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Intrinsic Value Wealth Report

Editor: Dr. Paul M. Wendee

INSIDE THIS ISSUE:

INDICES

(Close as of 6/28/19)

DJIA	26599.96
S&P 500	2941.76
NASDAQ	8006.24
10-YR TREAS	2.000%
GOLD	$1,409.70

Our Proprietary Award-Winning* Stock-Picking Model, *The Cassandra Stock Selection Model*, Was Established In 1994.

Tracking and Forecasting the Economy

Please click the link below for the article entitled, *A Simple and Effective Economic Forecasting Model*. We are introducing the forecasting approach described in this article as a new feature of the **Intrinsic Value Wealth Report Newsletter**. This economic forecasting model will make it easy for you to track current economic events and enable you to make an informed judgement on the state of and future direction of the economy. Dr. Wendee developed this tool in 2003 and published an article about it in a sister magazine of a well-known institutional investment publication.

A Simple & Effective Economic Forecasting Model White Paper

The current analysis of the economy using the Simple and Effective Economic Forecasting Model will begin in early July and will be posted in our **Weekly Commentaries**.

Economic and Investment Review

Report Date: June 28, 2019

Gross Domestic Product (GDP) grew at a strong 3.1% pace in the first quarter of 2019. Consumer spending grew 0.9% in the first quarter, but that was a slower pace than the 2.5% pace in the fourth quarter of last year. Business investment, exports, and government spending all grew at a faster pace, but have been slowing of late. These results reinforce our view that the economy is in a stable but vulnerable state. The Fed recently referred to this situation as “uncertainties” in the economic outlook.

Fed Chairman Powell said the Fed is carefully monitoring the financial markets, the economy, and other factors to determine when the next interest rate move up or down may be warranted. Powell said the scale of tariffs against China and other countries is not currently large enough to pose a threat to the economy; but the Fed is watching for signs of “a loss of confidence or financial market reaction” to these tariffs.

Bond yields across the globe have been falling amid concerns of a slowing economy. The 10-year U.S. Treasury fell below 2% recently, the first time since 2016, before closing the week at 2%. Currently, the yield curve has inverted with the 10-year Treasury yield below the 3-month Treasury Bill rate.

In a further sign of concern over European economic growth, the (continued on page 5)

Focus Lists

The ***Cassandra Stock Selection Model*** and ***Special Situation Stock Focus Lists*** spreadsheets and notes can be found at the end of this printed newsletter and in the online newsletter. The March 2018 issue of the Intrinsic Value Wealth Report has an article on **Special Situation** stock investing.

Visionary Ideas, which are at the top of the *Intrinsic Value Wealth Creation Pyramid*, will be included in this section as they are discovered. We conceive of a visionary idea as a business idea or model that is new and transforming. Starbucks, Uber, self-driving cars, and artificial intelligence are examples of visionary ideas. Please see our article in the September 2018 issue of the Intrinsic Value Wealth Report for a further discussion of visionary ideas.

Dr. Wendee visited the University of Chicago in June (Above, photo of the Quadrangle at the University of Chicago).

Cassandra Stock Selection Model Candidate List

The Cassandra Stock Selection Model spreadsheet and notes can be found at the end of this printed newsletter and in the online newsletter.

A good way to think about this spreadsheet is that it is a list of pre-screened and ranked stocks that are in raw data form and can be "mined" by the user of the research.

Stock Market Valuation

Our estimates of the market valuations for two stock market indices, the Dow Jones Industrial Average (DJIA) and the Standard & Poor's 500 (S&P 500), can be found at the end of this printed newsletter and in the online newsletter.

"Because of the convertibility feature, these 'hybrid' securities reflect movements in both stock prices and interest rates."

