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 March 2022

Summary

If you are like many people in our WSG client family, it is possible that you may not read these monthly updates cover to cover. If you do, you will read a touch of this next part again in Sign #6 below. So, a two birds one stone shot here! 😊

With all of the nutty world events happening all at the same time, I started to reflect back on my lessons from "The Big One"!

When the stock market had that really bad day back on October 19, 1987, dropping the DJIA by -22.60%, yes, I was at my desk, and I was left with a few observations.

First, after the crash, we workers did what we do best, we went to work the next day and each day thereafter, building value. The second observation came a few years later when I crossed paths with Peter Lynch, the legendary manager of the Fidelity Magellan Fund. During our conversation I asked Peter about his activity in the fund he managed during that day.

Peter said it was very sad to him, as he wanted to buy his favorite companies in Corporate America, but because the people were only sellers of his fund, he had no cash to do so. In his observation, as I remember our conversation, he found it surprising that "investors" could not see that the earnings of Corporate America were growing nicely, valuations were not uncertain based on the economic backdrop, yet they were fear driven sellers when they should have been buying for their bigger financial future.

There is no way to know the future, but I would argue that if we do continue to consolidate the gains made over the last few years it is likely to be a rather quick time frame. As for severity, no one knows, my guess would be we are already seeing signs of "capitulation". And, let's not forget the part about the crash of

1987 few remember, and that is that market values were back above the pre-crash high valuations in less than two years and then went on to grow almost +300% in the 1990's.

This is one reason I titled the WSG Weekly Update for 1/7/2022 "Five Year Money" (Read it here). If you click the link to that update, you will observe a chart, source-cited, that details the fact that there have been no five-year periods when market valuations were less at the end of the five years.

Like the 1987 economic backdrop, we currently have a strong economy right now. If not for the high inflation reported below in Sign #7, all Seven Signs would be positive. This strongly suggests if the herd does get spooked and starts to run off the cliff, it should be a rather short-term traumatic event versus long and painful like the 2000 – 2002 "tech wreck" or the 2007 – 2009 "Great Recession".

There is a ton of stuff to scare anyone who looks at the news. Unfortunately, my two years at Wharton School, decades of Continuing Education, nor my undergrad studies offered courses on "Investment Strategies During Times of War and Pandemics". So, there is some on-the-job training going on now.

The good news is that generally our client family asset allocations have had cash/money market, i.e., can't go down in value, at close to 20% - 25% since mid-January, inflation hedges in place since 2020 at close to 25% and the remainder allocated in a well-diversified holding of investment positions with a history of strong performance. We are liking this so far!

Which brings me to a few quotes from people known to be smart and talented investors. First up, the legendary "Oracle of Omaha", Warren Buffett:

"Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold."

Maybe now is one of those?!

Another favorite is from John Bogle, the founder of the Vanguard fund family:

"My rule – and it's good only about 99% of the time, so I have to be careful here – when these crises come along, the best rule you can possibly follow is not 'Don't stand there, do something', but 'Don't do something, stand there!'"

My mom:

"If you don't know what to say, don't say anything at all", AKA, "If you don't know what to do, don't do anything at all"

Based on our current asset allocations and the investment positions we hold inside them, it feels like we are well positioned for any incoming curveballs. Clearly there will be a few including the soon to arrive, "Sell in May and Go

Away", the "summer doldrums" and don't forget all the angst to come before the election on 11/8/2022!

Below are the time-tested Seven Signs of a Changing Economy™ data updated with sources cited. It reads positive, especially corporate earnings in Sign #6. If you read nothing else, read #6, as earnings, and they are great, are what drive market valuations over time.

This month's Seven Signs are updated below. As always, I have added some unique insight with my comments. Just scroll down to view these now.

Your thoughts, comments and discussion are welcome. Please call me at 303-933-2107 or e-mail me at Jlunney@wealthstratgroup.com.

