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 2018**

## Summary

**That didn't take long, did it?**

In the January 2018 update of The Seven Signs of a Changing Economy™ I detailed how we track "big money" moving from one investment to another. You can see it in the volume of large blocks of shares traded in specific companies and the general market value overall.

My detailed outlook, forecast, was that I expected some "backing and filling" to the extended uptrend in the valuations of Corporate America, as measured by the major indices like the S&P 500. As I wrote: "I suspect it will happen pre-summer and my guess is a temporary reduction of 10%-15% in value."

And that's pretty much where we sit as I write this on March 4th, 2018!

To quote myself from the January 2018 edition:

"Look at all these new bullish (positive) investors. All fresh, energetic and excited. Fresh out of hibernation having slept through the last 17,000-point uptrend in the DJIA! This is the perfect set up for the back and fill correction. If we get a few weeks straight of down days and say, 2,500 DJIA points (-10%), we will be able to watch them scatter like sewer rats. That 59.80% American Association of Individual Investors (AAII) bullish sentiment will drop back down to 29% so fast you will miss it if you blink."

The chart posted under sign #2 below is exactly that – "so fast you will miss it if you blink"! Wow! That's about all I can say.

Since that write up I have suggested there will be three to five more like episodes to come this year. This is good and there are reasons, and you may want to tighten up your seat belt, munch a few Tums and find a spot close to the bourbon barrel so you can calm your nerves.

"Jim, you just mentioned there are reasons for this volatility. What are they?"

1) The black box trading systems use software that directs "robot trading" to get in front of price trends of any share of common stock being affected by transactions, positive or negative. Thus, greatly exaggerated price movement. Keep in mind this is just the world we live in. My friend Rick Davis is the founder of The Consumer Metrics Institute. Rick is a super smart dude. He has a product he created, and makes available to the hedge fund traders on Wall Street, based on consumer's views of any brand name in America and it is "live" data. Think of it as a way to watch if consumers are trending away from X toward Y. So, the hedge funds sell X and buy Y to be in front of the trend. Rick has suggested to me in conversation these "managers" have no clue about most of the companies they buy and sell or what they do, nor do they care. That just doesn't strike me as investing? I collect great companies in Corporate America as they grow, evolve, pay dividends, acquire competitors, etc. That's investing.

2) There is this $2 billion per week habit! $2 billion per week! That is the amount of money flowing into…wait for it, no not Amazon or Apple, but Exchange Traded Funds (ETF's) and that is only for one company, Vanguard! (Source: Mark Hurlburt Research)

   Today's "fix all" for investors is the ETF low-cost solution, as there is no management, just a basket of companies, usually by sector. Shares are bought or sold depending on if the $2 billion is flowing in or out.

   As I have written here before, these people are <u>renters</u>, not <u>owners!</u>

   All those billions that flocked to Vanguard ETF's are average people who don't know what to buy, or how. They say I am a long-term investor and I will just buy a basket of good companies.

   They are renters and when the lease is up is when we hit that 2,000 point down draft on the Dow Jones Industrial Average (DJIA). As I noted above, this when the renters scatter like sewer rats - they did and I believe they will do it again another three to five more times this year.

   The ETF today is like the "portfolios insurance" story of the 1980's, the hedging story of the 1990's, and the long/short strategy of a year ago.

   Those of us who have been around long enough are the ones trying very hard to help our clients understand that this is just another Wall Street marketing vehicle. There is no easy route. The reality is this: there just happens to be some pain involved in growing our wealth!

   As investors, it is our structure, strategy, and processes that help us with clarity, confidence, and direction. We tend to do better because we understand all this and therefore react rationally and logically.

The dirty little secret is that it is okay for the investment markets to stink from time to time. This is how it has been my entire third of a century in this industry. Those who understand and react accordingly tend to do quite well and those who somehow think there is a quick, easy, and cheap solution usually find out the hard (expensive) way that there is not.

This month's update is actually really good. Not because I wrote it, but because the data is clean, clear, and suggests a clear economic background going forward. Use this to increase your confidence and wealth creation. From my perspective we have yet to see the mountain top highs in the capital markets.

