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 April 2020

Summary

This may be the most informative update since I started writing these monthly updates after my first book, Surviving the Storm, McGraw-Hill 2007, came out, before the Great Recession.

Take a moment during quarantine to read each of the Seven Signs. There is valuable insight, facts and thought given to each one.

I have written here often that I selfishly write the Seven Signs each month for me. This activity gets my thoughts, ideas, strategies out of my head and into potential action points. Then, as always, I love to share them with our WSG family hoping they will continually add to each client's clarity, confidence and direction toward their bigger financial future.

Sounds great and it actually is a great plan. As boxer, Mike Tyson, is quoted, "everyone has a plan right up to the part where they get punched in the face."

Every investor in America just got punched in the face! Use your own metaphor, but here at the WSG we still have our well thought out and actionable plan to meet all our bigger financial futures, CV or no CV, it will happen.

All of 2020 is likely gone as it relates to the "value" added by prior Seven Signs issues.

Data flow will now get disconnected, far from normal, and, in all likelihood, increasingly political.

From today, the requirement, not goal, for each of us as owners of Corporate America will be to view the future based on what to expect on the other side of our donut, past our current black hole, to 2021, 2022 and beyond!

As you will soon read, all Seven Signs are already “CV impacted”, i.e. they will measure how deep and how long this black hole is.

In Sign #1 below, there is good news toward the bottom in how the $2+ trillion in economic stimulus is close to what the economy is likely contracting. Hence, the economic pump is primed! “CV go away and let’s get a vaccine so you can’t come back another day!”

Sign #2 does a nice summary of concisely quantifying the cause, margin calls, and what “laying an egg” means to the valuations of Corporate America from here.

Sign #3 makes it quite clear that we are not going to have a recession, we are IN a recession. The question is how deep and for how long?!

If you are feeling good that this is just a “hit and run” event, you might want to skip Sign #4, which suggests 30% unemployment is likely. The source is impeccable.

Sign #5 has likely suggested the bottom for manufacturing is -70%. The question is now, how long does it take to bounce out of a -70% contraction that took only 25 days to get in? My suggestion is a year.

Soon we will have the 13F SEC filing for Warren Buffet’s Berkshire Hathaway company. This is an SEC required public disclosure of the prior quarter’s buy/sell activity. It will be a fun read for sure! Per the 13F dated 12/31/2019, the portfolio is down a touch over -34%. I guess misery loves company, especially when the company is multi-billionaires who didn’t happen to see this meteor arriving either!

What now? I suspect the “complete panic” stage is over. As detailed in The Weekly Update 3/20/2020, The Fear & Greed Index hit as low as it goes on 3/12/2020 at 10:02 a.m. when it hit 1. That’s out of 100.

One! My guess, you will never see this dial at one again in your life.

The CV government mandated self-containment has caused so much economic damage that even with the stimulus plans, recovery will take time. There are economists suggesting we will experience a recovery that looks like the letter “V”. Straight down followed by straight up.

I think the letter “W” would be more realistic after we see the final drop. Could likely see a bounce up to the middle of the W and a repeat of the prior lows, perhaps a touch below, depending on those pesky margin calls. Then over several months we will see the herky jerky upside on the left side of the W.

Tough spot to see wonderful companies on sale with the backdrop as it is. And an equally tough decision of; do I sell into the current bounce up in values

thinking prices could go lower based on the negative CV backdrop for NYC, Detroit and New Orleans, et al, or be bold and invest toward 2021 and 2022 the other side of the donut black hole, knowing this too shall pass.

So far, as planned, written and discussed we have completed our third sell event. Current thinking is we are done, the intent now is to ride this out from here and use our dry powder (cash) to thoughtfully and methodically reinvest on the most negative down days in valuations as we push through this black hole.

