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 July 2020

Summary

All seven data points that I collectively title The WSG "Seven Signs of a Changing Economy™" were Covid-19 impacted in April and May. In June and July all seven have stabilized, reversed course and are once again all positive.

I started using these seven data points decades ago as my economic weathervane. Combined, these seven provide uncanny insight as to which way the economic wind is blowing and how hard. At present, the economy has stabilized and is strongly recovering. In other words, the economic wind is blowing very positive and quite strong!

Yet, we remain in the "black hole" of our economic donut until we are hitting growth numbers above last year, pre-Covid-19. That puts us in between Monopoly games. As a youngster, I loved Monopoly. If you played by the rules, i.e. no loans, it was a pretty short game. Like all board games, once the game is over the board goes back in the box, as do all the pieces. Our best-ever economy, like a board game, just got put back in the box.

Now, we start a new game. That means change! And, oh how we humans don't like change!! Why? Well, because change is stressful. One reason our military elite train to the highest level possible is because under stressful situations it is human nature to default to your highest level of preparation.

Those who read these updates know I have no respect at all, to be clear, "zero" respect, for today's media. It is now called the "media" because they investigate nothing. Talking heads simply repeat their producer's agenda over and over citing no quantifiable or source-based facts. I believe this is because they are, as a group, under stress and fearful. They actually believe the junk they are repeating. As you get your news, consider how extreme it has become. They are defaulting to their highest level of preparation and, well I will be nice, they just aren't very smart, and they don't take the time, energy and courage to prepare.

Hence, the negative. I believe they are simply scared, stressed and that causes them to default to negative.

For example, I see no positive news on Covid-19, yet per the CDC website, new deaths peaked on 4/21/2020 with 2,749 deaths for that day. June 25, 2020, they reported 285 deaths, a 90% drop! Even with a 9-14 day lag time, this is super positive, yet the media does not cover it.

Per CDC, 10 times as many people, 23-25 million, have gotten the virus and the mortality rate is ½ of 1% versus the 5% projected, even with a huge increase in testing. Great news!

Key: The media is cherry picking negative news and ignoring the facts that are plain as day on the CDC website.

As you will read below in this month's source cited and fact-based Seven Signs update, we are in a strong recovery mode. Housing sales are off the chart, as are new car sales. When combined these two are also huge job creators. Pent up demand for "stuff" is causing Personal Consumption and retail sales to be at best-ever record levels. Yes, many businesses with 1-5 employees will fail to never return, yet many of America's largest companies are finding they can be more productive and profitable using the game pieces found in the "new" game box. Tools like software, artificial intelligence (AI), super computers and the new technology like Zoom, DocuSign and Square! All combined suggests a bigger, better and more productive America just ahead!

Yes, there is an election just a little over three months ahead. Stressful! Default to the highest level of preparedness! My preparation suggests the valuations of Corporate America could increase 5%-10% between now and November 3, 2020.

Focus on the Senate for a moment. If the GOP holds the Senate, regardless of who is President, the markets are likely up 10% in the days following the election. Remember the Clinton and Obama years? Gridlock! Markets like a D.C. that cannot get anything into law.

That said, Senate goes 50/50 with a Biden win and the V.P. has the "tie breaker" vote in the Senate. Markets will not like that idea. It is not gridlock. It is a free ride. In the days after the election the markets would likely pull back 5%-10% <u>to where we are today</u>. See above as I assumed a 5%-10% run up in value from here to November 3, 2020. So, potentially net even when the election dust settles.

If the GOP holds as is then the corporate valuation uptrend likely holds. Dems take Senate and Presidency and the economy continues to expand until the Biden tax plan is passed into law. It is on the Biden website. If you are interested to know how you might be affected just search it out on the web. FYI,

if you are reading this, your income, FICA and estate taxes are going up. In most cases, a lot! Markets will not react well to this, in all likelihood.

This is why my strategy from day one has been:

A) No debt where possible
B) Cash reserves at each person's comfort level. At least six months of expenses
C) Monthly expenses known
D) Monthly income sources ID's to cover C above

Only after these are done do we plan forward with a thoughtful asset allocation and conservative investment strategy.

