THE WEALTH STRATEGIES GROUP
Independent Unbiased 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 June 2016

Summary

This month I read a quote by Warren Buffett that seemed worthy of sharing. For those who aren't familiar with Warren Buffett, he is recognized as one of the most successful investors ever. In the piece I read, Mr. Buffett was asked what he thought about the Dow Jones Industrial Average (DJIA) going over the 15,000 level. Warren's reply:

"Not much, really, I recall watching it cross 100."

Well, things don't change all that much as time pushes on. As I write this month's edition of The Seven Signs of a Changing Economy™, the DJIA is bouncing around the 18,000 level.

To me there is one thing we can all count on and it is that each day most of our population, and those around the world, will get out of bed, go to work, create value, spend and save. It is because of this very predictable activity that the U.S. economy, as measured by GDP, has quietly grown to the highest of any in the history of earth at nearly $18 trillion. It is also one reason the values of Corporate America have trended from DJIA 100 to nearly 18,000.

When I was writing my first book, Surviving the Storm, McGraw-Hill (2007), it was August of 2006. The premise for the book was that people were getting older and that older people tend to spend less. Since Personal Consumption Expenditure (PCE), Sign #1, are nearly 72% of the U.S. economic growth (Source: JP Morgan Guide to the Markets, March 31, 2016) it seemed logical to suggest an economic slowdown was in order.

The economic route of 2007-2009 was certainly the economic storm I wrote about, as the daisy chain of economic events ticked down to as close as an economy can get to systematic failure without failure itself.

In addition to people spending less, there was also a lull in the birth rate. This meant fewer people born and clearly since they were not born the parents would

be spending less and since the kids weren't born, they would not grow up and spend either.

This lull in population growth is what we now refer to as Generation X, or Gen X. The lull happened between 1966 and 1976 when 61 million people were born. This was a significantly smaller generation than the Baby Boomers at 77 million people.

Push forward to today and Gen X is between ages 40 and 50/51. Those 61 million are hitting the peak of their spending consumption years. In addition, the Baby Boomers are living longer. One of the fastest growing age cohorts in this country is age 85+, and they are spending money on healthcare, retirement homes, travel, etc.

Now, here is the cherry on top, and why my next book should be titled something like Riding the Economic Growth Wave, the tail-end of the baby boomers who were born as late as 1960, had kids that are now spending at their peak. The Gen X group got busy and created the largest cohort of people to ever be on earth. They are labeled the Millennials and there are 92 million of them. That is 15 million people, and +19.48%, more than the prior largest generation, the Baby Boomers.

The Millennials were born between 1980 and 2000. Thus, the front edge is age 35/36 and the tail end is age 16. The front edge took awhile to get out of the house, out of school, into their apartments, to get married and have kids. But, they did it and kids are expensive, thus a great deal of Personal Consumption takes place!

Have you noticed, like I have, as you go about your day to day life with your social scientist hat on, how many pregnant ladies and strollers there are?!

These generational changes have now set in place all future economic activity. It is a causal effect as we know for well documented date when, on average, these people will:

- Move out of their parents house, age 18
- Continue their education or get a job, age 18-19
- Rent their first apartment, age 20
- Get married, age 25.5
- Have their first child, age 27.5
- Buy their first home, age 31
- Etc. until we all pass away

It is for this reason that I suggest our economic outlook appears to be much like 1982 when the then largest generation were starting to be consumers, only this millennial generation is much bigger.

In fact, the people who will be driving our economy for the next fifty plus years are already born, counted and spending!

As the famous Peter Drucker is quoted as saying:

"The future has already happened."

As investors, we simply need to be aware of this spending trend. Stay in front of it by owning value creating companies of Corporate America who sell to them, remain patient and add to our ownership in Corporate America on dips, economic weakness and the inevitable "Black Swan" event.

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
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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, July 14, 2016.

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)
In last month's update of The Seven Signs of a Changing Economy™, (read it here) I posed this question under this key Sign #1 of economic change:

"So, if more people have jobs and are making more money, why aren't they spending it?"