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

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

Respectfully,

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

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

**P.S. Please join me for our monthly conference call on The Seven Signs of a Changing Economy.** You have the option of calling in or listening live for free from your computer. To call in, simply dial **347-826-7481**. There is no access code needed. To listen live from your computer, go to our website, www.wealthstratgroup.com, and click on the **"LISTEN LIVE"** button on the home page. You will be sent directly to our page on the Blog Talk Radio website and you can click on the link there. Instead of having a live Q & A session at the end of the call, you can now e-mail your question to me prior to the call at JLunney@wealthstratgroup.com and I will address them after my commentary on The Seven Signs of Economic Change.

**The call is always on the first Thursday of each month at 1:00 p.m. MST/3:00 p.m. EST, unless otherwise noted. Please mark your calendar to join me for the next call on Thursday, April 12, 2018.**

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.

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|---|---|---|
| 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)
Business news is no different than any other news source in the sense that a reporter's personal bias will tend to filter into whatever data the reporter is writing about. This is a very big key reason to why I have chunked down all the available data sources to The Seven signs of a Changing Economy™. These seven have been correct, over time, and as I narrowed down the more correct sources over the years it was also very important to leave my personal biases outside the decision tree.

Each of the Seven Signs has a unique reason for inclusion and for their respective order of importance and impact on the collective of the seven. Sign #1, Personal Consumption Expenditure (CPE) is the gorilla as it represents 68.90% of our entire economy. (Source: JP Morgan Asset Management 12-31-2017). Our economy is now right at $20 trillion and the largest ever recorded on earth. So, if you can measure how that is doing with one data point, that is a good start.

That said, PCE gets recorded in both current dollars and inflation adjusted or "chained" dollars. For our monthly update I always use "chained" as it is logical to account for the effects of inflation. After a great 2017 with PCE +2.40% annualized, and the biggest holiday shopping season ever recorded, it makes sense that consumers would put the credit card away for a few weeks, and they did.

The most recent detail is for January 2018 and chained PCE came in at -.1%. This is not a trend and it is also pretty normal January reporting. For example, here are a few other January reports:

2017: -0.3%
2016: 0.0%
2015: +0.2%
2014: -0.3%

It is possible that the February detail will also contract slightly, but remember January Personal Consumption Expenditures came in at $13,717 trillion and remain at the highest level ever, as are household income and tax revenue to the U.S. Treasury. Expect all to continue up as construction spending was revised upward for 2018 by the U.S. Commerce Department to $1.26 trillion up to +4.3% versus 2017. It is very important to remember that consumer income leads to business income, not the other way around! The old school of business rule of thumb is the relationship runs from personal income growth to corporate profit growth by a four-quarter lag. Hourly wages just hit an eight year high! All of this is before the $2 trillion plus that is about to reenter the U.S. economy from overseas via the new tax law. Sign #1 is positive and is expected to build

momentum as the year rolls forward toward the biggest holiday shopping season ever, 2018!