Convertible Securities

Convertible securities include financial instruments such as convertible bonds, convertible preferred stocks, and warrants. Convertible securities can be converted into common stock at the holder's option. Because of the convertibility feature, these "hybrid" securities reflect movements in both stock prices and interest rates. To learn more about convertible securities, there are many excellent articles and books on the subject. One reference that we have found particularly helpful is: Knecht, L. and McCowin, M. (1989). Valuing Convertible Securities. In Fabozzi, F. (Ed), Advances & Innovations in the Bond and Mortgage Markets (pp. 97-116). Chicago: Probus. Periodically, we choose a convertible security to highlight in this newsletter. The stocks underlying the convertibles we review are ranked by the Cassandra Model in the same manner as other stocks in our Cassandra Stock Selection Model Candidate List. You can find our highlighted convertible securities at the end of this printed newsletter and in the online newsletter.

The Wealth Creation Pyramid

The Wealth Creation Pyramid is designed to show some of the major categories for building wealth. It is the result of many years of study of the wealth building process; experience working with clients who have built considerable wealth; and my own personal experience building wealth.

Newsletter subscribers should consult *The Wealth Creation Pyramid* as one of many useful investment tools while considering their investment plans. *The Wealth Creation Pyramid* can be found at the end of this printed newsletter and in the online newsletter.

Financial Planning Tip of the Month: Nine of the Best Ways to Build Wealth

"I embarked on a journey to find how people around the world had built significant wealth"

It is often said that the three main sources of wealth creation are the stock market, real estate and entrepreneurship. With this knowledge as a starting point, I embarked on a journey to find how people around the world had built significant wealth. I graphically documented and codified the results of my study into the **Intrinsic Value Wealth Creation Pyramid**. Much of what I share comes from my experience of over 36 years as an entrepreneur, investment banker, securities analyst, investment portfolio manager, private equity fund manager, university professor, and investment newsletter editor and publisher.

The **Intrinsic Value Wealth Creation Pyramid** is designed to show some of the major categories for building wealth. It is the result of many years of study of the wealth building process; experience working with clients who have built considerable wealth; and my own personal experience building wealth. Newsletter subscribers should consult the **Intrinsic Value Wealth Creation Pyramid** as one of many useful investment tools while considering their investment plans.

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Alternative Investments

Alternative Investments can provide very attractive returns, but also generally carry a much higher level of risk. Accordingly, they are placed higher on *The Intrinsic Value Wealth Creation Pyramid (TM)*. There are many different asset classes that are considered Alternative Investments. The following are some of the more common Alternative Investment asset classes:

Alternative Investment Asset Classes

- Real Estate
- Oil and Gas
- Private Equity

Potential Benefits of Alternative Investments

- May reduce the overall volatility of your investment portfolio
- May provide greater investment returns
- May provide greater diversification
- May provide greater investment flexibility

Please see *Book #4 – The Intrinsic Value Wealth Creation Pyramid* for a listing of some Alternative Investment sponsors. Also included in this listing are some other considerations that one should make before investing in these types of investments.

Announcements

Dr. Wendee is a contributor to **Forbes.com**. Please click the link below to read an article that he wrote for Forbes entitled, *Nine of the Best Ways to Build Wealth.* Here is the link: https://www.forbes.com/sites/forbeslacouncil/2018/09/04/nine-of-the-best-ways-to-build-wealth/#2d3c031b4460

Dr. Wendee has co-authored a book chapter entitled, "**An Epilogue to Succession Planning: Understanding the Value of Your Enterprise**," for a book on **Succession Planning**. The book was published in February 2018.

Paul and Renee Wendee opened their new coffeehouse, **Bistro on Main Street**, in Vista, California in January. If you are in the area, drop by and visit us.

Supplemental Materials

The Intrinsic Value Wealth Report is published in two parts: (1) the main newsletter; and (2) a supplemental materials section. *The Intrinsic Value Wealth Report Newsletter* is packed with useful investment information for investors. Because there is so much content in the newsletter, we publish it in two parts comprised of several PDF files to make it easier to access the material.

Be sure to review all of the supplemental material, as a great deal of the useful information in this newsletter is found at the end of this printed newsletter and in the supplemental materials sections of the online newsletter.

Economic and Investment Review (Cont'd)

(continued from page 1)

president of the European Central Bank (ECB) said the ECB is considering new stimulus as early as July.