I may have posed that question about 30 days too early!

Real Consumer Spending just posted the biggest gain since the summer of 2014! (Source: Bureau of Economic Analysis PCE report dated May 31, 2016)

In detail from the data flow here is what a "blow out" Personal Consumption Expenditure (CPE) trend looks like:

January through April:	2013	2014	2015	2016
	+.7	+.5	+.6	+.9

(Note to self: That is a +50% increase in year over year Personal Consumption Expenditures for 2015 vs. 2016.)

We also know from the BEA data released May 31, 2016 that citizens are working and earning more money! How? Via the personal current taxes paid. Here is the detail:

January through April:	2013	2014	2015	2016
	+$23.9 billion	+$17.3 billion	+$16.2 billion	+$29.4 billion

(Note to self: That 2015 vs. 2016 increase represents +80.24% year over year! Also, note those numbers represent an increasing increase each year, i.e. it just keeps getting better and better!)

This detail is "off the chart" good!

That said, I will revert back to a note I wrote in the April 2016 Seven Signs update:

"Are there any flies in the ointment? Of course, there always are. One is that oil prices appear to have bottomed."

This is one of the key reasons each of us has been reducing debt at the household level and holding some of the savings back as money to use toward discretionary spending.

Here is the "fly in the ointment". Energy prices appear to have bottomed, as stated in The Seven Signs of a Changing Economy™ update of April 2016. Since February 15, 2016 when regular gasoline at the pump prices bottomed at $1.69 per gallon, it has increased to $2.39 per gallon as of 6/10/2016. (Source: www.gasbuddy.com/graphs)

This will be a serious drag on Personal Consumption Expenditures (PCE) as we roll into summer. Remember, each $.1 increase in gasoline at the pump represents $1.3 billion in disposable personal income! (Source: Consumer Metrics Institute)

That increase at the pump from $1.69 to $2.39 represents a cool +.70 cents and that translates into about $91 billion less per year in disposable income that would have gone to discretionary PCE.

Sign #1 is super positive, yet increasing gasoline prices at the pump suggest this will not be as strong of a positive trend going forward.

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)
One of the key reasons Sign #2 of The Seven Signs of a Changing Economy™ is #2 is because, after Consumer Spending, it is a very strong trend indicator. Trends are useful, as they tend to roll along to a point where are they are exhausted and slowly begin to roll the opposite direction.

In last month's issue, I clearly detailed how Money Flow was rolling market values up to higher valuation based on three possible reasons.

- Institutional "short sale" covering of the "stubborn" $1 trillion
- Selling exhaustion by small retail investors
- Japanese "carry trade" buying more risky assets

I further suggested that we were now, once again, faced with the "sell in May and go away" theory.

Well, the "average", or non-institutional investor, clearly sold in May and went away! In just the week of May 18, 2016 investors liquidated -$5.8 billion in equity funds! (Source: Bank of America) Per Lipper Fund Flow Data reported at

www.lipperfundflows.com, nearly$25.5 billion was liquidated from equity funds in the last 30 days.

Wow!

Perhaps equally notable is the American Association of Individual Investors (AAII) report that the percentage of investors who are bullish, i.e. think the market will go up, is at a lower point than the Great Recession low when the Dow Jones was nearly 6,500 in March of 2009!

Wow again!

The Dow Jones Industrial Average (DJIA) sits just points away from the all-time high and is clearly in an upward trend. Yet, small retail investors remain fearful and the "carry trade" continues to have a positive impact, as do the share buybacks by the companies themselves.

Small investor selling at this high level is surprising. As you will see below, the earnings per share estimate for Corporate America, as measured via the S&P 500, are being forecast higher as the oil patch recovers.

This key sign of change remains positive. Sadly, I believe the average investor, as measured by AAII noted above, will miss the potentially large gains ahead. No one knows the future, a black swan event could occur at any moment, but based on pure earnings potential, the data clearly suggests higher valuations in the next 12 months.

