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 September 2020

Summary

If you are a regular reader of these monthly updates, along with The Weekly Update I write and post to the WSG website every Friday, you will recall that for months I have been suggesting the current "stimulus" plan is likely to cause some inflation over the next few years.

During "The Great Recession" in 2007-2009, the Federal Reserve teamed up with the U.S. Treasury to put trillions of dollars into the "banking system" so businesses and people had access to borrowing money as needed. Fine idea, but no one was interested in more debt at that time. Instead, both businesses and people started to drastically reduce debt. For that reason, the economic recovery took several years to gain traction.

The Covid induced economic recession was attacked in a completely different way. This time the Federal Reserve teamed up with the U.S. Treasury and created the Paycheck Protection Plan (PPP) and the Coronavirus Aid, Relief, and Economic Security (CARES) Act. These two programs put trillions of dollars into "people's bank accounts".

There is a huge difference between asking and receiving a loan from a bank who doesn't want to loan you the money, and a deposit directly into your pocketbook! This means trillions of dollars were immediately available to people who were impacted, so they could pay rent, buy food and as it turns out, make investments.

The Fed measures all liquid cash type deposits in the system using Money Supply-1 or M-1 as their comparison. Google M-1 and you will see a graphic available that shows M-1 jumped an unprecedented +34.20%. We are talking trillions of new dollars in our economy via your bank account, to go out and buy "stuff". Add in State and Federal unemployment benefits and many workers did not choose to return to their jobs when they were allowed, as they would incur a "pay cut"!

There is a cost to goosing the economy with trillions in new money and that cost is moderate inflation. As I detail below in this month's update, it is not late 1970's early 1980's 14% inflation, but more like 3%-5% per year for the next several years.

The Fed knows this! On August 27, 2020, Federal Reserve Chairman Jerome Powell announced a major policy shift. The Fed will now allow inflation to run "moderately" above their 2% inflation mandate "for some time". Of course, the Fed doesn't share what "moderately above" 2% means, nor did Powell explain what "for some time" means!

For today, let's just suggest that 3%, 4% and 5% inflation rates are real and we need to know where to reallocate our hard-earned assets to best take advantage of what appears to be pretty obvious. History has proven that one of the best inflation hedges is ownership in Corporate America, especially companies that have enough pricing power to raise their prices at the inflation rate level so that "real" profits are not affected. In addition, precious metals and commodities do well. Certain types of real estate will also do well, but in this example, I am thinking of our homes, so residential real estate.

As you will read below in this month's update, the economic backdrop is substantially better than what you might read, see or hear in your news source. In Sign #1, Personal Consumption is now down a modest -4.80%, not too shabby for a world shut down for several months! Side note; check out the 42% sales increase over at Amazon! Wow!!

Surprisingly, household income is down only a modest -3.56%, based on U.S. Treasury income tax receipts.

Our peek around the corner to what the economy might look like 6-9 months down the road, our Sign #3's Leading Economic Index (LEI) is down, again, only -4%!

In Sign #4, new job creation has been great and the four-week moving average of initial claims for unemployment is down 80.30% from the April 25, 2020 peak.

Shocking to just about every economist, Corporate America "knocked the lights out" on earnings during Covid. Per FactSet, 85% reported higher earnings than estimated as noted below in Sign #6.

To conclude on the inflation seed that has been planted in the Covid economic backdrop, read Sign #7 where you will observe a 433% increase in the Consumer Price Index (CPI). It looks worse than it is because the gain is off a nothing burger number. But, the key to inflation is to kill the dragon when it is small, and the Fed just told us they will not do that. Note to self: Reallocations are thoughtfully underway.

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,

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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, October 15, 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)
The tail that wags our economic dog is Consumer Spending. We measure Consumer Spending via The Bureau of Economic Analysis (BEA) Personal Consumption Expenditures (PCE) report. Per J.P. Morgan's Guide to the Markets 6-30-2020 update, PCE is over 68% of our entire economy. That is the reason PCE is Sign #1 of the Seven Signs monthly update.

As we all know from the June and July editions of this monthly update, the PCE was impacted greatly by Covid-19. A quick look back over our shoulder shows PCE contracting -7.3% in March and an unbelievable -12.4% in May! In two months, Covid induced a contraction of -19.7%!

As we crossed the bridge to our next normal, May through July has rebounded with the collective increase of +14.9%. The result in an impact of Covid on our most important driver of the economy now rests at a negative -4.80%. August data will be released after this update is written on September 22, 2020. The anecdotal evidence, a few I will note below, suggests a seriously positive increase.

