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 February 2019

Summary

As fast and violent as the selloff in the valuations of Corporate America was starting on 10/1/2018, our client valuations tended to hold up better than the overall market values, which is the goal, i.e. capture less of the downside while capturing more of the upside!

It now turns out that the low value level for that speed bump was 12/24/2018. I sent our clients the Special Update e-blast on 12/26/2018. This is a reminder of how emotional that period was for investors in general. During the selloff I remained convinced that valuations were grossly oversold by all measures normally used for quantifying value. In addition, our client base held a conservative asset blend thoughtfully diversified between large, medium and small companies in Corporate America using both the growth and value style of investment management, for the growth portion of the portfolios.

At the time, my research and my gut feeling, strongly suggested we would see a rather significant bounce up and perhaps to higher levels than before this speed bump. Yes, this upward trend will end someday, but not likely today and perhaps not this year. That said, there are also data points in the WSG "Exit Strategy" that I wrote in January 2018 for selling as the valuations trend higher. I intend to be just as thoughtful about each of those action points as I was during the recent sell off.

Usually, ugly years are followed by pretty good years. The data flow suggests that will be the case for this year of 2019. It is in this calm that it makes a great deal of sense to sit down and discuss how we will behave during the next speed bump. The next one, in my opinion, will be much worse as it will likely be magnified by what I see coming as a brutal fight for the Presidency from both sides of the aisle in D.C.

I look forward to having our client meetings to be sure we are all on the same planning page with each client's asset allocation, investment positions, time horizons and tolerance for risk and volatility.

If you would like to meet before we reach out to you, just call or email the office and we will set up a time that is convenient for you.

I like the clients of the WSG to know that we take this all very seriously and that we appreciate your continued trust and confidence!

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, March 7, 2019.

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)
Sign #1 is the 800-pound gorilla in The Seven Signs of a Changing Economy™ monthly update. The reason is simple. Consumers buying "stuff" represents 68.0% of our entire economy, as measured by The Personal Consumption Expenditures (PCE) each month by the Bureau of Economic Analysis (BEA). (Source: JP Morgan Guide to the Markets 12/3/2018)

This month the BEA was affected by our government shutdown. Shutdown equals no data and no report. This data lags behind the calendar and so this month's report would be on the PCE for December 2018. The great news is that we are looking for trends in the data versus specific data points. The trend through the end of 2018 was very positive as it was reported widely in the press as the largest shopping season ever.

It doesn't take too big of a stretch to suggest that the largest shopping season on earth would have very likely equated to a +.30% or +.40% as that is what it was for 2017 and 2016, respectfully.

In the past when data was not available, I used it as an opportunity to hone my prediction skills. With that as the backdrop, my guess is that the December PCE, when it is released, will come in at +.40%, or better.

Again, one month does not make a trend but this super important input is likely still very positive, based on anecdotal evidence, and this remains positive again this month.

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)

WWWBD

"What Would Warren Buffett Do?"

If you are not familiar with the name Warren Buffett, he is considered by most to be the most successful investor of Corporate America, ever. His holding company is Berkshire Hathaway.

On February 14, 2019, Mr. Buffett's Berkshire Hathaway will comply with the Securities Exchange Commissions (SEC) rules of filing a Form 13-F. This is the

public disclosure of all buys and sells done in 4Q18. It will disclose the updated shares owned for each company in the Berkshire Hathaway holdings.

As of the last 13-F filing on September 30, 2018, Berkshire held 252,478,779 shares, or 5.30%, of all Apple, Inc. (AAPL) outstanding. I will let you calculate the 10's of billions of dollars his position is down.

Per Lipper Fund Flows $143 billion was sold out of equity mutual funds in December 2018 alone. More than the combined year to data amount sold out before the December 2018 speed bump. So, we know what the average 401(k) investor was doing during the selloff, i.e. "selling"!

We won't know until 2/14/2019 what the arguably most successful investor in history was doing during that time, but I suspect it was about 180 degrees different than selling! You must understand that to be a successful investor you just must not do what everyone else is doing. If you did, you would get the same results!

So, I will update you later this month, but I am making a gentleman's bet on the WWWBD question and it is buying more of the great companies of Corporate America while they were "on sale", i.e. down in price.