Sign #2 remains positive!

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)
Per the signs noted above, I have now referred back to prior months' data for each to share a sense of perspective with you. Keeping with the reference theme I will note here that for Sign #3 in March 2016 I wrote, "I will be especially interested in the next two months' data."

In March, I stated that January and February 2016 LEI was -.2% and the most recent data? Well, let's call it really positive at +.6%. In addition to +.6%, which has only happened twice in the last few years, a more rare event took place in the subset of the ten economic inputs that make up the LEI.

The event is that of the ten indicator inputs, nine were positive. None were neutral and only one was negative. The negative contributor is, in my humble

opinion, is a “non-event”. Average consumer expectations for business conditions was reported as negative.

I suggest it is a “non-event”, as I honestly don’t believe “expectations” of, or for, anything really matters. What matters are key data points like Sign #1, PCE, and Sign #2, Money Flow, as there is no “expectation” in either. You make a or you don’t.

So, in my world, the LEI is not only positive, it is very encouraging as we head into the summer doldrums facing higher gasoline prices at the pump.

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)
If you are someone who reads the business news, you are probably choking on your beverage of choice, reading that Sign #4 is being posted as positive!

Please don’t write me off as a complete nut just yet!

“Epilogue as a Prologue”

Clearly the new jobs creation data, which I will detail below in the prologue, suggests there are a negative number of jobs being created.

I would suggest we need to step back from the very poor headline number of jobs created and turn our head just a little sideways, like my dog Bentley does when he’s questioning something I say to him, and suggest that a few things just don’t make sense!

Let me suggest this weak job creation report is perhaps a result of the education required to win the job versus the educational status of those applying for the job! To me, the data is strongly suggesting the jobs available are for a high school, Bachelor’s degree or higher, while the growing work pool available is comprised of folks who have chosen to remain below the high school educational level.

The detail suggests a very large skills mismatch between the unfilled jobs and the available work pool to fill them. If you are a realist, you knew this was coming. Even McDonald’s is automating the front counter versus paying $15/hour plus healthcare, etc.

Here are a few recent headlines:

- Record job openings

- Consumer confidence up (see Sign #1 above)
- Solid payrolls report via ADP

That said, only 38,000 new jobs were created last month. Worse yet, 224,000 were created by what I refer to as a questionable telephone survey of jobs creation that reported +224,000 new jobs created. The net result is that without the, in my opinion, fictional birth/death telephone survey there would have been a negative, or contracting, jobs creation of 186,000.

This is a volatile jobs creation report. It is spring and I would suggest that all elements considered the data is "off". We will watch for a trend change, but for now Sign #4 remains 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 +3.4% (a lot!). Shipments increased +.6% and Inventories decreased .2%.

Just two months ago in the April edition I set aside the press hype over weak numbers in Sign #5 as a "holiday hangover", which would allow inventories to burn down while we waited for the "spring zing" numbers to roll in. Well, "roll in" they have! Here is what "roll in" looks like in data form:

	2013	2014	2015	2016
Durable Goods New orders first 4 months/year	-.5%	+6.6%	+1.3%	+6.3%

If one were to Google search various inquiries like "shipping container volume", "railroad volume year over year" or "over the road semi truck traffic volume" you would very likely have data that quantifies the goods are moving around the world, around our nation and around our cities and towns down to nearly every zip code.

Clearly, Sign #1 PCE trending up requires the goods that consumers are buying need to be manufactured and shipped prior to purchase. For those non-durables, think washing machines, dryers, underwear, bedspreads, etc. to be in demand is to suggest all that consumers need and want, and want before these are also in heavy demand.

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)
Oh my! Just when you think the economy of the United States has gone down the drain, (you would not if you have followed these notes, as the quantifiable data has suggested growth) it bounces back like a ball held under water and then let go!

Just like that, the U.S. dollar has come down, putting the wind at the backs of foreign sales for Corporate America. Not only that, the energy sector has rebounded to a level that has Dr. Ed Yardini estimating 2017 S&P 500 earnings per share are likely to ratchet up +14.27%! Wow and wow!