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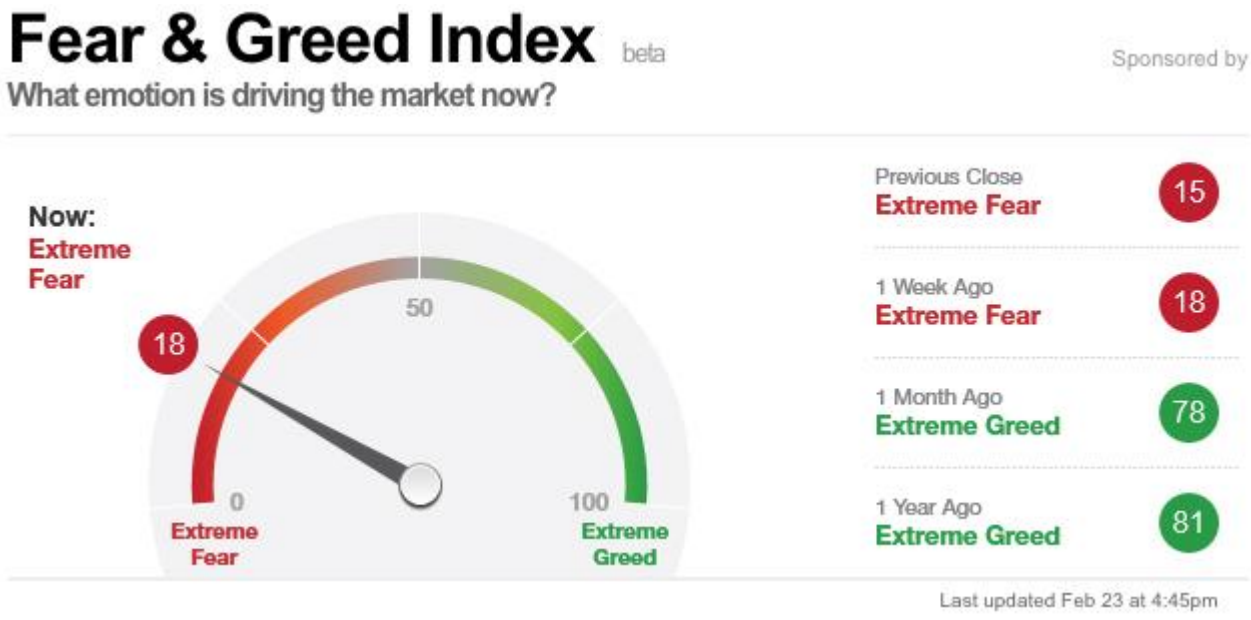
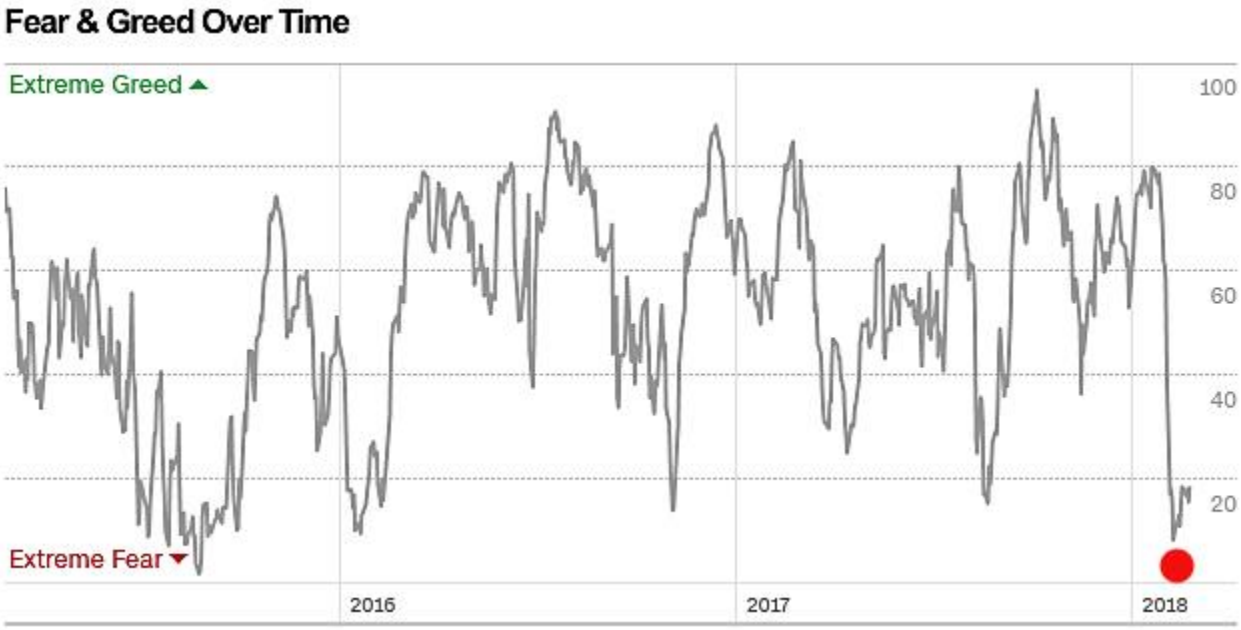
| 2) | **Indicator:** | *Institutional Money Flow* |
| | **Where to find it:** | *www.wordenbrothers.com or www.barrons.com/convictionoftraders* |
| | **What to look for:** | *Increasing or decreasing prices on high volume of large block trades* |

(Positive)
Since November of 2017 I have written here in Sign #2, money flow, how we will experience volatility as Mr. and Mrs. 401(k) remain both “fearful” and “fear of missing out” (FOMO)!

