SEM
WEALTH MANAGEMENT ™

Economic Update & Preparing for the Election

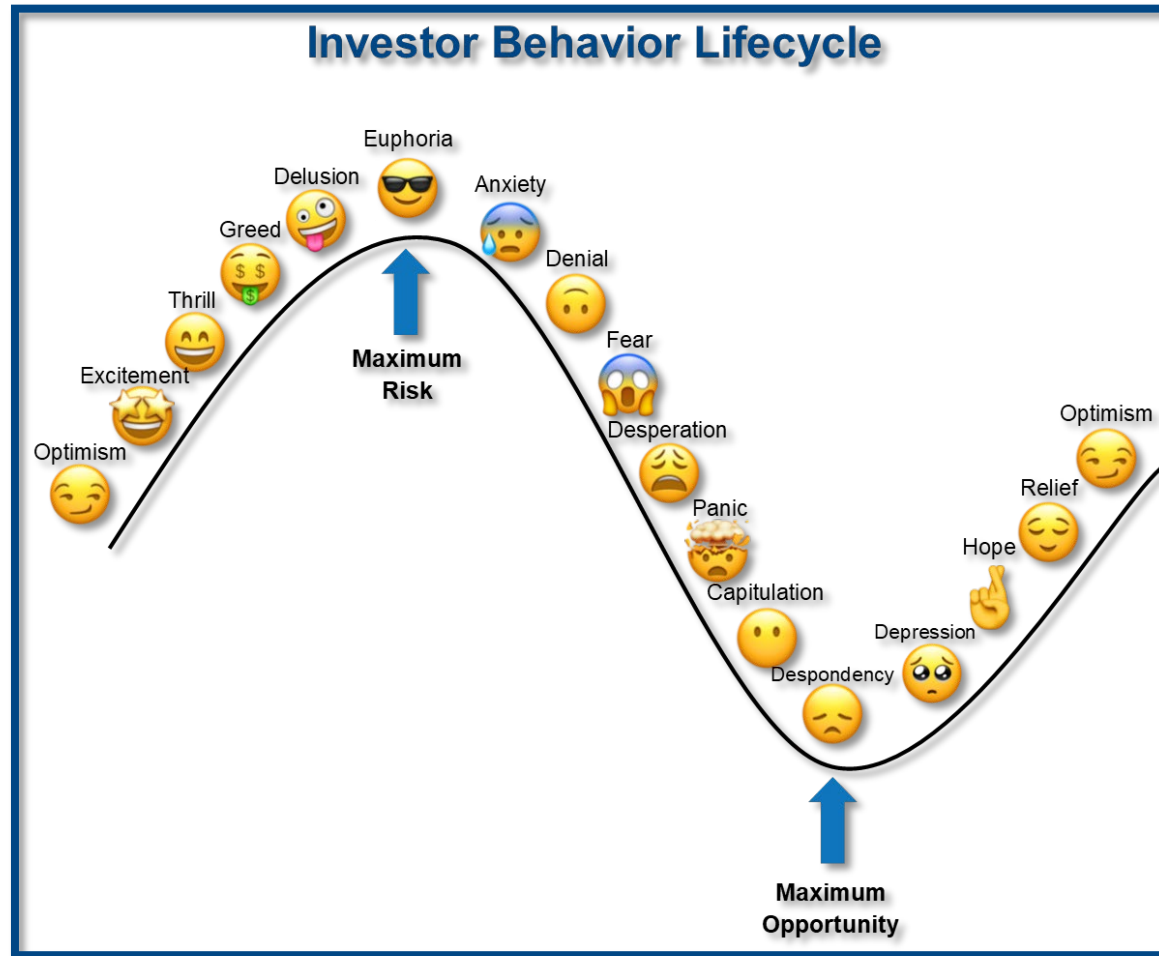Using Scientifically Engineered Models

A smooth road to lifelong investing.