Tariffs and trade tensions are increasingly hurting U.S. industries in both higher costs to manufacturers and lower demand for U.S. products. Factories are on track for their weakest performance since 2016. Manufacturing job growth has slowed since late 2018. Manufacturing output has declined in three of the past four months. Manufacturing accounts for 11% of U.S. gross domestic product, down from 16% twenty years ago. The HIS Market survey of sentiment among U.S. purchasing managers hit a three-year low in May; while a survey of the Institute for Supply Management was at its lowest point since October 2016 in April.

The World Bank lowered its global growth forecast for 2019 to 2.6% from 2.9% in January. Central banks around the world have begun considering rate reductions over concerns of global economic slowing.

Markets have been exhibiting a "risk-on, risk-off" phenomenon where markets split into two broad categories that move together.

On the consumer side, the jobless rate hit a 50-year low in April, a good sign for the economy. The unemployment rate fell to 3.6% and was accompanied by solid wage growth. Wage growth outpaced inflation which was 1.9% as measured in March by the consumer price index. That's the good news. The bad news is that the labor force participation rate declined slightly. A low labor force participation rate holds the economy back from achieving its full potential. While the immediate effect of a low labor participation rate may not be apparent, and the historically low jobless rate may be something to cheer, the long-term drag on the economy in reaching its full potential due to a low labor participation rate is something that is of concern.

The Conference Board's index of consumer confidence fell to 121.5 in June from 131.3 in May. This was the lowest level since September 2017 and was attributed to trade tensions and a cooling jobs market.

Retail sales at several major chains slowed in the latest quarter. Retail sales slipped a seasonally adjusted 0.2% in April from March.

Home price growth slowed in March; and U.S. new and existing home sales fell in April, continuing a softening in the U.S. housing sector. In a potentially positive sign for housing, mortgage rates dropped below 4% recently. However, there is an increasing trend of loans to borrowers with heavy debt loads. This raises the prospect of higher defaults should the economy falter. Some housing economists also contend that the increased demand from these loans is artificially raising housing prices.

Manufacturing has been slowing in the U.S. and other key economies around the world. The purchasing managers index for U.S. manufacturing activity declined to 50.1 in June from 50.5 in May. This is the lowest level in almost a decade. A reading above 50.0 indicates growth.

Spending on factories, equipment, and other capital goods slowed in the first quarter. Durable goods orders fell 2.1% in April. Factory output fell 0.5% in April from March.

U.S. hiring slowed in May as companies are starting to have concerns about trade

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Economic and Investment Review (Cont'd)

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tensions, slowing global economic growth, and emerging strains on the U.S. economy.

According to Factset, corporate earnings are expected to fall 3.9% in the first quarter of this year from a year earlier.

The Fed left interest rates unchanged at its policy meeting in June but indicated that a rate cut would be considered if the economy falters. The Fed is now referring to "uncertainties" in the economic outlook.The Fed had raised its benchmark rate by a quarter percentage point at its December meeting to a range of 2.25% to 2.5%. They had indicated two more rate increases were likely this year but said that they are patient and future rate hikes will "depend entirely on the data." The Fed is also evaluating whether to hold a larger stock of Treasury securities, which they had started reducing 16 months ago. Inflation has stayed just below the Fed's 2% inflation target, reducing the need for the Fed to be in a hurry to raise rates. U.S. inflation slowed in May with the Consumer Price Index (CPI) rising by only 1.8% from the previous year. This is well below the 2% rate of inflation that the Fed has been targeting.

There are indications that the benefits from the 2017 Republican tax cut were temporary, representing a short-term boost to the economy rather than a long-term benefit. Employee bonuses have slowed in 2019; business orders for capital goods such as equipment have slowed since 2017; and new hiring has slowed to its lowest level since 2010. Overall, there is an increasing number of indications that economic growth is moderating to a more normal level from the very robust growth recorded in 2018.