Respectfully,

James O. Lunney, CFP®
CERTIFIED FINANCIAL PLANNER™ Professional

The Wealth Strategies Group was founded by James O. Lunney under the guiding principle that comprehensive wealth counseling combined with independent investment advice will provide high net worth clients with complete trust in our competence, execution and integrity.

P.S. Please join me for our monthly conference call on The Seven Signs of a Changing Economy. You have the option of calling in or listening live for free from your computer. To call in, simply dial **516-387-1595**. There is no access code needed. To listen live from your computer, go to our website, www.wealthstratgroup.com, and click on the **"LISTEN LIVE"** button on the home page. You will be sent directly to our page on the Blog Talk Radio website and you can click on the link there. Instead of having a live Q & A session at the end of the call, you can now e-mail your question to me prior to the call at JLunney@wealthstratgroup.com and I will address them after my commentary on The Seven Signs of Economic Change.

The call is usually 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, 4/14/2022.

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 anecdotal data point I look at every month, but don't always mention in these updates, is the amount we collectively pay the U.S. Treasury in "Personal Current Taxes". For the most recent month the taxes paid came in at the highest in history at an annual rate of $2.767 trillion, up +23.47 from the pre-Covid level. (Source: St. Louis Federal Reserve 2/25/22)

This clearly suggests people are back at work, earning money at higher income points, paying taxes, saving money and spending.

Last month I was concerned that this most important sign of economic expansion, Personal Consumption Expenditures (PCE), would turn neutral or even negative. But, just in the nick of time it roared back at +1.50%. The reason this is so outstanding is I have always reported PCE as "chained dollars", i.e., this is already adjusted for inflation. (Source: Bureau of Economic Analysis (BEA), 2/25/22)

Behind this our economy also experienced a robust retails sales jump of +3.80% versus last month, nearly 100% higher than those pessimistic economists were expecting. This highly suggests next month's PCE will be up once again.

The fly in the ointment, and there is always a fly in the ointment, is gasoline at the pump. President Biden won the election in November 2020 on a key change to going green, i.e., close down the big oil company's greedy ways. On election day a gallon of gas was $2.09 per gallon. On 3/7/22 the same gallon is exactly $4.09 (Source: www.gasbuddy.com). That is an increase of 96% to you and me at the pump. This also represents 20% of the inflation post WWII (Source: J.P. Morgan Guide to the Markets 12/31/21). More important, a $.01 cent increase in a gallon of gasoline reduces our collective household disposable income by $1.3 billion, suggesting $260 billion less for us to collectively spend on fun "stuff".

This is a personal thought, but the more we send to foreign countries for oil, who don't really like us all that much, the less we have to drive our economy here via this #1 economic driver, PCE! To me, I ask, is this the start of a negative feedback loop where energy costs eat the core out of our spending to a point that this key economic driver collapses in on itself?

Watching closely, but for now Sign #1 roared back and remains positive!

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

(Positive)

I will share with you a little “trend trick” I look at each day to get a better sense of which way most market valuations for Corporate America are moving, versus just the broad-based indices. Instead of looking to see how, say, the S&P 500 is performing, look at the S&P 500 “Equal Weight Index”! Key point here: in the normal S&P 500, the larger a company is the more it impacts the index, as the S&P 500 is a “weighted” index. This simply means that today the four largest companies make up nearly 20% of the entire index. Those four companies are in fact the tail that wags the other 496 companies in that index. The weighted index holds all 500 companies in the index in equal weight. So, yes it has come down, but nothing like the S&P 500. This clearly suggests money is not leaving the market, and we know it is not from the Lipper Fund Flow Report dated 3/7/2022, instead the money is simply moving around to different sectors. We also know from the Thompson/Reuters “Insider Transaction Ratio” report that insiders, on average, are not selling.