Understanding Human Behavior

2

Investor Behavior Lifecycle

Optimism
Excitement
Thrill
Greed
Delusion
Euphoria
Maximum Risk
Anxiety
Denial
Fear
Desperation
Panic
Capitulation
Despondency
Depression
Hope
Relief
Optimism
Maximum Opportunity

The stock market is a story of **cycles** & of the **human behavior** that is responsible for **overreactions** in both directions.
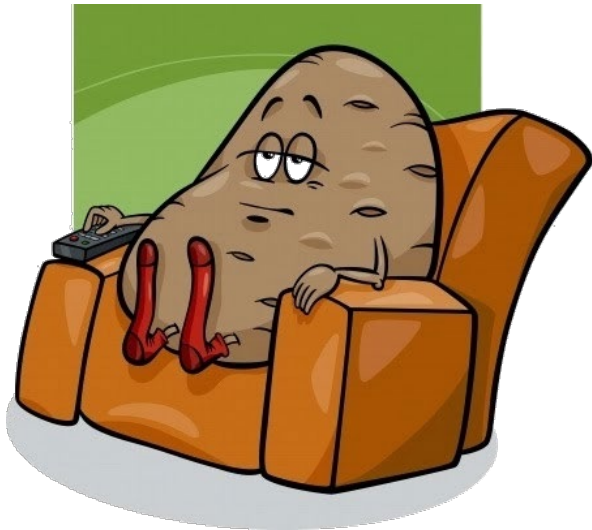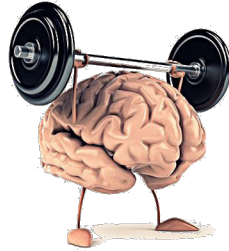
– Seth Klarman

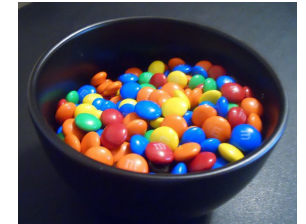**For current market updates go to: tradersblog.semwealth.com**

Behavioral Finance 101

Drs. Daniel Kahneman & Amos Tversky

Your Two Brains

Dr. Richard Thaler

Econs (Robots) vs Humans

Key of Behavioral Finance:

1.) Our brains use short-cuts to make difficult decisions
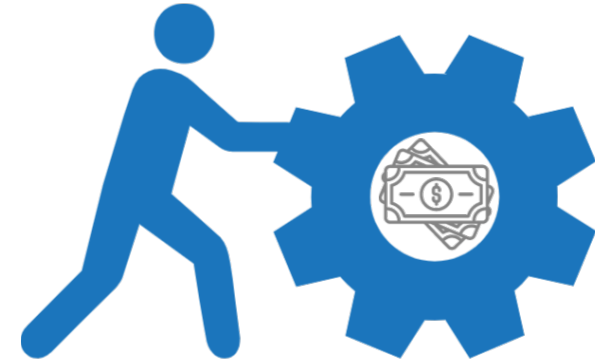
2.) Our actions do not match the economic models