For example, a near-perfect way to peek behind the curtain is to look at one of the world's largest online retailer's news reports on what they are doing to satisfy consumer demand. That company speaks for all of E-Commerce as they are now approximately, 40% of all on-line retail. Next largest represents a mere 5%.

As a side note, we know people are still earning money by looking at personal current taxes paid to the U.S. Treasury. Pre-Covid the Treasury brought in an annualized $2.24 trillion as of February 2020! As of July 2020, the annualized level is $2.16 trillion. Thus, down -3.56% on an annualized comparison.

Noted above PCE is -4.80% versus tax revenue, which is an obvious extension of earned income, is down -3.56%. Consumers are still earning, spending and based on this difference, saving money. Saving money (savings) is simply fuel to push PCE higher in coming months.

Yes, these are scary times, but even scary times can't stop the American consumers' battle cry of "Low down, easy monthly payment"! Sign #1 got Covid, but is coming back strong, healthy and positive!

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

(Positive)
August tends to be a slow month for dataflow. The big money desks of the world that manage trillions of dollars tend to take their free time starting around the July 4th weekend through Labor Day. This tends to make the markets more volatile, as the volume of transactions is greatly reduced. This is the reason I also take a break from writing this monthly update in August.

So, to catch up, let's again look back at July money flow as reported by Lipper Fund Flow Report Newsline. Between July 8, 2020 and July 29, 2020, Mr. & Mrs. 401(k) sold another -$13.4 billion in their household ownership of Corporate

America. Between July 29, 2020 and September 2, 2020, they sold an additional -$27.7 billion.

As of September 2, 2020 YTD, there has only been one month of money flowing into funds and a collective net outflow of several hundred billion. Yet, the valuation of Corporate America, as measured by the S&P 500, rests near all time highs. What gives?

In your spare time, do a "Google Search" for M-1 or Money Supply-1. As I wrote above in The Summary, a chart from the St. Louis Federal Reserve will be available. In the chart, notice that between February 17, 2020 and August 24,2020, the liquid money, i.e., cash, available for reallocation to "whatever" is up +34.20%. A collective $18 trillion looking for a home that will pay more than a 10-year U.S. Treasury Bond at .67%, and more like the dividend yield on the S&P 500 of nearly 3%.

Once again, this data strongly suggests the smaller investor is fearful and the institutional "Big Boys and Girls" are positive and capturing gains.

Sign #2 remains positive and M-1 suggests it will remain positive well into 2021.

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

(Positive)
Sign #3 is our peek around the corner to see what economic backdrop Corporate America will be operating in six to nine months in the future, i.e., March through June 2021.

In the June 2020 update, I noted how the Covid contraction had wiped out four years of solid economic growth! Per the Conference Board's Leading Economic Index (LEI) was positive again this month coming in at +1.40%. The collective of the last three months of post Covid growth total +6.2%. YTD the LEI is -4%, much like Sign #1 PCE above at -4.80% and earned income at -3.56%.

The common denominator across the economic expansion appears to be about a -4%. In my opinion, not too bad based on earth being shut down for two months to six months, depending on your State's/Country's political leaning.

That M-1 money supply highlighted in Sign #2 above will continue to dramatically prime our economy back up to full speed over the next several months. If we get the tailwind of additional Covid therapeutics, or a vaccine, our economy will blow the doors off of the pre-Covid strongest economy ever on earth.

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, "The August reading is only 5.8% below its' pre-Corona Virus level, and the indicator appears to be improving at a fairly good pace."

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*

(Positive)
For the most recent month, Bureau of Labor Statistics (BLS) reported new jobs created at 1.4 million and the unemployment rate dropping to 8.40%. These are very good improvements and reflect the continued resumption of economic activity that had been curtailed due to Covid and the shut-down efforts to contain it.

Our long-time readers know I am a lover of trends. Trends tend to remove the noise that results from only observing a few data points. So, let's take a look at the Covid impacted trend on the 4-week moving average of initial claims for unemployment, as reported by the St. Louis Federal Reserve.

2-15-2020	209,250	
3-28-2020	2,612,000	(Covid arrives in the data!)
4-25-2020	5,033,250	(Peak Covid impact)
5-23-2020	2,608,000	
6-30-2020	1,437,250	
7-25-2020	1,368,500	
8-29-2020	991,750	(Down 80.30% from 4-25-2020 peak)

With a few other rare recession data points, this 4-week moving average hangs around 200,000. Any number below 300,000 is considered a strong jobs market. Thus, at 991,750 we have many jobs to be created to get back to "normal", and per this trend we are well on our way to that.

