



Prosperity Fundamental Value Indicator Current Reading:



Advisor Sentiment



Economic Climate



Relative Value



Chart of the Month



SOURCE: FACTSET

Commentary:

Oil prices have rebounded by \$16 a barrel since the low point was reached at \$45, and investors are already wondering whether the worst is over for the energy sector. Based on the past chronology of commodity bears, the trough is overdue. Last year's collapse in oil prices was not built into the forward markets. Nor was it predicted by economists and oil analysts.

A consensus has now emerged about the main cause of the 2014 oil crash. The prime factor was the unexpectedly rapid growth in fracking production in the US. This added to global oil production, at a time when global oil demand was rising more slowly than usual. In retrospect, the main surprise is that it took so long for the price to crack. When it did, the second surprise was that OPEC refused to cut output, reversing its traditional behavior in periods of excess supply. Speculative and short-term trading then exacerbated the collapse, and there was some slowing in global energy demand towards the end of 2014. With the dollar rising, oil prices faced a perfect storm.

Overall, the combination of excess inventories, still-high US production, the refusal of OPEC to cut output and sluggish demand growth may hold oil prices down for quite a while before a sustainable balance is restored to the market. Prices may remain very volatile before settling in a range of perhaps \$60-\$70 next year. This is somewhere near the consensus forecast and the forward market prices for next year. The trough of this cycle may be close, but the golden era for oil producers is nothing more than a very distant memory.

(EXCERPT: Gavyn Davies, *Financial Times*, 2/16/2015.)

ECONOMIC CLIMATE

COMPOSITE =



UNIVERSITY OF MICHIGAN SENTIMENT INVESTORS SENTIMENT



12 MONTHS AGO: 80.4

LAST: 98.1

Declined



This metric, a consumer confidence index published monthly by the University of Michigan and Thomson Reuters, uses information gathered in 500 telephone interviews and measures how consumers view their financial situation and both the near and long-term economy.

ISM INDEX SUPPLY MANAGERS ECONOMIC PERSPECTIVE



12 MONTHS AGO: 57

LAST: 56.5

Improved



The ISM index is created monthly from surveys of more than 300 manufacturing firms that include factors like employment, inventories, new orders and supplier deliveries. An increasing index reflects stronger business activity and may translate into improving economic results.

CAPACITY UTILIZATION MEASURES NEED FOR CAPITAL EXPENDITURES



12 MONTHS AGO: 79.2

LAST: 80.1

Declined



Here is a measure of potential output by the economy. It is a “Goldilocks” measure in that it shouldn’t be too hot or too cold but somewhere in the middle. High capacity utilization puts pressure on corporate margins and inflation (though it could foretell the demand for capital expenditure), while low capacity utilization indicates a weak economy.

RAILTIME INDICATOR MOST CURRENT GAUGE OF COMMERCE



12 MONTHS AGO: 269K

LAST: 289K

Improved



This monthly report from the Association of American Railroads looks at U.S. rail traffic data. *Rail Time Indicators* provides a convenient, clear look at the content and volumes of railcars that can reveal where the economy — and, therefore, rail traffic — has moved.

JOBLESS CLAIMS EMPLOYMENT TRENDS



12 MONTHS AGO: 331K

LAST: 293K

Improved



The United States Department of Labor issues a weekly report detailing the number of new individuals who have filed for unemployment benefits in the previous week. While many labor statistics provide deeper views of employment and consumer spending capacity, jobless claims is a real-time indicator.

YEAR OVER YEAR MEASURES OF RAIL TRAFFIC ARE UP IN ALL AREAS EXCEPT NONMETALLIC MINERALS, INCLUDING DOUBLE DIGIT PERCENTAGE GAINS IN GRAIN AND CRUSHED STONE, THE LATTER BEING AN INDICATOR OF INCREASED FRACKING ACTIVITY AND HOME BUILDING.

Source:
Association of American
Railroads, Feb. 2015

RELATIVE VALUE COMPOSITE =



PRICE TO EARNINGS RATIO USING TEN YEAR AVERAGE EARNINGS



12 MONTHS AGO: 24.8

LAST: 27.16

Declined



This is the most common tool used to gauge whether stocks are fairly priced. Most pricing analyses use current earnings ratios. Instead, we use the annual S&P 500 earnings over the previous 10 years because it reduces fluctuation in profit margins caused by the cyclical nature of businesses.

VIX INDEX INDICATES PRICE VOLATILITY



12 MONTHS AGO: 17.87

LAST: 17.51

Improved



The VIX index is used to measure anticipated volatility of the S&P 500 index over the upcoming 30 day period. A lower number indicates lower anticipated volatility within the U.S. equity market.