Together and combined as one, this strategy has "always" worked. Unless, the client becomes fearful and panics. This usually happens right after watching the news, regardless of during which period…1987, 1998, 2000 – September 2002, 2007 – 2009 and now.

Today, right now, is the time to think about that sick feeling of being down several thousand dollars and make sure you have cash levels, asset allocation amounts and investment positions that will not negatively affect your lifestyle package going forward.

Please don't miss this bigger future but do have a plan. A financial plan that you trust. Promise yourself and your future self that you will not waiver. A financial plan where all your effort will be on meeting your goals calmly, logically and patiently over time. If you don't have one of these, call me and we'll update your current plan, or create a new one, that will work for you.

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, September 17, 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*

(Positive)
As we left last month's update and our most impactful sign of The Seven Signs of a Changing Economy™, Personal Consumption Expenditures (PCE), I wrote "the consumer is still there and thus the economy that Corporate America must operate in is likely better than your news source wants it to be."

We can now measure how accurate that quote was. The PCE expenditures surged at +8.20% last month, more than doubling the previous record.

One subset of PCE is "retail sales", which grew +17.70% month over month. This is the largest monthly gain since data began in 1992. Just for fun, the economists' consensus was for +8.10%, so once again they only missed reality by over 100%!

This level of increase strongly suggests consumers are feeling good about spending and are spending faster than most had anticipated. That said, "yes" retail sales were down -6% versus the same month in 2019, but after a multi month economic shutdown, remarkably strong.

Inside of "retail sales" are auto sales. Auto sales, which represent a rather large 20% of retail sales, rose +44% for the month. In the May 2020 update, I mentioned both of our daughters had purchased new autos and now I have too! When I picked up my car at the Toyota dealership, I asked why the usually full lot was nearly empty. The reply was they had sold so many cars, including ten

courtesy cars, that they were nearly “sold out”. Supply chain interruption is holding up new delivery but expected to return in 30 days or less.
How about new home sales? You guessed it! Up +16.6% versus last month and up +12.70% versus last year! New homes supply, i.e. inventory is now down to a few months versus a normal supply of about one year’s demand. It takes time to build a new home so you could assume we will close out 2020 with little to no supply.

This is all great news for our economic backdrop! However, inside of this lurks the reality of increased inflation. It remains realistic to believe that 2021 sees inflation closer to the 3-5% range than the 1.63% rate the Bureau of Economic Analysis (BEA) used in their final estimate of Gross Domestic Product (GDP) in Sign #7 below.

At this point, Sign #1 is positive and gaining momentum.

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*

Updated by Brittany Jarocki, CFP® (Jim’s daughter, business partner and the succession plan he hopes to never need!)

(Positive)
The disconnect between institutional money and Mr. and Mrs. 401k continues. Per the Lipper US Fund Flows, which we use to track Mr. and Mrs. 401k money flow, individuals remain fearful. The report shows equity net *outflows* of -$9.863 billion and taxable bond net *inflows* of $5.628 billion. Thus, individual money is flowing out of equities and into bonds and money markets/cash.

Yet, markets continue to rise and create new all-time highs. How can that be? Institutional money, the big money, continues to be invested and move the market trend upward. This is the driving force in the markets, as institutions have more investing power than Mr. and Mrs. 401k who are comparatively small. That said, Mr. and Mrs. 401k are still a large part of the markets, as their money collectively is billions of dollars. Thus, once they become even a touch less fearful and begin to invest once again, it is time to buckle up.

Eventually these individuals will realize that the money market and bonds they are invested in is costing them money. The 10-year US Treasury is paying a whopping 0.67% while inflation sits around 1.63% (per the BEA in Sign #1 above) and rising. Do the math – that’s a near 1% delta i.e. money in treasuries is losing investors -1%/year, and closer to -1.30% after taxes, “guaranteed”.

The M1 Money Supply chart from the St. Louis FED shows that between February 17, 2020 and June 22, 2020 there was a 25% increase in M1 money supply. The Fear and Greed Index dropped from 61 (greed) to 52 (neutral) month over month, and the AAII Investor Sentiment Survey dropped 11% on bullish sentiment down to 22, making the neutral/bearish reading 78%! This confirms the small investor fear/uncertainty about investing while the "big boys" once again captured big gains!