Potential GDP Equation

How many people are working?
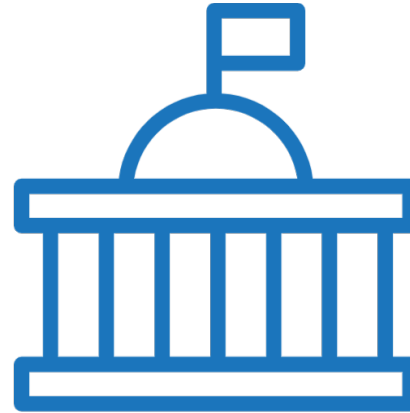
+

How much are they producing?
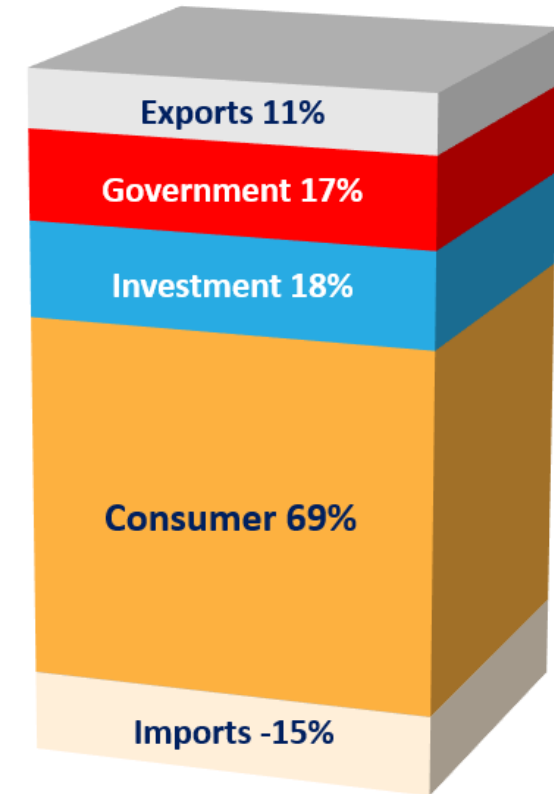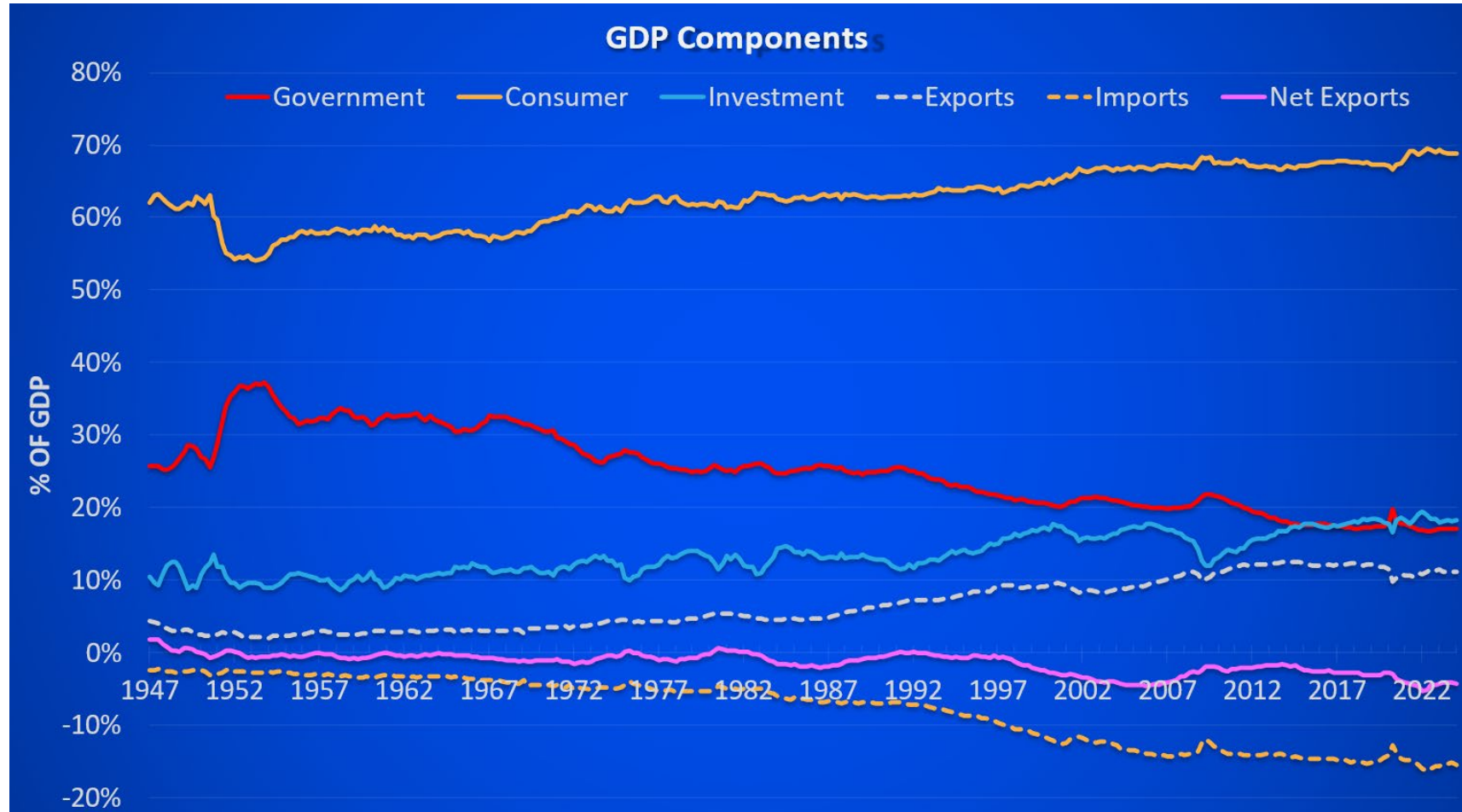
GDP Equation