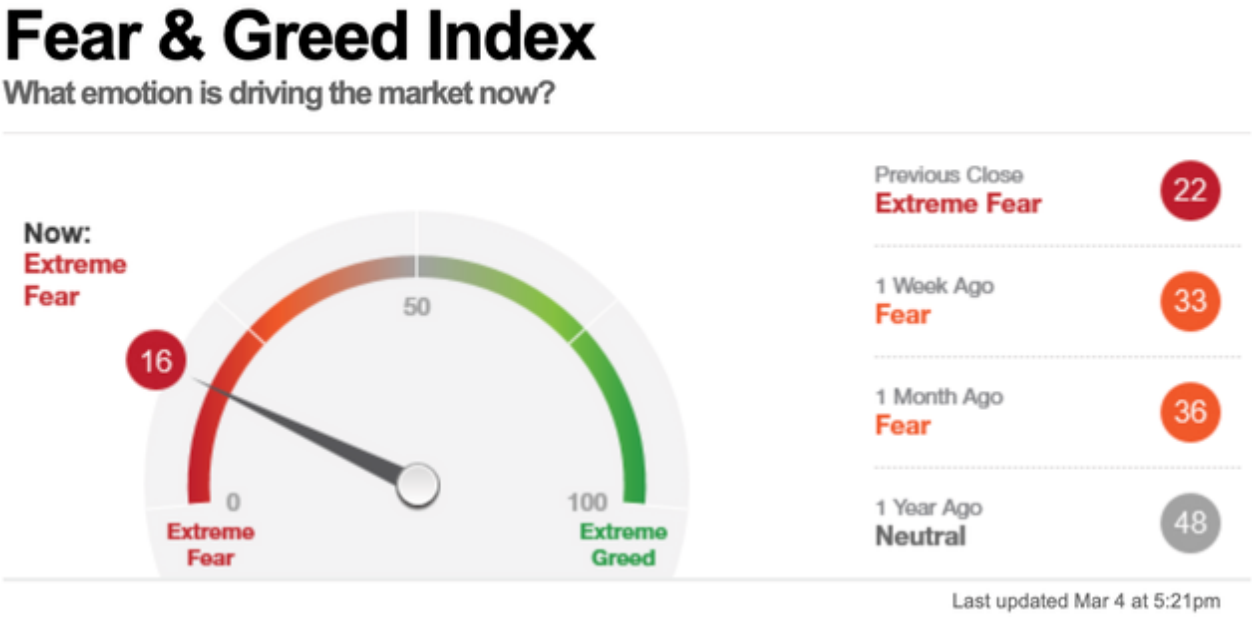
But you know what is? Yup! Mr. and Mrs. 401(k), again!

“Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold.”

~Warren Buffett

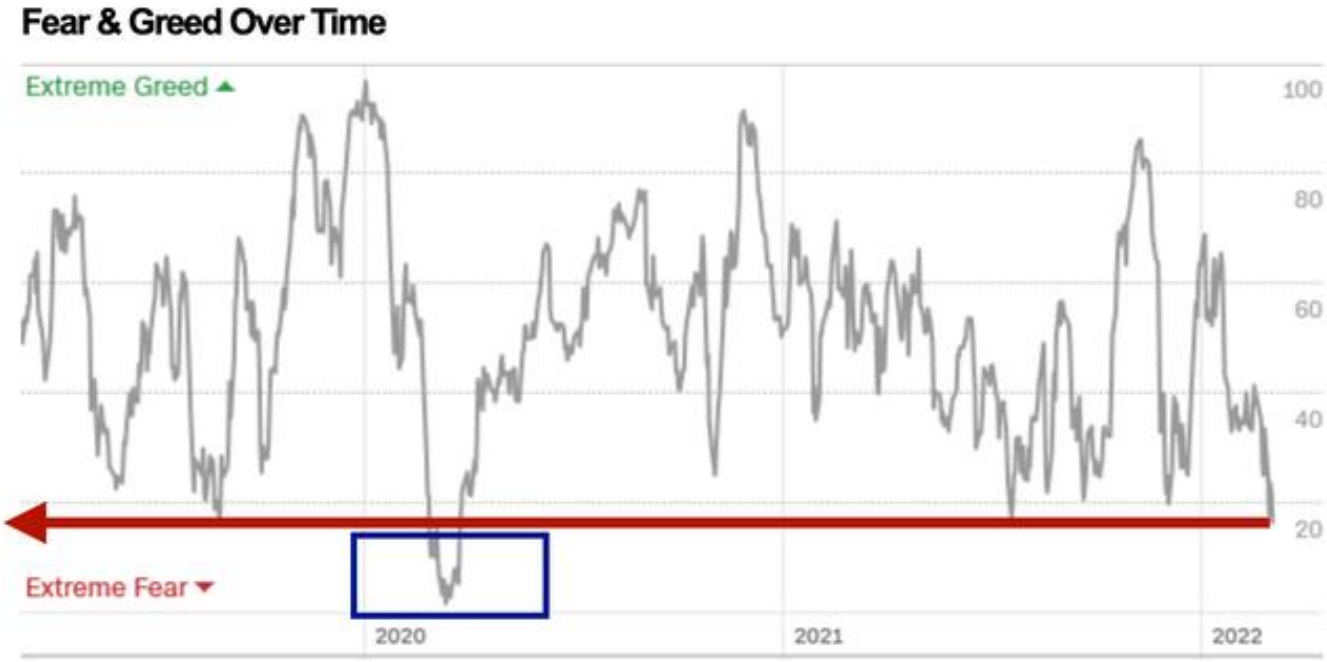
Well, here are a few dark clouds in the sky!