DORSEY WRIGHT RATIO TECHNICAL TRADING INDICATOR



12 MONTHS AGO: 6.7

LAST: 5.2

Improved



We utilize an independent technical analysis service (Dorsey Wright) to show the supply and demand of stocks in the marketplace. Known as Point & Figure methodology, it records the price movement of stocks as well as momentum and relative strength.

10 YR/2 YR TREASURY SPREAD EXPECTATION FOR ECONOMIC ACTIVITY



12 MONTHS AGO: 2.38

LAST: 1.3

Improved



This indicator gives us a measure of the return expectation for long-term investors. When the spread is wide, investors are demanding higher yields to equal their otherwise expected returns in other asset classes. It is an absolute spread. A negative spread is often an indicator of economic contraction.

CAP RATE OF PE VS. 10 YR TREASURIES CURRENT VALUES VS. RISK FREE RATE OF RETURN



12 MONTHS AGO: 1.28

LAST: 1.73

Declined



The relative return expectation of earnings yield from equities is compared to the yield expectation of the 10 year Treasury. When the reading is significantly negative, it may indicate that stock prices are overvalued and are dependent on strong earnings growth to justify current prices.

INVESTING TO MEET CURRENT AND FUTURE FINANCIAL NEEDS IS A CONSTANT EVALUATION OF ASSET CLASSES AND THEIR RELATIVE RETURN EXPECTATION VERSUS THEIR RISK EXPOSURE. THE PFVI PROVIDES DATA TO SUPPORT AND IDENTIFY FACTORS THAT CAN IMPACT THOSE INVESTMENT DECISIONS.

Methodology

The Prosperity Fundamental Value Indicator (PFVI) is used to communicate to our clients where we stand on the economy and the stock market. It is based on a 0 to 10 scale and is a quick way to show our clients whether we are in “advance” mode or “protect” mode. In advance mode, we are favoring riskier assets for a client’s portfolio (stocks, high yield bonds, etc.) and when we are in protect mode we favor less volatile assets for the portfolios (bonds, managed futures, etc.). Each holding we select fits into the client’s overall risk profile, but we overweight and underweight certain assets depending on if we are in advance or protect mode.

The PFVI helps us communicate our advance or protect status by having a value, calculated weekly, from 0 to 10. Above 5 is “advance” and below 5 is “protect”. The PFVI is made up of nine data points, five advisor sentiment scores, and one technical score, each of which is listed below. Each component is a score from 0-10 based on historical ranges, ranges for all data available in the St. Louis Federal Reserve Data collection found online at <http://research.stlouisfed.org/fred2/>. The data value is then given a weighting and contributes to the overall value of the PFVI. The data points can be split into Economic Data and Relative Value components. Those values are then combined, and along with the Advisor Sentiment scores, comprise the overall value of the PFVI. The components are as follows, with weighting in parenthesis:¹

PFVI Data Points:

Economic Climate Composite Data Points²:

University of Michigan Sentiment (5%)
ISM Index (5%)
Capacity utilization (5%)
Railcar weekly carloads (5%)
4 week moving avg. for initial jobless claims (5%)

Relative Value Composite Data Points²:

Trailing normalized P/E ratio of the S&P 500 (5%)
VIX Index (5%)
Spread between 10yr Treasury yield and the 2yr Treasury yield (5%)
Cap rate of P/E v. 10yr Treasury Yield (10%)
Dorsey Wright Technical All Stock Index (10%)

Advisor Scores:³

Advisor Team (40%)

(1)The process of weighting takes the value of the data point, converts it to a 0-10 value based on historical range described above, and multiplied by its percentage weighting. For example if a data point has a historical range of 40 to 60, a score of 52 would receive a value of 6. This value is then multiplied by 5% to give a value on 0.30. This data point would contribute 0.30 to the total value of the PFVI for that week.

(2) Both the Economic Climate Composite Data and the Relative Value Composite data are data points already used in the calculation of the PFVI. The data is combined into a composite based on whether that data point is considered an economic reading or a market valuation tool. The purpose is to show our clients a deeper view on what comprises the PFVI and how the composition of the PFVI can affect our commentary.

(3)Advisor sentiment scores are calculated on a 0-10 scale with 0 meaning the advisor thinks the market will be substantially lower in 12 months, 5 meaning the advisor think the market will be flat 12 months from that date and 10 meaning the advisor thinks the market will be substantially higher in 12 months. The Advisor Team is comprised of the advisors and analysts of Prosperity Advisory Group, weighted on industry experience.

Disclosures

Investors cannot directly invest in indices. Past performance is not indicative of future results. Therefore, no current or prospective client should assume future performance of any specific investment, investment strategy or product will be profitable or equal the corresponding PFVI (Prosperity Fundamental Value Indicator). Different investments involve varying degrees of risk and there can be no assurance any investment will either be suitable or profitable for a client or prospective client portfolio.

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