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, May 7, 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*

(CV impacted)
As noted in the summary, all of our independent, objective and source-cited data points will now become our tools to measure the depth of economic destruction we are experiencing. The Seven Signs will also become our primary tool to measure the amount of recovery taking place, once it starts, and to estimate the timeline back to a more normalized economy.

As I have written in The Weekly Updates, posted to our WSG website every Friday before our economy was hit by the Coronavirus (CV) meteor, the U.S. consumer spending was increasing at a +2.50% annual growth rate (full-year 2019). The first quarter of each year is generally a touch slower as we all pay off the holiday bills versus buying more "stuff". We were on track for 1Q20 Personal Consumption Expenditures (PCE) growth of 2.00%.

The spread and depth of the effect CV has had on all of us as consumers has been jaw-dropping. Per Bloomberg news 3/30/2020, the PCE for 1Q20 has now been reduced to a -1.80! Per J.P. Morgan Guide to the Markets 3/31/2020, consumer spending represents 68.10% of our entire economy.

Here is some good news. Just a little back of the napkin arithmetic; let's take a $21.7 trillion economy x 68.10% = $14.777 trillion. $14.777 (PCE) x 1.80% (the projected consumer spending contraction) equals $2.66 trillion. Almost the same amount of the $2.2 trillion +++ stimulus package passed into law March 26, 2020.

In my opinion, this will prime the economic pump. As we slowly emerge from isolation and get back to our lives, it seems reasonable to expect the economic backdrop to turn more positive. In addition, gasoline prices have dropped from $2.81 per gallon to $1.94 from 4/28/2019 to 4/2/2020 (Source: gasbuddy.com). Per Rick Davis, over at Consumer Metrics Institute, each $.01 reduction in gasoline at the pump adds an annualized $1.3 billion of disposable household income to our economy. This will put as much as an additional $113 billion in disposable income back in our collective consumer wallets.

No one knows the future, yet it seems reasonable to conclude the U.S. economy will not collapse. Instead, it is possible we slowly grind back up to where we were when CV arrived.

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*

(CV impacted)

Just a few weeks ago the capital market valuations rested at all-time highs on February 19, 2020. It took exactly 19 business days for the Dow Jones Industrial Average (DJIA) to drop 19.99%. That -19.99% is the rule of thumb for when a negative trend or "bear market" starts. This represents the fastest and deepest contraction in history.

If you felt confused, maybe it had to do with this; The DJIA registered daily moves of 4%, or more, for eight consecutive days in March 2020. Correct; this, too, has never happened before!

Sign #2 is all about tracking the flow of "big" institution-type money. The elephant always leaves a footprint. Elephants just don't tend to change direction as fast as a school of fish, except for this time. Here is the money flow data:

Between 3/23/20 – 3/27/20 (1 week) $153 billion flowed out of stock mutual funds and ETFs. Bond mutual funds had a record $114 billion sellout. For perspective, that $114 billion outflow is 6x the previous record. (Source: The Investment Company Institute (ICI))

Per ICI, in the two weeks ending 3/31/20, $400 billion flowed out of "risk" assets to money market funds that represent government bonds. I believe history will show the carnage started in the bond markets. It turns out those boys and girls used borrowed money, leverage, of between 50-90% in their various "products". When the sell orders started coming in, they were forced to sell to raise cash for the investors, but there were few buyers. That rolled to selling stocks to cover, which then triggered more margin calls and that is how you see -20% markets evolve so fast. I think this is a temporary crisis, but it seems to be about as extreme as it gets!

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*

(CV impacted)
As noted in Sign #1 above, "The Seven Signs will, for now, become our primary tool to measure the amount of recovery taking place, once it starts, and to estimate the timeline back to a normalized economy."

Clearly, The Conference Board's Leading Economic Index (LEI) has no input for the probability of a pandemic breaking out. The most recent data was released on 3/19/20 for the month of February 2020. The LEI increased +.10%. This, on top of January 2020's +.80%, suggests we were on track to enjoy a wonderful economic back drop for Corporate America to operate in six to nine months in the future. Then, of course, the CV meteor hit!

