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 May 2020

Summary

As Matthew Broderick succinctly stated in the movie, The Freshman, "There's a kind of freedom in being completely screwed because you know things can't get any worse."

I love "boots on the ground" stories simply because they're true. Of course, the source must be known and known to be trusted. If used in my publication, both will have passed both tests.

This is a quote from an email to me from a client of over 35 years on March 26, 2020.

"Last Monday at the Marriott Kauai with 365 rooms, at 11:00 am, five people were at the pool (which is the largest pool in the state of Hawaii) and there were three people at the beach. I am the ONLY guest left at the Marriott Lagoons (originally the Ritz Carlton) for the last three days."

To me, I read that to be, people are scared beyond belief and in retrospect, justifiably so! Perhaps it is no coincidence the valuations of Corporate America, at least to date, bottomed just a few days later.

"Justifiably so", based on some economic data flow for the month of April like:

- The New York Empire State (business activity) Index dropped to a record low of -78.2%
- U.S. Industrial Production fell to the steepest decline since 1946
- U.S. Home Builders' confidence measurement fell to the lowest level since 2012
- Texas future business activity and future company outlook dropped -42.1% and -41.50% respectively

As I wrote here last month, we are now at the “economic ground zero” of the black hole in this economic donut caused by Covid-19 and I think as The Seven Signs of a Changing Economy™ supports it. Per the opening quote, you kinda have to think it can’t get much worse. Now, no one knows the future (a few politicians say they do, but I don’t buy it!) so, perhaps it can get worse.

This month, The Seven Signs of a Changing Economy™ are collectively suggesting that the complete shutdown of our $22.5 trillion economy is close to bottoming out. As I write this month’s update on Sunday, May 3, 2020 the country is slowly starting to implement re-opening policies.

In the reopening, we are in fact seeing what I warned about right here last month, i.e. “data flow will now get disconnected, far from normal, and, in all likelihood, increasingly political.”

You would be very hard pressed to convince me the data flow from here gets worse. Heck, at -78.2%, how much worse can it get? Yes, rhetorical, but still!

I hope you enjoy this month’s update. As I wrote it, the flow of the data and where it might lead to next, just felt better! For example:

I apologize in advance for Sign #2. My favorite professor of finance at Wharton School, University of Pennsylvania, Dr. Jeremy Siegel, would scold me for trying to explain liquidity leading to inflation in four paragraphs. (Google Dr. Siegel, he is still the best. I have communicated with him four times in the last four weeks.)

The second “boots on the ground” story is in Sign #4. It is real and a lynch pin to our recovery if not put in check! Serious stuff!

Sign #5 adds a touch of investment advisor humor as we flashback to the TV program, Happy Days and “Jump the Shark” with the Fonz!

I plagiarized my Weekly Update of 5/1/2020 in Sign #6, just because it’s really good and my intent is to touch it daily for direction until we are again best of class allocated for where the economy is going.

If you are one of the 50%-ish of people unsatisfied with the President, you may not like how the economic data flow could be suggesting a strong recovery just 30, or so, days before election day on November 3, 2020.

For now, I hope all of our brilliant scientists working with their super computers, advanced software, and artificial intelligence (AI) applications create an effective therapeutic and vaccine ASAP!

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, June 11, 2020.

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*

(Covid-19 impacted)
For over a decade, Sign #1, Personal Consumption Expenditures (PCE), has been positive, until last month when all Seven Signs were re-titled "Covid-19 impacted". To quantify what that means, PCE for March 2020, most recent, was reported by the Bureau of Labor Statistics (BLS) at -7.30%!

To put that into perspective, a -7.30% wipes out the entire growth in Personal Consumption made since June 2017. Just a touch under three years of positive

growth gone in 30 days. Easy enough to understand. PCE is “demand” for, well, everything we have in our day to day lives.

Of course, many of us used the shutdown to shop online for great deals. I personally bought a new pair of skis and bindings at 70% off the price I was not willing to pay pre-Covid-19. But, that level of demand is not close to what will be needed to get us back to pre-Covid-19 levels!