In the January 2018 issue I included a graphic from The American Association of Individual Investors (AAII) that reflects the FOMO stage as bullish sentiment doubled from 29% bullish to 59.8% bullish in one week.

This March I came across this table from CNN. Notice that one-month reversal from 78% bullish down to 18%. That’s 30 days!






The point here is pretty basic. Since the bottom of the Great Recession in March of 2009, the Dow Jones Industrial Average (DJIA) has moved up 17,000 points while the average person could not have cared too much less. Then, with a few thousand points of "backing and filling", which is healthy market activity, they now sense something is terribly wrong. The herd is likely wrong again. This is normal and we haven't even seen the money held overseas by corporate America flow back yet. As it does, and it is already, expect to see hundreds of billions used by corporate America to buy back their own shares and those of others as the financially strong acquire the undervalued companies in their competitive space.

Sign #2 is positive.

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| 3) | **Indicator:** | *Leading Economic Indicators (LEI)* |
| | **Where to find it:** | *www.businesscycle.com or www.newyorkfed.org/research/global-economy/globalindicators.html* |
| | **What to look for:** | *Trends up or down for three to four months* |

(Positive)
The creator of the Leading Economic Index (LEI) is the Conference Board. The LEI is made up of ten input points that combined have been unbelievably accurate at suggesting what might be happening with our economic backdrop six to nine months into the future, i.e., September-November 2018. It isn't exactly the same as having tomorrow's edition of the Wall Street Journal, but a great indicator of the economic backdrop we will all be operating in just around the corner.

This month the LEI increased +1.0%. In the six-month period ending January 2018, the leading economic index increased +3.00% (about a +7.80% annual

rate), faster than the growth of +2.30% (about a +4.60% annual rate) during the previous six months. Thus, picking up steam.

Perhaps more important than a +7.80% annual LEI increase is that the growth is very broad. Of the ten inputs, eight were positive, two were neutral and none were in contraction.

For the last several 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 of two to fourteen months, with an average lead time of eight months, before a recession starts. This month the CAB reported in at 120. This is higher than before the "Great Recession", highest level ever recorded and remains +6% year over year.

Sign #3 remains very positive!

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| 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)
Once again, we are in a month where the new jobs created data for the prior month lags by a week due to the calendar. So, as I write this on March 4th, 2018, the new jobs created will not be released for February until Friday March 9th, 2018.

As in the past I will make my educated guess as to how many jobs were created and then update versus actual next month. Before I get to my best guess, which is positive, I will share that the 4-Week Moving Average of Initial Claims for unemployment dropped to a 40-year low this month at 220,500. (source: St. Louis Federal Reserve).

Also, each month I read the Bureau of Labor Statistics (BLS) Job Opening and Turnover Survey (JOLT's Report). I rarely refer to the data detail, but I like to look specifically at the number of "separations", i.e. quits, layoffs, discharges, and other separations, i.e., the turnover of the workforce. For the most recent JOLTs report this was unchanged.

Lastly, per the National Federation of Independent Business (NFIB): a "record number of small business owners say now is a good time to expand".

- ✓ Expansion reading sets a 45-year high in the NFIB Optimism Index
- ✓ "Main street is roaring"

- ✓ "Small business owners are reporting better profits"

I could go on, but you get the idea. Small businesses are who hire the most people and they are making money, optimistic and expanding. The fly in the ointment is the talent in the labor pool…shallow!

My guess for new jobs creation in February is +250,000 with little if any input from the telephone survey named the Birth/Death model. We will follow up next month to see how close "Jim" got to reality with his "educated" guess!