As I have shared here for years, all things good and bad, happen in the chemical industry first. The American Chemistry Council released the Chemical Activity Barometer (CAB) detail for March 2020 on 4/2/20.

The CAB data clearly quantifies an economy that simply stopped. The three-month moving average, which is used to smooth out sometimes volatile data inputs, fell -2.60%. The month over month was -8.0% and the year over year was -7.40%. Not good.

The CAB has contracted 2-16 months before every recession since 1948. Conclusion per the data set: We are in a recession now.

> "The CAB signals recessionary conditions in U.S. Commerce", Kevin Swift, Chief Economist at American Chemical Council (ACC), 3/31/2020.

I would agree and add that it should be a quick two quarter type of event. Just a guess, as some experts suggest, CV may return in the fall!

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*

(CV impacted)

> "The labor shortage remains one of the biggest obstacles to a more robust small business economy", Bill Dunkelbert, Chief Economist, National Federation of Independent Business 3/5/2020.

Problem solved! Over 6.6 million people filed new claims for unemployment for the week ending April 3, 2020. That is double the prior week's 3.3 million and almost 10 times the worst number previously recorded.

With nearly 10 million new claims for unemployment benefits in two weeks, this represents 1 in 16 workers, which is roughly all the people hired into the work force since mid-2015.

The good news is the cause is CV versus an eroding economy. It would be reasonable to expect these jobs to come back, and the $2.2 trillion stimulus package, noted above in Sign #1, to help bridge that difficult transition period!

The Great Depression of 1929 had a record of 24.90% unemployment. 1982 saw 10.80% unemployment. Both were the result of a horrible economy. This is not.

That stated, it will likely get worse before it gets better. James Bullard, president of the Federal Reserve Bank of St. Louis, suggested the unemployment rate could reach 30%. That is much higher than now.

In my observation of the data, I believe this will take a year before we crest and resume to "the next normal".

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*

(CV impacted)
Way back in February 2020, 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 +1.20% and up four of the last five months. As a side note, these new orders would have been much higher except for the Boeing 737 Max problem.

What will be really interesting is to see the impact, if any, on new orders during CV. At the core, we as a country are still in need of, well, everything. I will report back on the specifics over the next few months, but it seems reasonable to think; "how could new orders go down?" Boeing is already DOA, so sans auto sales, we should be steady?!

Shipments pre-CV are +.80% and inventories, up seventeen of the last eighteen months, were +.10%. Interesting that unfilled orders were mostly unchanged after being up four of the last five months. I suspect that as we push through CV this will increase, maybe a lot?!

Supporting detail, American Trucking Association (ATA) data released 4/2/20 for February 2020 (most recent) is up +2.60% YOY! In addition, The Drewry World Container Index has bounded up from the recent free fall. Not a major trend change, more of a "thank you God" that it stopped going down.

In past updates I have referenced the Texas Manufacturing Outlook Survey as a valuable resource for all things manufactured, after all, they are a big state, large manufacturer and willing to open up the statistics detail page. There is impact to the detail related to oil patch activity. Oil prices just dropped to an 18-year low. That is bad for manufacturing (11% of the U.S. economy) and good for the consumer, see Sign #1 above, 68.10% of the economy. So, a win, but…

Texas-area manufacturing activity plummeted to a record -70 in March 2020. Below 0 represents contraction. This, like many CV-related divots, will self-correct, but it won't be by next Thursday!

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*

(CV impacted)
Just 30 days ago, i.e. ancient history, we noted right here that the earnings of Corporate America, as measured by the S&P 500 had, in fact, not come in at -4.50% against the prior year's +20% increase from the corporate tax cuts. Instead, the S&P 500 was coming in at +1%. Outstanding, in the sense that the 20%, plus a touch, was hitting well above the economists' estimate of -4.50%.