So, the questions I see raised in the press, like,

- When will we go back to work?
- How long will it take for our economy to recover?
- How many bankruptcies does it take to sink our economy?

are all dumb questions! There is just “the question”, as it is 68.10% of our entire economy (Source: J.P. Morgan Guide to the Markets, March 31, 2020) and the question is, “When will the Personal Consumption Expenditure level return to pre-Covid-19 levels?”

If we knew when an effective therapeutic would be available followed by a vaccination, we would know, but we don’t. So, I will guess it is much, much faster than any news report will suggest. They need this scary stuff to keep your eyeballs on the pop-up ads, but I don’t. However, the combination of sheer human brain power combined with unbelievable computers, software, artificial intelligence (AI) and money would suggest less than six months for an effective therapeutic and less than a year for a vaccine.

If a good guess, then you would expect to see consumer spending trending up slowly starting in a month, then ramping up into the fall. Yes, I read that too—the Covid-19 will likely return in the fall. Maybe, maybe not!

Either way, I think we see consumers spending like crazy into the holidays and yes, I still think this holiday shopping season will be the biggest on earth. I also think it will take twelve to eighteen months to return to the PCE levels where we were before hitting the Covid-19 the stop button.

The worst appears to be over and Sign #1 will be our focal point of how fast we recover from here!

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*

(Covid-19 impacted)
Per an article issued by Stansberry Research on 4/10/2020, the U.S. stock market saw the total valuation reduced by $12 trillion from February to March

2020. The last two weeks of March 2020 recorded a $400 billion flow out of "risk" assets to money market funds that represent government bonds.

At that point the U.S. Treasury and Federal Reserve took steps to add liquidity to the short-term credit facilities, bond market and stock market. With that back stop we have now seen stability return to the bond market and stock market at all levels.

What is liquidity? Very few people, even many in the finance industry, don't have an informed answer. The purpose of Sign #2 is not to go down the detail rabbit hole, but from the edges liquidity is a function of monetary policy, i.e. how much cash and short-term in instruments the Treasury wants in the economy. The amount put in is based on four measurements:

- Immediacy
- Tightness
- Market breadth
- Activity

Combined, these determine the amount of money that will be released into the financial system. When the economy slows, or just stops like we have witnessed, the Treasury puts in trillions. Those trillions prime the economic pump, and it does work to do at least two other things. First, the money finds its way to where it will get the highest return. At present, that is ownership in Corporate America as the outlook one to two years from now remains positive. Second, it is inflationary. Inflation is the choice over deflation, as deflation causes depressions, i.e. all values from homes to businesses devalue.

My guess is that slowly the trillions that have been injected into the economy will result in an inflation rate of 4-5% per year. The Fed is likely to accept that based on the reality of a Covid-19 induced depression, if they didn't.

As we thoughtfully reallocate some of the cash in our client accounts, it will include a few of the more traditional inflation hedge investments. Historically, one of those has been ownership in the companies of Corporate America and subsectors, like energy, for example.

In this month's bounce back up in valuations, the Fear and Greed Index has also bounced up from a reading of just "1" a month ago to 47 on April 30, 2020. It would be a touch nutty to think this rocket side of volatility is over, but we should see it slowly mellow.

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*

(Covid-19 impacted)
The Covid-19 induced collapse of our economy is easily quantified with just a quick look at The Conference Board's Leading Economic Index (LEI). The most current release is for March 2020 and it registered a record -6.70% decline. It took just 30 days in March to wipe out all gains since April 2016. Wiped out four years of solid economic growth in 30 days! Wow!

The not so good news? It will get worse, perhaps a lot worse. Recall, the economy did not start to shut down until mid-March, so this is really just a few bad weeks. April's LEI will be out in mid-May and my guess is it will be negative double digits, as April was a complete shutdown month.

The Chemical Activity Barometer (CAB), which is sourced by the American Chemical Council, is a solid measure of how deep of a recession we are in. This month, the CAB and it reported a -14.8% year over year reduction. This wiped out eight years of growth.

