, economy and companies of Corporate America.

The Signs are updated below and I will continue to update these each month as these trends continue to evolve and change. This is in addition to The Weekly Updates I have posted on the WSG website each Friday. I write this detail to help our clients, and prospective clients, to gain clarity, confidence and direction. I sincerely hope you use it to your best advantage.

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®, CEP
CERTIFIED FINANCIAL PLANNER Professional
Certified Estate Planner

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 10, 2016.

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)
We left last month suggesting this most important sign of The Seven Signs of a Changing Economy™ would continue the strong upward trend. Worth noting that 2Q2016 Personal Consumption Expenditures (PCE) came in with the biggest quarterly gain since the economic recovery started in mid-2009!

This was a relatively easy dot to connect, since 2Q16 was followed up with a +.3% gain in July and we were headed into the back-to-school shopping season. Well, my suggestion was not correct! It turns out the back-to-school spending is now happening in late August and early September.

Where I grew up, and with our kids, it was back-to-school in mid-August, i.e. back-to-school meant August retail sales. As I write this, it is October 8, 2016. The Bureau of Labor Statistics (BLS) lags one month in their reporting of PCE, so we won't have September data for another week.

That said, there are a few knowns: 1) August Personal Consumption Expenditures were -.1%, hence my incorrect suggestion for the month, but; 2) Correct in that the back-to-school shopping season is estimated to conclude with $75.8 billion in sales, up +11.47%. (Source: National Retail Federation); 3) The reporting of the highest in history back-to-school retail sales will be more

weighted into September, suggesting my incorrect suggestion for an increase in August is simply delayed and likely to be correct in September's data flow.

We are right on track with the growth pattern building on the prior two years as follows:

2014: January through August = +1.7%, full year = +2.90%

2015: January through August = +1.80%, full year = +2.60%

2016: January through August = +1.80%, annualized = +2.70%

I will finish Sign #1 by not only suggesting this is very positive data, but perhaps more importantly that if back-to-school sales were up 11.47%, to the highest ever, the holiday shopping season will be especially strong.

How strong? Well, as I have already suggested in The Weekly Update, it should be the biggest holiday shopping season recorded so far!

How big? Between online and brick and mortar, I anticipate $750 billion to $800 billion! The millennials are age 21-36. Perhaps you have noticed all of the babies, toddlers and youngsters everywhere you go – they will all get holiday presents this year and there are way more new people coming into the equation than old people checking out, i.e. our population is bigger each year.

The consumer is back, spending and likely to drive our economy forward for years to come! 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)
The money flow out of ownership in Corporate America, remains at the highest levels of the year. (Source: Lipper Fund Flows) This suggests fear levels from 401(k) type investors combined with other non-institutional investors remains high.

In fact, per the same source noted above, these investors have been net sellers every month this year through 9/28/2016! Per Bank of America Merrill Lynch, AKA "BAML", the total outflow year to date is over $285 billion.

This begs the question; "With all these sellers how can the various stock market indices representing the valuations of Corporate America be right near all-time highs?" Pretty simple, really. First, many sold shares they didn't own with the intent to buy the shares back at lower prices. This is a reverse of the "normal"

investor, i.e. they sell first and buy second, a strategy termed “short selling”. I have seen estimates of a whopping $1 trillion in total short sales.(Source: Bloomberg Report 4/6/2016, “The $1 Trillion Short Underlying U.S. Stocks’ Spring Awakening” by Dani Burger) As market values go up, creating a loss, they buy the shares back to present a bigger loss and in the process push prices up in value. As the old Wall Street saying goes: “He who sells what isn’t his’n, must buy it back or go to prison”!

Second, Corporate America remains actively involved in selling billions upon billions in bonds to those fearful 401(k) investors at 1-2% and using the proceeds to buy back their own shares, many of which have internal rates of return in the double digit area. Smart! Take a debt at 1-2% to invest in something returning 10%, 15% plus.

Make no mistake about what was just stated above! The companies of Corporate America are selling a 1-2% return vehicle to investors too afraid to buy ownership in those same companies. The companies are then turning around and buying the shares of Corporate America, where they expect double digit returns on, over time of course. But, the “set up” is crystal clear. Take note and don’t fall for it. Sign #2 is all but screaming positive, positive and 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)
Sign #3 remains very positive this month, but the numbers are a little strange because of a revision. Specifically, last month’s LEI was adjusted by The Conference Board, the creator and tracker of the index, from -.20% to +.50%. But, this month’s data reported at -.20%. I said it was odd!

The good news is that the key internal components remain positive. The data flow remains quite strong and the fluctuation in this reported detail is well within the normal data flow we have seen in the past.