Clearly, due to CV, the earnings are going to change for the less good when the final 1Q20 is recorded. This will no doubt slip into 2Q20 S&P 500 earnings per share and personally, I would be thrilled if 3Q20 was not affected, but I don't expect to be thrilled. This CV hit was a direct hit, it will heal but with time. As noted before 2020, in my opinion, is now a build out to 2021 and beyond.

Key point: The economic hit from CV is a severe bump in the road, not an end to the demand from consumers or the growth cycle we were in pre-CV. The facts are CV is/was not nice to us in any way, will become rear-view mirror and become a stepping-stone to an even bigger future…time and patience required.

So, let's take a stab at what Fair Market Value (FMV) might look like in the near term.

Yardini Research had S&P 500 earnings for full-year 2020 at $173.73 per share as of 3/19/20. Let's assume that, like Sign #4 above, Jobs Creation, that reduces by 30% down to $164.12 and run our FMV "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) "third and final estimate" for 4Q2019 released March 25, 2020 of 1.36%.

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

- 20 – 1.36 = 18.64
- 2020 S&P 500 earnings (reduced) estimate = $164.12
- 2020 S&P 500 Fair Market Value estimate = $164.12 x 18.64 = 3,057.33

As of 4/3/2020, the S&P 500 trades at 2,488.64, or 18.60% below FMV. Could earnings go down more? Yes! Could fear expand? Yes. Could the current FMV of 2,488.64 drop 20% more? Yes. Should I sell? At the WSG, as of 4/3/20 we have completed three "sell events" based on our WSG "Exit Strategy" to add cash to our shock absorber positions and remaining conservative asset allocations.

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 is 15.11 + .09 = 15.25, below 20 and also a mile below Dr. Sjuggerud’s 22 level “danger” zone.

No one knows where the bottom is, but we should be close??

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*

(CV impacted)
The Producer Price Index (PPI), which measures the inflation rate at the manufacturing level, reported in at 1.40% annualized for this month. “In check!”

The Consumer Price Index (CPI), which measures the inflation rate at the household level, reported in at 2.30% annualized this month. “In check!”

The “third and final” estimate of our Gross Domestic Product (GDP) for 4Q2019 was reported by 2.12% 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 release is “real”. This simply means it is adjusted for the effect of inflation. In this 4Q2019 “third and final estimate” report, the Bureau of Economic Analysis (BEA) used a deflator of 1.36%.

Meanwhile, over at their sister government agency, The Bureau of Labor Statistics (BLS), the inflation rate was reported as 2.92%.

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 2.93%, the GDP would be reported as +.55% versus the BEA’s +2.12% above.

The focal point used to be which inflation rate is more accurate. Now, I would suggest all of this detail will become bombed out by the meteor effect of CV on our economy.

PPI, CPI and GDP are now 100% irrelevant! We will now enter the “black hole” of our “donut economy” as we move from the support of the pretty darn good numbers for economic growth to the unprecedented short-term economic contraction.

Just an educated guess here, and based on all you have just read in this month’s summary and these CV impacted Seven Signs of a Changing Economy™, it is “realistic”, I remain a realist, to expect the above detailed +2.12% growth of our U.S. economy to stop growing and contract by the same 10% quantified and detailed in Sign #1 above. Thus, our economy is likely to contract by approximately $2.2 - $3.0 trillion as we pass through the “black hole” of our new donut economy to the other side, which, in my opinion, is going to be more solid than the side we left pre-CV. See Sign #6 above and consider, as we are and will be, systematically adding to our conservative growth investments in our asset allocation via dollar cost averaging.

Per one of my favorite living economists, Paul Romer, born 1955, “A crisis is a terrible thing to waste”!

Here at the WSG we are laser focused on not letting this crisis go to waste.

*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 $164.12 turns the 3,057.33 2020 FMV into 1,312.96 and even worse if earnings were to drop below the example of $164.12/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 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.