Consumer + Investment + Government + Net Exports

GDP Components

GDP Contributors over Time

Growth Rate Contribution of Each GDP Component

Legend: ■ Exports ■ Imports ■ Investment ■ Consumer ■ Government

Imports subtract more from GDP than **Exports** add (normally)

Component	Long-term Rate	30 Year Rate	10 Year Rate	1 Year Rate
Government	0.4%	0.2%	0.3%	0.6%
Consumer	2.2%	1.9%	1.8%	1.6%
Investment	0.7%	0.6%	0.6%	0.9%
Exports	0.5%	0.4%	0.1%	
Imports	-0.9%	-0.7%	-0.5%	-0.2%

SOURCE: Federal Reserve Bank of St. Louis; Mar-24

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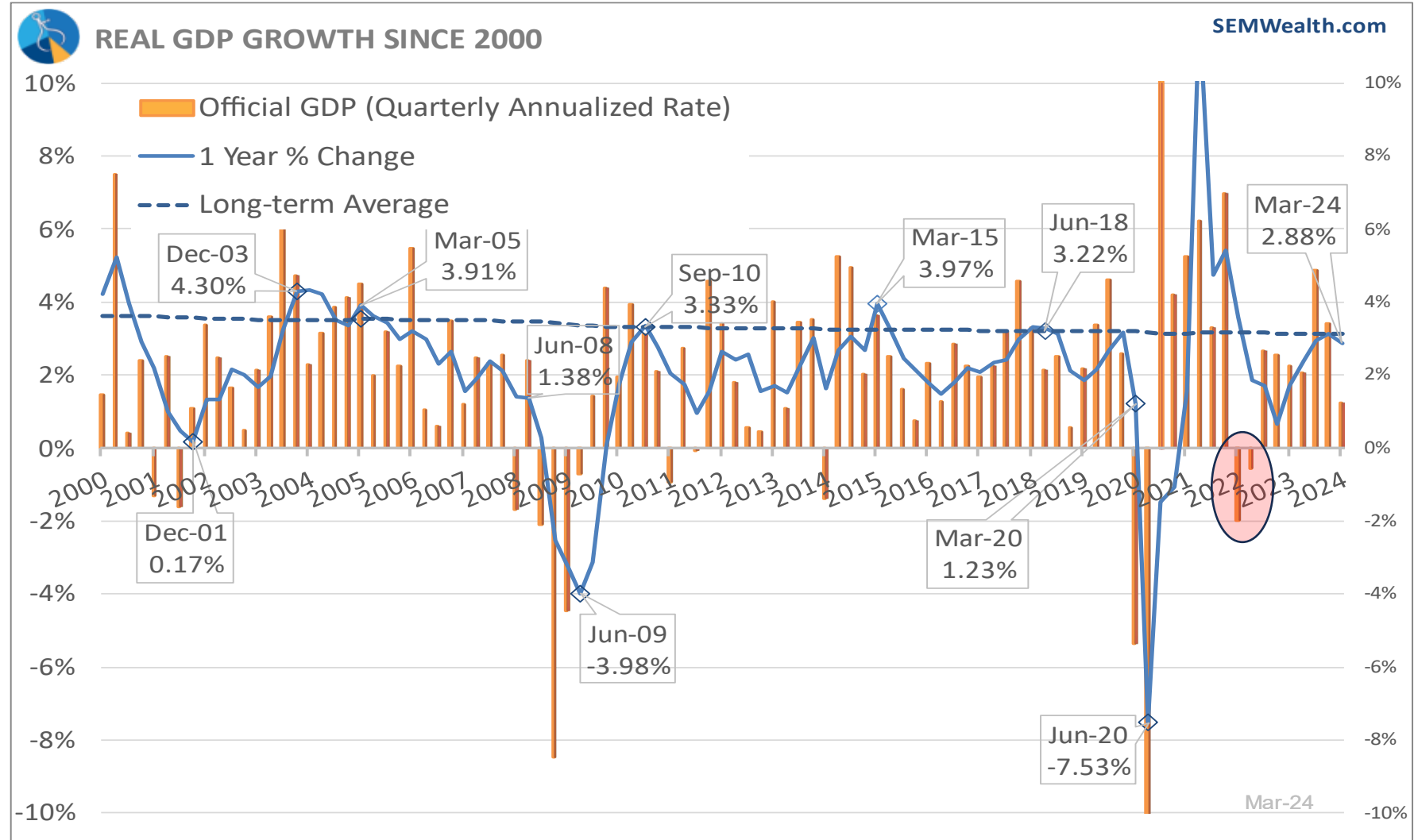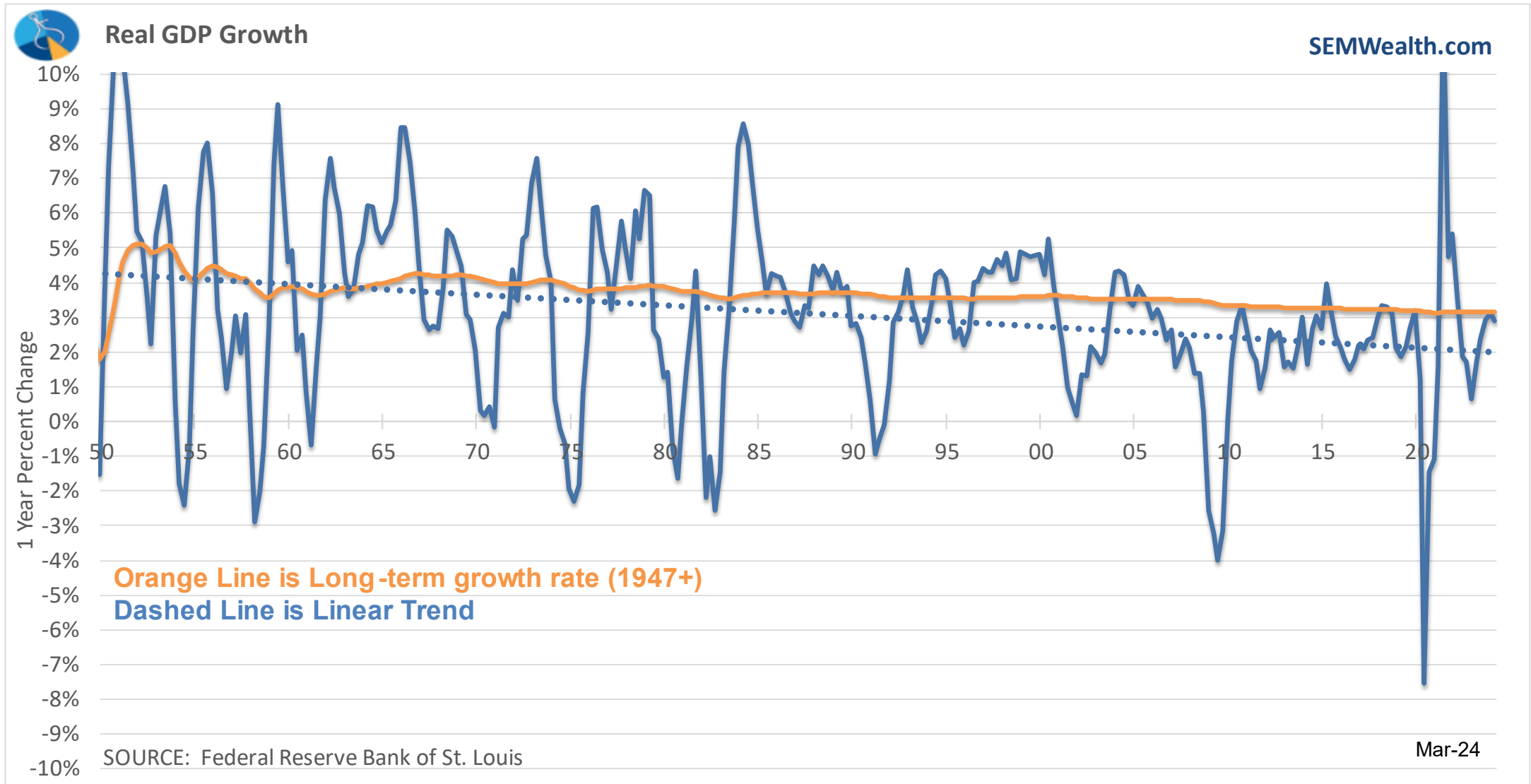
7