Chart #1 is our old friend, “The Fear & Greed Index”! All the way back down to 16, “extreme fear” level!



Note on the bottom right that just one year ago we rested at 48!

Now here is the same Fear & Greed Index over the last few years.



Note: In the box, at the "darkest clouds" of the pandemic, the Fear & Greed Index hit 1.

Now, here is the "briefly rain gold" moment…

Back in 2020, the Dow Jones Industrial Average (DJIA) was at 18,800 versus today's 33,000+!

Yes, there is bad news out there, i.e., dark clouds. If you have been reading these updates, you know all about what I call "Five Year Money". We are now investing for 2027. Raining gold now, in my opinion.

Is your glass half full or half empty?

Sign #2 remains positive, as money is moving around but not leaving the building.

3)	**Indicator:**	*Leading Economic Index (LEI)*
	Where to find it:	*www.businesscycle.com or https://www.conference-board.org/data/bci.cfm*
	What to look for:	*Trends up or down for three to four months*

(Positive)
As it turns out, the Covid virus is a gift that just keeps giving! This data point tends to lag in the time it takes to collect and report the data. So, this most recent data point is the month of January 2022. Recall January was the month

we experienced the most recent Covid variant and the various shutdown, rollbacks and stoppages.

The result being a small setback in the Conference Board's Leading Economic Index (LEI), of -.30%. Overall, this was a good report, given the virus flare ups in January.

Most of all, it is a tiny back up after the full year 2021's incredible increase of +10.10%, the highest ever!

Digging a little deeper into the data detail we see the "big three" of the ten data points that make up the LEI, were all very positive. Recall that all things "new" create jobs all the way down the supply chain. This month saw positive flashing on:

- ISM New Orders Index
- Manufacturers' New orders for non-defense capital goods
- Manufacturers' New orders for consumer goods and a bonus positive for future economic expansion with building permits also coming with strong growth.

This report would have been more positive as the only two negatives were 1) a jump in unemployment claims due to the variant and 2) stock prices.

Knowing we are once again past the current variant, I suspect LEI will come in slightly positive next month, before gaining even more strength going forward.

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)
Slowly but surely, we are getting back to normal, post-Covid! Clearly, the new jobs creation supports this comment!

Looking backward, December of 2021's job creation was adjusted upward from 199,000 to 311,000 new jobs! I agree, how can you be off on your calculation by 50%? This 311,000 new jobs number was followed by another 581,000 in January and the latest data for February 2022 came in at an unbelievable +678,000 new jobs. Just for fun, the consensus forecast was for 423,000 new jobs. So again, off by a mere 60.28%, versus reality.