Up, down, or sideways, Sign #4 is positive!

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| 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* |

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 decreased -3.70%, up three of the last four months. Shipments up eight of the last nine months increased +.2%. Inventories increased +.30%.

Once again, this data lags. As I write this Marth 4th, 2018, the data is for January 2018. It's the data for the month immediately after the largest shopping season ever on earth. As detailed in Sign #1 above (PCE), the consumer has put the credit card back in the wallet/purse for this month.

Like other Signs, I am always looking at my "data bench" of additional data points and anecdotal support detail. One of those I watch, and to the best of my memory, have never referenced is the Institute for Supply Management (ISM) "Services" Index. This services index is responsible for measuring 80% of our economic output and per ISM, remains "firmly in expansionary territory"!

I have also referenced here in prior issues the Texas Manufacturing Outlook Survey. I pick Texas as they are a huge producer in multiple industries. A few key notes from the February 26, 2018 update:

- The Production Index rose +11 points, supporting a pickup in output growth
- New Orders and growth rate of orders "remained steady"
- Shipments Index rose +5 points, its highest reading since 2006

Last but not least, the American Trucking Association (ATA) tonnage shipped index jumped +8.8% year over year through January 2018. Just FYI, that is huge!! Per ATA Chief Economist Bob Costello, "With the economy strong, the

drivers of truck freight solid, and the inventory cycle in favor of motor couriers, I expect freight tonnage to remain robust in the months ahead."

Sign #5 remains solidly positive!

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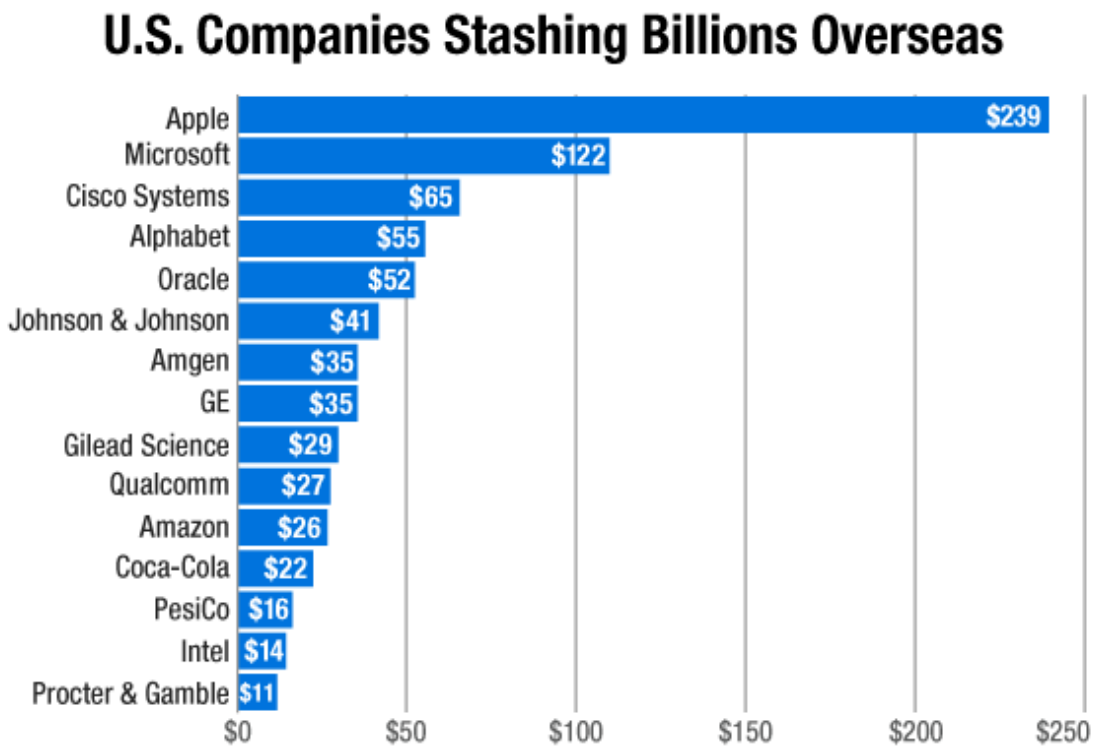
| 6) | **Indicator:** | *S&P 500 Earnings per Share growth* |
| | **Where to find it:** | *www.standardandpoors.com* |
| | **What to look for:** | *Two quarters of S&P 500 earnings per-share growth, up being a positive trend and down being a negative trend* |