I don't cite this negative detail for any other reason than for us all to know how deep this recession is and from that we will be better able to measure when we have hit the bottom of the current recession. With that a known, we can start to quantify a timeline back to where we were.

Once again, a twelve to eighteen-month timeline seems reasonable to assume based on the current economic bungee jump.

On a positive note, two out of the three, in my opinion, most impactful inputs to the LEI were positive in March.

- Manufacturers' new orders for non-defense capital goods
- Manufacturers' new orders for consumer goods and materials

These two were the second and third most positive inputs of the ten measured for the LEI.

Again, we went into this economically strong, so the rebound should be shorter than a typical economic recession. Perhaps, much less than my twelve to eighteen-month estimate. Let's hope for that!

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*

(Covid-19 impacted)

“Boots on the ground” update. A long-time client who owns a thriving business, pre-Covid-19, located in the breadbasket of America, and in a state that opened up April 27, 2020, has a problem. It is likely one you have heard about, like I had, but until you hear it from a trusted source, it gets blown off as a “sure, maybe”.

When he re-opened the business, 15% of his workforce quit! Most quit because they could make more money at home. Between federal and state unemployment benefits they made more than their income from work. These are jobs that pay well, well above minimum wage, so the unemployment benefit program is clearly flawed.

A few more said they quit because on top of the pay increase to stay home, they could not find daycare. This poses a real issue, as those stay at home benefits cost us taxpayers a ton, i.e. expect your taxes to go up by the same amount, and those stay at home benefits will end.

As of April 25, 2020, total unemployment filings are estimated at 30,000,000. Backlogs of filings suggest May will show an increase. Yes, many of these jobs will come back as the economy re-opens, but per the sample above, not all will choose to go back to work, at least not right away.

If workers don’t rush back to work, businesses will collapse. When the workers are ready to go back to work, there will be no jobs to go back to. Not all, but some businesses will be gone, leaving workers without unemployment benefits or a job.

This is an example of the rocky road to recovery we now get to deal with. This does not strike me as 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*

(Covid-19 impacted)

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 -14.40%. This decrease, down following three consecutive months of increases, followed a +1.10% in February. Yes, like most government reports, this is the most recent data released on April 24, 2020 for March 2020. And, like Sign #3 above, will most likely be worse next month when we see the April 2020 data and for the same reason…March was only bad for the second half of the month. April, however, will represent two things, I think. First, the whole month was just terrible and two, it will most likely be our economic bottom. Why? Well, May should represent the first half as not

great and the second half opening up. From my pencil (yes…I write these and Lisa makes them pretty) to God's ears!

Shipments reported at -4.50%, which is a big drop, while inventories increased +.6%. As you would expect, if new orders are down, so are shipments, but on a lag of about 30, or so, days. That suggests we will still see our bottom in April data when it is released the third week of May.

As anecdotal third-party evidence of this slow down in distribution, the Cass Freight Index for March 2020 was -9.2% year over year. Emphasis on March 2020, i.e. a half shut down month versus what will be coming in the April data representing a month in total shut down.

The only way to read this as positive is that we already know we are in the process of reopening the U.S. economy, as I write this on Sunday, May 3, 2020. Thus, it seems realistic to "jump the shark" (I miss the 1970's TV program Happy Days) from April being the worst to our "next normal".

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*

(Covid-19 impacted)

QUANTIFICATION!

Long time readers know I tend to write The Seven Signs of a Changing Economy™ to increase my clarity of what is happening in the economy that our investments in Corporate America must operate in. With this high level of clarity come the byproducts of direction, capability and confidence.

On February 19th, 2020 our economy was the strongest in the history of earth, on arguably every point of measurement. The valuations of Corporate America were justifiably about +10% above the 25-year price to earnings (P/E) average. (Source: J.P. Morgan Guide to the Markets 12/31/2019)

In just four weeks, valuations lost one third of their value only to be followed by a +30% rocket ride back up over the last five weeks! Makes a roller coaster look like child's play! In a word: sickening. But we survived to this point.