The unemployment rate fell to 3.8%. Historically, an unemployment rate below 4% is inflationary. Ha! We already have the inflation dot covered in a few different ways as you will read below in Sign #7.

Perhaps more important, at this point is our economy, is that wages are up 5.13% over last year. That appears good on the surface until you see in Sign #7 below, that our current inflation rate is 7.50%. Thus, when the workers go to the grocery store they buy less with their higher income.

Just a guess here, but a darn good one, that is likely the reason the job "quits" rate jumped to a record 4.5 million. These are people who feel comfortable leaving their current job because they believe they can get a higher paying job elsewhere.

If you pause to think about that it becomes clear that those higher wages at the new jobs will be passed onto all of us as consumers and therefore the increase in "quits" adds to our inflation rate on about a three to six-month lag.

Job openings remain near at record at 10.6 million with only about 4.5 million people to fill them.

As noted here last month…

I predict the millions of people between age 62-75 who retired, left the work force or just decided they were done will now face the sobering reality that with inflation running at 7.50% their ability to survive on their fixed income five years from now, i.e., collective household costs 50% higher, will re-enter the work force. Timeline? Starting about…now!

Sign #4 remains positive (which can be too much of a good thing, per Sign #7 below).

5)	**Indicator:**	*Durable goods spending*
	Where to find it:	*www.census.gov (Monthly Advance Report on Durable Goods Manufacturers' Shipments, Inventories and Orders)*
	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 new orders, up eight of the last nine months, increased +1.40%. Shipments, also up eight of the last nine months, increased +1.10%. Inventories up for twelve consecutive months increased +.40%.

The new orders for “stuff we can live without” are strong, but most importantly, they are being shipped out to consumers at a rate that continues to draw down inventories. When new orders are significantly above shipments, like now, and when shipments are drawing down inventory as they are now, it implies consumers have the desire and ability to buy “stuff” they could delay. This is a strong leading indicator that suggests the consumer, see PCE above in Sign #1, is strong and most of all this data point tends to be a slower mover.

Again, a touch of anecdotal evidence tells a story of demand strength; per Blackstone Investment Strategy report, “a relatively small Pana-Max container ship fetched a daily charter of $200,000 at the end of 2021; a couple of years ago, these ships were being sold for scrap.” Wow!

Per the St. Louis Federal Reserve’s Freight Transportation Services Index, transportation is back above pre-pandemic levels. In addition, The American Trucking Association tonnage shipped in the most recent month is back to 98.5% of the pre-pandemic levels of March of 2020.

Nice to see the Cass Freight Index, which measures container shipments and rail car loadings, has seen a large increase in automotive rail car shipments, which implies the semiconductor shortages to complete new autos for sale has diminished.

Sign #5, our canary in the coal mine, remains full of oxygen and chirping healthy.

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)
When the stock market had that really bad day back on October 1987, dropping the DJIA by about 22.60%, yes, I was at my desk, I was left with a few observations.

First, after the crash, we workers did what we do best, we went back to work the next day and each day, therefore building value. The second observation came a few years later when I crossed paths with Peter Lynch, a legendary manager of the Fidelity Magellan Fund. During our conversation I asked Peter about his activity in the fund during that day.

Peter said it was very sad to him, as he wanted to buy his favorite companies in Corporate America, but because the people were only sellers of his fund, he had no cash to do so. In his observation, as I remember our conversation, he found it surprising that “investors” could not see that the earnings of Corporate America

were growing nicely, valuations were not uncertain based on the economic back drop, yet they were sellers when they should have been buyers.

Sounds at least a little bit like today's environment. Full-year 2022 earnings for Corporate America, as measured by the S&P 500, continued to increase to $229.60. How does that affect our estimate for Fair Market Value (FMV)?

Let's plug into our Fair Market Valued (FMV) calculator using "The Rule of 20" to get both FMV and the price to earnings, or P/E ratio (a measure of risk).