(Positive)
Before we peek behind the curtain and see the current Fair Market Value (FMV), as calculated using my business school rule of thumb, the "Rule of 20", let's take a closer look at what isn't being reported in your business news.

According to the organization, Citizens for Tax Justice, the total amount currently being held by Corporate America overseas in order to avoid paying U.S. corporate taxes tops $2.6 TRILLION!



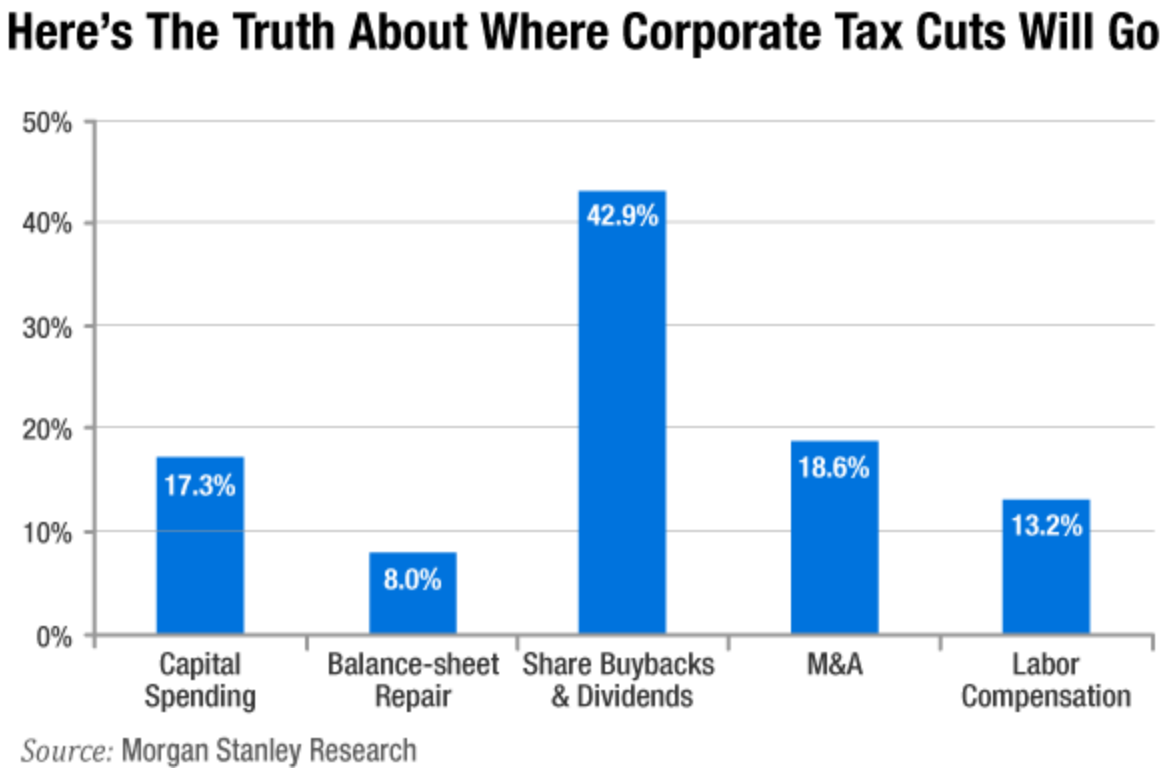

The new tax law will allow these companies, and many others, to bring that cash back to the U.S. at a 15.5% tax rate.

With $2.6 trillion on hold overseas, that's potentially a $400 billion windfall for U.S. taxes, and a more than $2 TRILLION money flow (Sign #2) for investors, as companies put all that repatriated cash to work.