It is good to remember the LEI is a “peek around the corner” to what we may see in our broader and bigger economic back drop seven to nine months down the road, i.e. February through April 2017.

So far, so good and Sign #3 remains 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)
The Great Recession "peaked", i.e. was worst, during the first few months of 2009. The 4-week moving average of initial claims for unemployment hit almost 700,000 per million during those months. As a reference, when I searched if there was ever a time in history where this initial claims for unemployment insurance number was higher, it pulled up exactly nothing!

The interesting part is that today, when investors are quantifiably "frozen" on the side lines and selling out of ownership in Corporate America, this same initial claims number has gone down to 253,500! So, I searched this to see if there was ever an initial claims number below this 253,500. Yes, there was a time, it was 1973. Quantifiably, this states we have not had this low level of initial claims for unemployment for 43 years!

New jobs creation for this month was equally impressive. There were 156,000 new jobs reported, but it was better than it appears. In a rare twist, like it is the first time this year, the "birth/death" model, which is a telephone survey of businesses to ask if they have hired new employees and how many, which is generally inaccurate for many reasons, actually added 57,000 new jobs to the total reported 156,000 for a total of +213,000 new jobs.

Jobs are available, but clearly there needs to be an increase in the talent capacity in the people looking for a job. "New" home builders continue to hire at all levels. It turns out they were so fearful during the Great Recession that they have been slow to build up inventory. At the same time, millennials are moving out of their parents' basements and buying new homes like crazy.

"New" housing, versus "existing" homes, inventory is down to 4 months with 6 months the assumed "normal". One of the reasons prices of "new" homes keep increasing is this lack of supply. "New" homes create many thousands of jobs in all related areas, down to the plunger in the sink! Expect new jobs creation to continue, led by the demand from "new" home sales.

Note to self: There are 92,000,000 millennials, age 21-36 and they all want a new house. This is versus 77,000,000 baby boomers who were doing the same thing back in 1981. We are just getting warmed up.

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. This month's detail is very interesting! To start, let's go back to the July issue of The Seven Signs of a Changing Economy™ Sign #5. In that issue, I highlighted the fact that the U.S. Department of Commerce data for Durable Goods spending could be considered accurate but "historical", i.e. the data collection methods are archaic and take about six weeks to collect and report.

On the other hand, the Purchasing Managers Index (PMI) is more "leading", as it reports what purchasing managers are buying now, i.e. closer to real time report.

Supporting data would suggest the same as in the July update, the U.S. Department of Commerce reported new orders for manufactured Durable Goods at -2.20%. At the same time the Chicago area PMI reported up +15.21% to 56.80%. Any number above 50.00 is considered positive growth.
Based on this observation I suggested we would see the Commerce Department data "catch up" to reality and report a big jump up the following month. I was correct. Not only that, for last month, September 2016 new orders for durable goods jumped +4.4% supporting that +15.21 surge in the PMI back in the July issue.

Naturally, you tend to see a slight lull after a surge like this one. For the most recent data, which is August 2016 (I did suggest above, this report is historical by the time it prints) the new orders was exactly zero. Unchanged.

Once again, I looked to the Chicago Purchasing Managers Index (PMI) to see what a more current, or "leading", number might be and it is up +2.70% for September 2016. The PMI rests at a comfortable expansion level of +54.20%.

This suggests the September Durable Goods report, when released for September on October 28, 2016, will report positive. This is good because this is a report on long shelf life, non-perishable, non-fashion items that we can do without, if need be. Thus, they are usually the first to show signs of a slowing economy. But, the demand remains, and this equates to continued steady Consumer Spending and a growing economy. Growing slow, but growing.

Sign #5 is positive.

P.S. If you were to search "Texas Manufacturing Outlook Survey", you would see a September Production Index that spiked +12%. This suggests an output pick

up notably faster for the month. It would also suggest the energy patch is round tripping the collapse bottoms and is likely to be adding to the earnings of Corporate America, as measured by the S&P 500, sooner rather than later, as noted below in Sign #6.

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)
The earnings of Corporate America have continued to trend up and now rest at the highest lends in history. (Source: Yardini Research, Inc.) This dove tails in with what I have written here for over a year, that sales, revenues and profits are solid. They continue to be solidly supported with Consumer Spending, as measured by Personal Consumption Expenditures (PCE), see Sign #1 above, and the return of the energy sector.

Since 2015, the energy sector has been almost all of the cause of slower growth in the overall earnings of Corporate America, as measured by the S&P 500 Index. That is changing and likely to not repeat anytime soon! How can I be so sure? Well, I will emphasize once again no one knows the future. I will also suggest that data, like the seven data points I use to create this report, allow one to connect the dots to a reasonable assumption.