Based on the pent-up demand, and cashflow and savings to support it in Sign #1 above, the jobs are being added as you read this. 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.

New Orders increased an amazing +11.20%. This increase, up three consecutive months, follows a +7.7% increase over the prior month. March and April of 2020 collectively reported at -30.1%, a very large pothole, followed by three months at a collective +34.60%, a very large rebound!

Shipments came in +7.30%, following a +15.24% in June and Inventories increased at near zero, +.50%, i.e., the "stuff" is flying out the door, not being held in inventory.

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

As anecdotal evidence, the St. Louis Federal Reserve's Freight Transportation Services Index has bottomed and is now reflecting a transportation recovery.

Per the Cass Freight Index, "Everything in the freight world, although modestly below year ago levels, seems at least to be moving in the same direction-UP."

At this point in time, a very large percentage of the "stuff" we buy as consumers comes from outside the USA. You will be happy to know that more stuff is on the way. Per the Drewry World Container Index, their 40-foot containers we all see on ships, in docks, on trucks to stores, etc., have increased in cost by +46.10% in three months (June 4, 2020-September 5, 2020). That is basic econ 101 supply and demand!

Lots of demand pushes the cost of "X" up! If you look through my eyes, you would read that as "demand push", which results in modest inflation, and starts about now. Hence, the inflation hedge adjustments you are starting to see in our client asset allocation investment positions. A thoughtful approach, but on purpose, based on data points like these.

Sign #5 is very 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*

(Positive)
The valuations for the companies that operate in Corporate America are measured against their current earnings and future earnings potential, then based on investors buying and selling, the price is measured on an Index like the S&P 500.

The key is earnings. How much you earn as a company measures your current and future value. Covid caused most economists to recalculate earnings for Corporate America for 2020, 2021 and 2022. Yes, you guessed it, they recalculated lower, in some companies a lot lower, and they were wrong.

How do you spell "knocking the lights out"? Per FactSet, with 99.8% of S&P 500 companies reporting, 85% have reported earnings higher than estimated. In fact, the 2Q2020 earnings for the S&P 500 represented the most positive EPS surprises since FactSet began tracking this metric in 2008. Those crazy economists, always a glass half empty with a hole in the bottom!

We are very close to the other side of the "black hole" of our economic doughnut, 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) for 2Q2020 released August 26, 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 – 2.30 = 22.30
- 2021 S&P 500 earnings estimate = $166.43
- 2021 S&P 500 Fair Market Value estimate = $166.43 x 22.30 = 3,711.39

As of 9/16/2020, the S&P 500 trades at 3,3385.49, or a -9.63% discount to FMV.

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

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 21.53 + .11 = 21.64, below Dr. Sjuggerud's 22 level "danger" zone.

With a presidential election less than two 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 -.20% annualized for this month. This month reported up from last month's -.30%. If not for a drop in energy, in my opinion short-lived, i.e., the inflation comments above, it would have been up more.

The Consumer Price Index (CPI), which measures the inflation rate at the household level, reported in at +1.30% annualized this month vs. last month's +.30%. Re-read that: CPI increased from +.30% to +1.30%. That is, quadrupling, and the first shot over the bow of inflation entering the households of America. I don't think it will not cause late 1970's or early 1980's inflation, which was the second highest inflation rate since the Civil War, but more like 3%-5% inflation starting, well, about now.

The "second estimate" of our Gross Domestic Product (GDP) for 2Q2020 was reported as -8.64% annual growth rate of all the goods and services we produce as a country. (Source: Bureau of Economic Analysis (BEA)).

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 2Q2020 "second estimate" report, the Bureau of Economic Analysis (BEA) used a deflator of -2.30%.

Meanwhile, over at their sister government agency, the Bureau of Labor Statistics (BLS), the inflation rate was reported at -1.14%.

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 -.1.14%, the GDP would be reported worse at -9.80%, as lower inflation rates have the effect of increasing real GDP. As detailed above in Sign #6, we are crossing through the "black hole" of our Covid-19 doughnut economy. As bad as a -8.64% contraction sounds, it is better than predicted.

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 now start to see better economic growth.

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 $166.43 turns the 3,051.32 2020 FMV into 1,331.44 and even worse if earnings were to drop below the example of $166.43/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!

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.