As noted here last month the CNN Fear/Greed Index hit an all-time low of 2 in December 2018. It only goes down to 0! As of this writing on February 6, 2019 the same index rests at 65. It turns out my "Special Update" email of 12/26/2018 was spot on!

If you were one of the many investors who decided to sell during the December volatility, perhaps you would like a "second opinion" on your current asset allocation, investment positions and wealth management process. If so, feel welcome to reach out and we will schedule time that works for you.

Our structure, strategies and processes served the clients of The Wealth Strategies Group during that challenging time.

Sign #2 is now very positive once again!

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)
Each month The Conference Board measures ten key economic data points for expansion or contraction. They report their research as the Leading Economic Index (LEI).

The LEI has long been considered a reputable and quantified peek around the economic corner for most economists. Several of the ten components are "leading" in the sense that they measure detail at the manufacturers' level, which implies demand happening now from businesses and consumers and that we will see as economic activity six to nine months in the future.

It is useful to have a sense of what type of economic backdrop our companies of Corporate America will be operating in around August through November 2019. Not all of the data was available for this month's report due to the government shutdown, but the LEI did report a -.10% for the most recent month.

Contractions are not a good thing to see and yet one data point is not a trend. If we see two more months of contraction, with full data reported, that will be a negative trend.

Unfortunately, what has become a trend of three months, and yes, that is a short trend, but one worth paying attention to, is the Chemical Activity Barometer (CAB).

I have also highlighted here several times before, the Chemical Activity Barometer (CAB). All things chemical tend to happen before many other activities in our economy. So, this is also one of the first to show a weakening economy. Since 1919, it has shown to provide a lead time of two to fourteen months, with an average lead time of eight months, before a recession starts.

Unfortunately, for the third month in a row, the CAB has contracted. After being positive for over five years straight, this is a negative sign we will be watching closely.

Should the full data LEI contract in the next release and if the CAB once again contracts, it will place us on alert that our economic back drop six to nine months out is changing for the worse and to start our timeline for next steps in our client asset allocations and investment positions.

Sign #3 remains positive for now.

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)
The end of the jobs creation story is that the job market is consuming humans faster than we can graduate them and get them entered into the work force.

Per the Bureau of Labor Statistics (BLS) there were 304,000 new jobs created in January 2019. The economists' consensus estimate was that 165,000 jobs would be created. Once again, this economists' consensus begs the question of "How do you get to keep your job when you miss the target by 84.24%?" Yes, rhetorical!

Yet, It is even better than it appears in new jobs land. Not only were 304,000 jobs created, but it would have been closer to +479,000 new jobs if the birth/death model had not removed 175,000 new jobs. The birth/death model adds or subtracts jobs based on a BLS telephone survey of businesses. The survey suggested 175,000 people lost jobs. That said, the survey, as long-time readers know, is one I suggest is filled with fiction and mystery.

One piece of anecdotal evidence is the weekly jobless claims number, which reported in at the lowest in 49 years. This is a sign that the recession is further off than many expect.

As noted above in Sign #3, the Chemical Activity Barometer (CAB) supersedes the new jobs creation in our peek around the economic corner (which is why it is Sign #3 versus Sign #4, #5, #6 or #7), so as great as the new jobs data is, our focus for now will be on the CAB.

For now, Sign #4 could not be more 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.

Unfortunately, the U.S. Census Bureau was affected by the government shutdown. Consequently, the report on Durable Goods, Manufacturers' Shipments, Inventories and Orders was not generated.

Instead, we will reference two other fact-based research pieces I have referenced here on prior occasions. First, The Texas Manufacturing Outlook Survey. Texas is big and represents a large part of our economic inputs. In fact, I referred to this source two months ago and expressed concern that several of the statistics measured were in contraction.

Good news! Per the January 28, 2019 report, all the key inputs are once again expanding:

Production Index up 100% to 14.5, indicating an acceleration in output growth.