For example, here are a few recent data points related to the energy sector and what I have reasonably assumed from connecting them:

- The International Energy Forum (IEF) meets every two years.
- Attendees are “the” global experts in energy, i.e. Energy ministers from the Middle East, Company CEO’s, etc.
- Press reports from the meeting suggested the oil producing countries would “cap” production, in order to lessen supply, and thus allow the price of a barrel of oil to trend up.
- History tells us a “cap” is a good idea that has seldom, if ever, worked, as there is always one country that agrees but doesn’t comply. It is usually a country who desperately needs the oil money. This time I believe that will be Iran and the production “cap” will once again work in the meeting but not in reality!
- On October 6, 2016, there was a special meeting held by the energy ministers in Istanbul. Very little was reported in the press. Interestingly, I came across a newsletter edited by Dr. Kent Moore. In the report he proposed the Istanbul group had floated the “cap” production idea to the press, but were actually working on the supply needed to create an “oil price floor”.
- I searched “The Texas Manufacturing Survey”, also cited as a source above in Sign #5, and observed the spike up in the monthly results, i.e. Texas is a large part of our energy industry.

My conclusion becomes pretty clear. It is this: If energy producers, including U.S. companies, understand the downside is benchmarked to say $50-60 per barrel they once again know how much profit they will make based on their cost level. Knowing this, they are more likely to spend on expansion and once again begin to grow revenue. At the very least, it would be reasonable to conclude the worst of the energy storm is over.

It was with this thinking as my back drop that I had to smile when I read a research report from Northern Trust Wealth Management's Chief Investment Officer, Katie Nixon. Ms. Nixon's quote regarding the S&P 500 earnings:

"The energy sector is projected to report the highest earnings growth (30%+) as well as being the strongest overall contributor."

Energy is what has been causing the rather large drag on the growth of earnings for the overall Corporate America, as measured by the S&P 500 and it appears, quantifiably, to be over.

Per Yardini Research, 2016 full year S&P 500 earnings are estimated to be $128.30 and 2017 is estimated at $134.30.

Let's plug full year 2016 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 U.S. Gross Domestic Product in their "second" estimate released on June 27, 2016, which was +.36%.

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

- 2016 S&P 500 earnings estimate = $128.30
- $128.30 x 19.64 = 2,519.81

As of 10/7/2016, the S&P 500 trades at 2,153.74 (a 16.99 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 the historic average of 20, the market returns were above average. When above +22, it was considered the danger zone. Based on this, I did some quick math to see the forward price earnings ratio calculated above is 16.79. The 90-day T-bill as of 9/9/2016 is .34.

16.79 + .32 = 17.11, 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.

For now, 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)
One of the Federal Reserve's mandates is to provide stability to the overall U.S. economy. In simple terms this means to provide an economic back drop that is growing, i.e. not contracting, as measured by deflation. Thus, growing or inflating at a controlled and modest level. The Fed's current target for the inflation rate is 2%.

This month the Consumer Price Index (CPI), which is meant to measure inflation at the household level, is annualized at +1.10%. Thus, below target.

The Producer Price Index (PPI) is meant to measure the increasing costs upstream at the manufacturing input level. The PPI this month is +1.20%. Thus, no upstream surprises flowing down to CPI anytime soon.

To complicate the economic growth calculation, the Bureau of Economic Analysis (BEA) reported an annualized inflation rate of +2.29% for the period of April through June 2016. Another government agency, the Bureau of Labor Statistics (BLS), reported inflation at +3.42%.

That's a lot of variance! It is simple, but I take the low CPI at +1.1%, add it to the BLS high number of +3.42% and average them to a +2.26% annual inflation rate. So, based on this simple math, the Fed's target inflation rate of 2% economic growth has been met. It is "okay" to go ahead and raise interest rates so economic growth does not overheat toward higher inflation levels!

As for economic growth, it is solid. The BEA reported all the goods and services produced in the U.S. grew at an annualized +1.42% as of 2Q2016. The BEA used 2.29% as their inflation rate to get the "real" GDP result of 1.42%, which is a rounding error from my simple calculation from above!

To be clear, +1.42%, inflation adjusted, growth on an $18,000,000,000 economy is pretty darn good. That will add $255.6 billion to our economy for the year, or the equivalent of about 1.3 new countries of Greece.

Sign #7 is positive again this month.

*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 $128.30 turns the 2,519.81 2016 FMV into 1,026.40 and even worse if earnings were to drop below the example of $128.30/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!

The opinions voiced in this material are for general information only and are not intended to provide specific advice for every client.

All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

•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.
•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.
•Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.