And what point is that, you ask?

The point where we have hit the pause button to quantify the question of where would a thoughtful person invest cash, and we hold some from the rather small sell points triggered by the WSG "EXIT Strategy", sell more or continue on pause until we have more clarity around the re-opening of the largest economy on earth.

I suspect there could be some of all three.

The WSG "Exit Strategy" remains in force and could be thoughtfully executed, but the table I created below suggests that will not happen.

There are investment positions inside our asset allocations that are worth holding as we pass through this blackhole in the donut, and there could be a nice opportunity for new purchases at certain price points. Here are a few price points I will be watching very closely as they are a result of my updating the "Fair Market Value" using the "Rule of 20".

Target “Buy” area based on:

Estimate of Fair Market Value (FMV) for S&P 500

Earnings estimates are sourced from IBES/Refinitiv

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) “first estimate for the first quarter" released April 28th, 2020, of 1.38%.

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

- 20 – 1.36 = 18.62

As of 4/30/2020, the S&P 500 trades at 2,902.63

Year	**Earnings Per Share**		**Rule of 20 multiplier**		**FMV**	**S&P 500 interday 4/30/2020** **2,902.63**
2019	$162.93	x	18.62	=	3,033.75	4.52% under value
2020 pre-Covid-19	$179.01	x	18.62	=	3,333.17	14.83% under value
2020 less 20% for Covid-19	$143,21	x	18.62	=	2,666.57*	8.13% over value
2021 best case	$182.20	x	18.62	=	3,392.56	16.88% under value
Using Bank of America 2021	$150.00	x	18.62	=	2,793.00	3.90% under value

estimate of

2022	$200.22	X	18.62	=	3,728.10	28.44% under value

*Target buy area

Conclusion: At the current valuation level of Corporate America, as measured by the S&P 500, we appear to be about 8% overvalued on this measuring stick. Within reason, if restarting the country goes without a hitch.

I suspect there will be a bump or two and for that reason we will be thoughtful with our add to's, but ready to take action as warranted. Without a doubt, this is a moving parade. In my opinion, it is impossible to take a "snapshot" and determine value. Thus, we will likely have multiple re-enter and reallocation points. All thoughtful, yet dynamic during this uncertain period in our history.

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*

(Covid-19 impacted)
The Producer Price Index (PPI), which measures the inflation rate at the manufacturing level, reported in at 1.00% annualized for the month. Down from last month's +1.40%. This suggests deflation and hence the comments above in Sign #2, toward the Treasury's desire to ignite inflation.

The Consumer Price Index (CPI), which measures the inflation rate at the household level, reported in at 1.50% annualized this month. Down from last month's +2.30%. Again, pieces are in place for inflation ahead.

The first (preliminary) estimate for 1Q2020 Gross Domestic Product (GDP), which is the total of all the goods and services we produce as a country, come in at -4.79%. That is down -6.91% from the final 2019 growth rate. Ugh!

As you have read in each of the Seven Signs this month, the common denominator is that half the data was, in a word, "awesome"! Then, Covid-19, AKA, the party wrecker, entered the room. Thus, the second half of the economic data flow was dismal, at best. Put the two together and the 1Q2020 GDP of -4.79% is likely to be that again, or a little more, by the time we see the final 1Q2020 GDP estimates in June.

When we see the "first estimate" for 2Q2020 GDP in July it should improve. Still negative, but since it will represent the period of April through June 2020, i.e. 2/3 getting better, we should see early signs of improvement.

Like it, or not, July through September 2020 GDP is likely to be representing a herculean level reversal. Why the “like it or not”? Well, because it will be reported just about 30 days before the next Presidential election.

Historically, people vote with their pocketbook. It is highly likely this nightmare will have a therapeutic and perhaps a vaccine before then. If true, our economy will be rebuilding beyond where it was when this chapter started. I’m voting for a vaccine! Ha!

*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 $182.20 turns the 3,392.56 2020 FMV into 1,457.60 and even worse if earnings were to drop below the example of $182.20/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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•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.