So where will it go?

According to a recent report by Morgan Stanley, only 13% of company's tax savings will go to employees via pay increases and bonuses.

Where will the rest go? Per Morgan Stanley, almost 43% will go to stock buybacks and increasing dividends.




That 43% represents nearly $860 billion that will soon be flowing toward dividends and stock buybacks.

Per Louis Navellier Research, many companies have already announced plans to buy back their own shares, i.e. they think the shares are fair in value and worth investing in.  Hmmmm, note to self!

For example:

Boeing announced an $18 BILLION buyback.
Home Depot committed to $15 billion.
Honeywell authorized another $8 billion for share buybacks.
Bank of America said it will buy an additional $5 billion of its own stock.
MasterCard, $4 billion.
Wells Fargo announced a giant $22.6 BILLION share buyback plan.
Amgen , $10 billion.
Alphabet, $8.6 billion.
Visa, $7.5 billion.

Ebay, $6 billion…Anthem Inc., another $5 billion…Lowes, $5 billion…Valero, $2.5 billion

I continue to believe we still have a meaningful amount of upside in the valuations of Corporate America. I will continue to track our "three Points to Ponder", the other detail of the Exit Strategy I created and e-blasted to those on our client and prospective client list earlier this month and the Fair Market value (FMV) of Corporate America, via the Rule of 20, in each monthly issue of The Seven Signs of a Changing Economy™. You should make the time to read these updates and stay informed as to what is really happening versus the "hot" news story of the day in your local news source.

The reduction in corporate tax rates combined with business' ability to fully expense their capital expenditures for the next five years are powerful tail winds for profits. So much so, that Yardini and Associates has seen earnings estimates for 2018 accelerate to $153.58/share for the S&P 500 as of 1/26/2018. FactSet remains at $159.09 on same. To be as conservative as possible I will use Yardini's $153.58 per S&P 500 share for our 2018 Fair Market Value (FMV) estimate, using 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 Gross Domestic Product (GDP) "second estimate" for 4Q2017 released February 27, 2018 of 2.34%.

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

- 20 – 2.34 = 17.66
- 2018 S&P 500 earnings estimate = $153.58
- $153.58 x 17.66 = 2,712.22 (S&P 500 2018 FMV estimate)

As of 3/4/2018, the S&P 500 trade at 2,691.25 (2018 FMV rests at a -.78% discount to FMV).

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| 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)
Sign #7 is about measuring if our economy is expanding (inflation) or contracting (deflation, i.e., depression). The good news per the Bureau of Economic Analysis (BEA) Gross Domestic Product (GDP) report released on February 27, 2018 expanded at an annualized rate of +2.53%. As I like to say, "growth is growth", so this is good. The BEA will release their "third" and final estimate of

4Q2017 GDP the third week of March and it will likely remain close to this +2.53% growth rate.

This is down from 2Q2017 at +3.10% and 3Q2017 +3.20%, BUT STILL A SOLID 2017 GROWTH RATE. No matter how you choose to view a +2.53% growth rate in our economy, it is still the largest on earth at $19.736 trillion. It is clearly more difficult to grow $19.736 trillion at +3-4% per year than say a $5 trillion economy. Thus, I happen to be in the camp that suggest this is just fine.

If you consider inflation at the household level, as measured by the Consumer Price Index (CPI) is holding solid at +2.1% per year, it is great! Remember, GDP of +2.53% is already adjusted for inflation, i.e., the economy grew at +4.87% before the +2.34% reduction to adjust for inflation. That works!

In addition, the input cost to manufacture products as measured by the Producer Price Index (PPI) also remains in check at +2.5% per year.

Each month I review the Atlanta Federal Reserve Bank's "GDP Now" forecast as a backup data point. As of March 1, 2018, they are posting their GDP estimate for 1Q2018 at +3.5% annualized. This marker is subject to a good amount of adjustment and it could be reduced, but if it holds, the end of the 1Q2018 story is our economy is growing solidly and without a negative impact from inflation.

Sign #7 remains positive!

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