Capacity Utilization up nearly 100% from 7 to 14.8

General Business Activity Index jumped from -5.1 up to 1.0 in January2019

Company Outlook Index out of the negative zone and up 10 points to +7.1

Our second source is The U.S. Federal Reserve. Each month the Fed reports on the economic conditions across all 12 Fed districts. Reported growth was "modest to moderate" with the majority of districts indicating that manufacturing expanded. The Philadelphia Fed hit the highest level in six months based on "largely driven by new orders!"

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)
The earnings of Corporate America are doing GREAT!

As of 2/1/2019, total earnings for the 136 S&P 500 companies reporting results so far are up +12.60% versus the prior year. This is outstanding as revenues, on average, are up +5.90%, i.e. more productivity in the processes.

As you will likely read in the press, there is a "dark side" to this great news! Eeek!

"This is a much lower growth rate than the previous 4 quarters."

Reply: Yes, tax cuts only have impact on the next four quarters and then they are in the reporting process.

In other words, you would need another tax cut of the same size to repeat the same result. Not sure what grade that came up in school, but about 4th grade, maybe 5th grade arithmetic.

So, for our mathematically challenged press core, let's have a quick math lesson:

Plan A: No tax cut but, instead, a regular 7% annual growth rate

Year 1: 1.00
Year 2: 1.07
Year 3: 1.1449

Plan B: Tax cut and roughly a 20% jump in earnings in year one then back to 7% growth annually

Year 1: 1.00
Year 2: 1.20
Year 3: 1.284

So, is the earnings growth rate better or worse after tax cuts? For the press, worse and for those who know how to run a solar calculator, better, much better.

Let's now quantify, measure and use the earnings of Corporate America to get a Fair Market Value (FMV) of same using estimated 2019 earnings per share.

I will use Yardini Research's $171.34 per S&P 500 share for our 2019 (a/o1/17/2019) Fair Market Value (FMV) estimate, using "The Rule of 20".

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 3Q2018 released December 20, 2018 of 1.50%.

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

- 20 – 1.50 = 18.50
- 2019 S&P 500 earnings estimate = $171.34
- 2019 S&P 500 earnings estimate = $171.34 x 18.50 = 3,169.79 S&P 500 Fair Market Value (FMV)

As of 2/1/2019, the S&P 500 closed at 2,706.53.

This represents a 17.12% reduction to 2019 Fair Market Value, i.e. opportunity knocking! Not only is this market not overvalued, but how can it be overvalued when the underlying fundamentals and earnings are projected to keep getting better!

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. it 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 forward price/earnings (P/E) ratio above is 15.80 as of 2/1/2019 (S&P 500 as of this writing on 2/1/2019 is 2,706.53 divided by Yardini & Assoc. 2019 estimate of S&P 500 earnings of $171.34.)
The 90-day T-bill as of 2/1/2019 is 2.41%.

Thus, 15.80 + 2.41 = 18.21, well below the value range of 20 and very much below Dr. Sjuggerud's 22 level danger zone. This is interesting detail!

Sign #6 is very 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 input level reported in at +2.80% annualized for this month. "In check!"

The Consumer Price Index (CPI), which measures the inflation rate at the household level reported in at +1.90% annualized for this month. "In check!"

A solid economy, growing at +2.70% (per Atlanta Fed GDP Now), with inflation in check, the Federal Reserve preferred inflation rate of Personal Consumption Expenditures (PCE), our Sign #1 of +1.50% (last month annualized) provides the perfect backdrop for Corporate America to operate in. As noted above in Sign #6 we are now approximately 17.12% below Fair Market Value, i.e. it would be reasonable to sell bonds and buy ownership in Corporate America.

The markets have been stressed over increasing interest rates, along with China trade tension and oil prices, but this detail clearly sets the stage for the Fed to not increase interest rates this year.

I believe those "traders" who have no investment plans, as they just rent these fine companies until their prices drop, will continue to flip back to the buy side.

And our $20,663 trillion economy will grow another $516 billion in 2019 (+2.50%), more than the entire GDP of Sweden, Norway, Austria and about 289 additional other countries. (Source: worldgdp.com)

Sign #7 remains very positive at +2.50%

*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 $171.34 turns the 3,169.79 2019 FMV into 1,370.72 and even worse if earnings were to drop below the example of $171.34/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.

•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.
•Stock investing involves risk including potential loss of principal
•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.