This money won't sit on the sidelines forever. Sign #2 remains positive as institutional money flow is moving in the right direction and individual investors will eventually see the light.

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*

Updated by Brittany Jarocki, CFP®

(Positive)
The Leading Economic Index turned positive this month as it increased +2.8% versus last month's -4.4% decrease. This is important because the LEI is our peek around the corner to see where the economic backdrop Corporate America must operate in will be six to nine months in the future.

Seven of the ten indicators were positive, up from last month's four. The three that turned positive are 1) average weekly initial claims for unemployment insurance 2) average weekly manufacturing hours and 3) building permits. These three components turning positive indicates that people are getting back to work and the economy is back up and running after the supply chain interruption. You will see effects of this in Signs #4 and 5 below as well.

It will take a month or two to get the large engine of America back up and running at full speed, but this is a good start.

Other good news comes from the Chemical Activity Barometer (CAB), which has now shown consecutive months of gains. Kevin Swift, Chief Economist at American Chemistry Council, said, "We'll want to see at least another month of gains in order to conclude that the economy has turned a corner".

The chemical industry is an important leading indicator due to its early position in the supply chain – it sees changes before other areas and has consistently led the US economy's business cycle. Sign #3 is positive and will be very positive if it shows a gain next month.

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*

Update by Brittany Jarocki, CFP®

(Positive)
The unemployment rate continues to drop, coming in down 2.2% to bring the unemployment rate to 11.1% in June. As the economy begins to reopen – and stay open - this rate is expected to fall.

Barron's predicted a nonfarm payroll increase of 3 million, which means they were only off by 37.5% as the actual nonfarm payroll employment rose by 4.8 million in June.

However, we will see a threshold at some point, possibly around 8% unemployment, where the number is "actual", i.e. no longer "temporary" unemployment. Many folks were furloughed during the pandemic but knew they would have their jobs back in a month or two. Some employers asked their employees to return only to have the employees decline because the unemployment benefits were paying more than their salary! (I have two real-life examples of this: one being an owner of a hair salon and the other an ATV rental business). This will run out – unemployment benefits are temporary and the extra $600 benefit ends July 31, 2020, unless extended (likely). At some point "soon", these people will then return to work.

But let's not be fooled – many businesses have closed for good. With the permanent closings comes actual unemployment. That is until new businesses are created, expanded, people hired, etc. The circle of business life continues.

Unemployment will be a volatile input that gets bumped around as we work our way through the reopening, then reclosing, then reopening again of the economy as COVID19 evolves. Sign #4 is 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.

In the May 2020 update, which was for April data, I wrote that April would be the bottom as we transferred into our "next normal", i.e. the economy reopening.

Well, that was a safe call, but even I didn't expect new orders to jump up +15.70%! Remember, "non-durable" goods, think washing machines and underwear, are items we can either do without or delay replacing if we don't have the money right now.

Clearly, this represents pent up demand being relieved via the "retail therapy" spending outlined above in sign #1! New orders being placed to stock the empty shelves. Shipments jumped +4.40%. Unfilled orders were flat at .10%.

Inventories were also flat at +.10%. To me, this data set supports what we saw in Sign #1, i.e. PCE +8.20% and retail sales up 17.70%, as here come the new orders to replace all that has sold. Shipments are getting the "stuff" to the shelves and manufacturing is keeping up with demand as unfilled orders and inventories are flat.

As a side note, we also know the supply chain interruption, like the empty car lot I mentioned in Sign #1, is in the process of being filled. Per the Drewry World Container Index, 40-foot shipping containers just hit a 5-year high. More "stuff" from overseas is already on the boat and headed for your home!

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)
As we continue to work our way back to the strongest economy ever known to earth, it makes sense to push the "pause" button along the way to gauge where "fair market valuation" (FMV) of Corporate America is versus actual market values.

There is no doubt we are still traveling through the "black hole" of our economic donut, and for that reason it makes sense to once again make our fair market value calculation, so let's plug in our FMV calculation using the "Rule of 20" estimate.