The forecasters in the Philadelphia Fed's Survey of Professional Forecasters (as of May 10, 2019) predict real GDP will grow at an annual rate of 1.9 percent this quarter and 2.1 percent next quarter. On an annual-average over annual-average basis, the forecasters predict real GDP to grow 2.6 percent in 2019, 2.0 percent in 2020, 1.9 percent in 2021 and 2.3 percent in 2022. The forecasters predict the unemployment rate will average 3.7 percent in 2019, 3.6 percent in 2020, 3.7 percent in 2021, and 3.9 percent in 2022. The next Survey of Professional Forecasters will be released on August 9, 2019. We would not be surprised to see the forecasters in this August survey pare back their estimates of economic growth somewhat given the economic results since the last survey was taken.

On a longer-term basis, there are several trends which have been a drag on the economy; and which don't appear to be improving anytime soon. The first is U.S. worker productivity, which has been sluggish for more than a decade. In 2017, U.S. worker productivity grew below its long-run average for the seventh year in a row. Slow productivity growth can prevent wages from rising and can slow economic growth. The second disturbing trend is the labor force participation rate, which is currently just below 63%, having declined from above 67% in early 2000. A low labor force participation rate holds the economy back from achieving its full potential. Going forward, several other trends pose long term concerns. The first is a sharp increase in lending to the most highly leveraged companies, not just in the U.S., but worldwide. Fed Chairman Powell warned again of the risks of rising corporate debt. The second major trend posing a possible risk to the economy is the unwinding

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Nine of the Best Ways to Build Wealth (Cont'd)

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The chart in this section is an expanded version of the **Intrinsic Value Wealth Creation Pyramid Chart** referenced in the Forbes.com article entitled, *Nine Of The Best Ways To Build Wealth*.

Intrinsic Value Wealth Creation Pyramid

Economic and Investment Review (cont'd)

(continued from page 6)

of the Fed's $4.2 trillion bond portfolio, which was bought to stabilize the economy after the 2008 financial crisis; although the unwinding seems to be going well so far. Third, the U.S. savings rate fell to a 10-year low of 3.1% in the third quarter of last year and further fell to 2.4% in December, down from 6.3% two years ago. Low savings rates can persist for long periods of time; but have been associated in the past with financial bubbles that collapsed. One-quarter of working Americans have no retirement savings. Projections are that the costs of Social Security will exceed its revenue in 2020. A fourth unsettling trend is the level of national debt, which may only get larger with the tax overhaul and likely increases in government expenditures on defense and social programs. The national debt of the U.S. was 108.1% of GDP, according to estimates by the International Monetary Fund. This puts the U.S. in fifth place among large countries for its debt burden. The four nations with larger debt burdens are Japan, Greece, Italy, and Portugal. A fifth and new threat to the economy is the Trump Administration's pursuit of trade sanctions and tariffs on U.S. trading partners. While benefiting some domestic firms, at least in the short-run, tariffs and sanctions create a potential danger of retaliatory action by U.S. trading partners, which hurts U.S. exporters; raises prices on manufacturing inputs for domestic producers; and poses a threat of derailing a global economic expansion which has been benefiting all countries, including the U.S. However, in a reinforcement of Trump's trade concerns, there was a 12% increase in the U.S. trade deficit in 2017. This was the widest deficit since 2008. The trade deficit in October of last year again reached its highest level since October 2008. Overall though, most economists are in agreement that global trade is good for all trading partners; and economic theory from nearly all economic disciplines affirms this notion.

The stock market now stands at record high levels. The broad market remains overvalued, although the Dow Jones Industrial Average looks more fairly-valued than the broad market. But that does not mean that a market correction is imminent. Markets can and do stay overvalued for long periods of time. As discussed above, we believe the economy is in a stable but vulnerable state that is showing signs of weakening. If the economy remains strong, the markets will likely remain strong. If the economy deteriorates, the markets may well correct. There are other events that could trigger a market correction, of course, but economic conditions are the most likely and foreseeable events that could make that happen.

We believe it is important to maintain a long-term view toward investing. This means that you should continue building your investment portfolio using the Cassandra Stock Selection Model to select individual securities that offer growth and value opportunities.

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* *The Cassandra Stock Selection Model* ™ picked the winning stock in the Wall Street Journal's 1999 Experts vs. Darts Stock-Picking Contest (January 12 – June 30, 1999).

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