Yes, Yardini and Associates now estimate 2016 S&P 500 earnings per share at $125.49 and 2017 at $135.67. Just so you know, you can Google "Dr. Ed" and it will take you to these estimates and the research has been statistically accurate for, well, years.

Even with this quantifiably good news, we find our favorite journalists, who I choose not to respect based on their quantifiably poor and inaccurate forecast of future earnings, suggesting the end of Corporate America is just around every corner.

I will remind journalists, many who use my "Seven Signs of a Changing Economy™", of a quote from the famous research analyst James Grant:

"To suppose that the value of a stock is determined purely by a corporation's earnings is to forget that people have burned witches, gone to war on a whim, risen in the defense of Joseph Stalin and believed Orson Welles when he told them over the radio that the martians have landed."

For now, full year 2016 earnings estimates for the S&P 500 are estimated to be closer to $125.49 per share.

To calculate the "Fair Market Value we like to use 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 U.S. Gross Domestic Product in their "second" estimate released on May 26, 2016, which was +.61%. This becomes your multiplier and is multiplied by the respective year's earnings per share to calculate the estimate of Fair Market Value.

- 2016 S&P 500 earnings estimate = $125.49
- $125.49 x 19.39 = 2,433.25

As of 5/10/2010 the S&P 500 trades at 2,096.07 (a 16.08% discount to FMV).

A research piece I recently read was titled “Daily Wealth” by Dr. Steve Sjuggerud. In the issue, Dr. Sjuggerud presented research that added the price/earnings ratio to the 90-day T-bill rate. The research quantifiably showed that when the total of the two was under the historic average of 20, the returns were above average. When above +22 it was considered the danger zone. Based on this, I did some quick math to see the forward price earnings ratio calculated above is 16.70. The 90-day T-bill as of 4/30/2016 is .29.

16.70 + .29 = 16.99, which is well below the average of 20 and very much below Dr. Sjuggerud’s 22 level danger zone.

This is interesting detail, so I thought I would share it again this month.

For now, Sign #6 remains 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) measures cost increases at the manufacturing input level. This data does matter, as it is an early indication of inflation entering the economy at the early stage of production. The PPI remains benign at +.90%.

The Consumer Price Index (CPI) measures the inflation rate each of us is experiencing at the household level. Unfortunately, the Bureau of Economic Analysis (BEA) chooses to exclude the volatile moving inputs of energy and housing. Because of this, the Federal Reserve tends to use Sign #1, Personal Consumption Expenditures (PCE) as their inflation indicator of choice. This month the CPI also came in at an annualized +.90%.

The good news is that both the CPI and the PCE are suggesting the inflation rate is around +1% annualized. Based on the Fed’s target of 2.5% inflation and the very weak jobs report noted above in Sign #4, it is quite unlikely the Fed will choose to increase interest rates when they meet on June 15, 2016.

The inflation input used to calculate the output of all the goods and services for the U.S., the Gross Domestic Product (GDP) was .61%. Per the Bureau of Economic Analysis (BEA) the “second estimate” of GDP was reported on May 16, 2016 as +.82%. Clearly the inflation adjusted, or “real”, growth of our economy remains weak at +.82.

However, I would emphasize that over the last six months one of the largest sectors of our economy was completely re-tooled, i.e. energy. As the energy sector re-emerges as a smaller and more efficient complex I would suggest, and

the earnings data already supports, that we will see the U.S. GDP increase, perhaps significantly more than the economists and analysts are predicting.

Sign #7 remains 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, 19.39x the expected Earnings per Share. Both EPS and the multiple of 19.39 could drop. The earnings could be reduced due to the consumers spending less. The multiplier of 19.39 could drop to, say 8 for example, if investors were to get scared and become risk adverse. All of a sudden 8 x $125.49 turns the 2,433.25 2016 FMV into 1,003.92 and even worse if earnings were to drop below the example of $125.49/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!