To use "The Rule of 20" you just subtract the inflation rate from 20. I will use the same inflation rate the BEA used in calculating the Gross Domestic Product (GDP) for the 4Q2021 "second estimate" released February 24, 2022, of +7.60%

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

This month's calculation is going to sting a little as the inflation rate just jumped up to 7.60% from +4.40% a few months ago.

Take a peek!

- 20 – 7.60 = 12.40
- 2022 S&P 500 earnings estimate $229.60 (Source: Yardini Research, 3/7/2022
- 2022 S&P 500 Fair Market Value estimate $229.60 x 12.40 = S&P 500 (FMV) 2,847.04

As of 2/11/2022, the S&P 500 trades at 4,204.31, or a 47.67% premium to 2022 FMV.

In my humble opinion, this inflation calculation into the FMV multiple gives a bit of a "false read" for now, so, watching closely, but still real in the moment.

Perhaps a more realistic view is via this research piece I recently read titled "Daily Wealth" by Dr. Steve Sjuggerud. In this issue, Dr. Sjuggerud presented research that added the price/earnings (P/E) ratio to the 90-day T-bill.

This is a tool that accounts for the cost associated with borrowing money, i.e., accounts for the impact of low interest rates on a company's ability to earn profits. The research quantifiably showed that when the total is above 22, we are in the danger zone. Below 20 represents quantifiable value.

Based on this, I did some quick math to see the 2022 projected price/earnings (P/E) ratio is 18.31. 18.31 + .36 (yield of the 90-day T-bill) = 18.67 and in the "value" zone, i.e., below 20.

Current valuations for Corporate America are high and arguably overly affected by the bounce up inflation. With earnings momentum in a strong upward trend and with Sign #3, LEI, suggesting a positive economic backdrop for the next six to nine months, this suggests Sign #6 remains positive. But if inflation persists, and I believe it will, this could change soon.

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*

(Negative)
The Producer Price Index (PPI) measures the inflation rates at the manufacturing level. The most recent report represented a +9.70% annualized increase. That is significant, and in line with what I have suggested here for over a year! My guess was more like 7% vs. this 9.70%.

It seemed reasonable to think producer input costs would start to slow their increase, but the opposite is now in play. Producers are paying more for everything. Raw material inputs are up in cost as we are labor and energy costs. To add insult to injury, property values have increased due to inflation, this in turn will be pushing property taxes up for years to come.

The Consumer Price Index (CPI) is meant to measure inflation at the household level. This month CPI came in red hot at +7.90% and it is the highest since 1982, i.e., forty years! We are likely to see this continue to be in the "hot" area for the next few years as well. Why? Housing costs. An entire one-third of CPI is housing. It is calculated using "Owners Equivalent Rent" (OER). Rent increases tend to lag behind housing price increase by 18 – 24 months. Thus, "about now" we are likely to see many months of +7% annual CPI increase (like 18 months to two years) even if other inputs like cars and travel start to reduce.

Just for fun I will add that over the last seventy-five years inflation is up 13x! Back in 1947, that like item you bought for $100 costs $1,261 today.

No "stagflation" (where our economy grows at the same rate or less than inflation, a bad thing) yet. As all the goods and services we produce (our Gross Domestic Product) GDP increased at a +14.6% annual rate, per the Bureau of Economic Analysis (BEA) in their "second estimate" released on 2/24/2022. Reducing for inflation at their designated percentage rate and we are still growing the economy at a "real", i.e., inflation adjusted, +7.0%.

Our GDP is now the largest in the history of the world at $24.01 trillion. If not for that inflation pinch to the work force detailed above in Sign #4, Jobs, we would have nothing but blue sky. Yet, inflation does exist, is trending higher and the higher interest rates needed to stop the "Real Return Illusion™ are dead ahead and add complexity to what could be next.

Sign #7 remains negative.

*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 $229.60 turns the 2,547.04 2022 FMV into 1,836.80 and even worse if earnings were to drop below the example of $229.60/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.

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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.