To use "The Rule of 20" you just subtract the inflation rate from 20. I will use the same inflation rate the BEA used in calculating the Gross Domestic Product (GDP) "final estimate" for 1Q2020 released June 24, 2020 of 1.63%.

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

- 20 – 1.63 = 18.37
- 2021 S&P 500 earnings estimate = $163.43
- 2021 S&P 500 Fair Market Value estimate = $163.43 x 18.37 = 3,002.21

As of 7/10/2020, the S&P 500 trades at 3,185.04, or a +6.00% premium to FMV.

A research piece I recently read was titled “Daily Wealth” by Dr. Steve Sjuggerud. In this issue, Dr. Sjuggerud presented research that added the price/earnings (P/E) ratio to the 90-day T-bill.

This is a tool that accounts for the cost associated with borrowing money, i.e. 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 2021 projected price/earnings (P/E) ratio is 19.50 + .15 = 19.65, below 20 and also a mile below Dr. Sjuggerud’s 22 level “danger” zone.

With a presidential election less than four months away, I suspect there will be a bump, or two, in the road ahead. We will continue to be thoughtful of how the assets entrusted to our oversight are allocated and to closely monitor each investment position to be sure each continue to be lower volatility (as measured by beta), lower risk (as measured by standard deviation) and a top performer in each respective peer group.

Sign #6 is 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)
The Producer Price Index (PPI), which measures the inflation rate at the manufacturing level, reported in at -.10% annualized for this month. Covid-19 impacted!

The Consumer Price Index (CPI), which measures the inflation rate at the household level, reported in at +.10% annualized this month. Covid-19 impacted!

The “final estimate” of our Gross Domestic Product (GDP) for 1Q2020 was reported as -4.99% annual growth rate of all the goods and services we produce as a country. (Source: Bureau of Economic Analysis (BEA)). Covid-19 impacted!

As I write here each time the GDP is released, the released data is “real”. This simply means it is adjusted for the effect of inflation. In this 1Q2020 “final estimate” report, the Bureau of Economic Analysis (BEA) used a deflator of 1.63%.

Meanwhile, over at their sister government agency, the Bureau of Labor Statistics (BLS), the inflation rate was reported as a much lower -.76%.

As my friend, Rick Davis, over at The Consumer Metrics Institute, likes to point out, had the BEA used the inflation rate from the BLS of -.76%, the GDP would be reported as contracting at a -2.69% annual rate.

As detailed above in Sign #6, we are crossing through the "black hole" of our Covid-19 donut economy. As bad as a -4.99% contraction sounds, it is over 43% better than the predicted -7.18%!

As we travel from the pre-Covid-19 best economy to ever exist on earth, via most any metric you choose to compare, through the contraction black hole, it is my guess that we will see better economic growth than pre-Covid-19 on the other side!

How can this be? Many reasons, but here are a few keys:

- Liquid money in people's bank accounts are the highest ever recorded at $18 trillion. This will start moving "soon". (Source: U.S. Federal Reserve)
- Productivity! 120 days ago, the thought of millions of Americans working from home (think no traffic time waste/better lifestyle package) was a "like that will never happen".
- Productivity = Corporate cost reduction = increased profits.

It is reasonable to think that the shares of Corporate America are not overvalued as detailed via the "Rule of 20" above in Sign #6, but perhaps undervalued based on this "new next". Maybe that is a reason the valuations of Corporate America just keep going up, "for no reason". Hmmm…maybe.

Sign #7 is positive.

*The Rule of 20 is in this calculation implying, and using, a price/earnings ratio, which is the valuation ratio of a company's current share price compared to its per-share earnings. Thus, 18x the expected Earnings per Share. Both EPS and the multiple of 18 could drop. The earnings could be reduced due to the consumers spending less. The multiplier of 18 could drop to, say 8 for example, if investors were to get scared and become risk adverse. All of a sudden 8 x $163.43 turns the 3,002.20 2020 FMV into 1,307.44 and even worse if earnings were to drop below the example of $163.43/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!

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.
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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.
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