Understanding GDP Reports

- Official GDP numbers can be misleading

- "Seasonally adjusted annual rate" causes large swings

- Focus should be on 1-year rates of change

- We have had few periods this century above the long-term average

REAL GDP GROWTH SINCE 2000 — SEMWealth.com

Legend:
- Official GDP (Quarterly Annualized Rate)
- 1 Year % Change
- Long-term Average

Annotations:
- Dec-03: 4.30%
- Dec-01: 0.17%
- Mar-05: 3.91%
- Jun-08: 1.38%
- Sep-10: 3.33%
- Jun-09: -3.98%
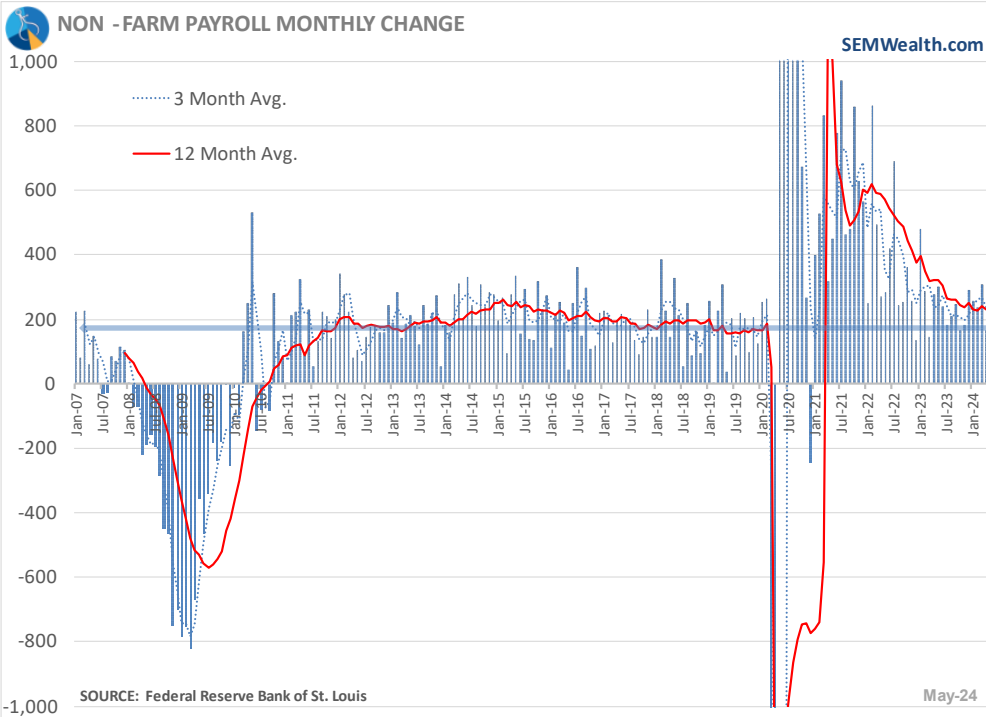- Mar-15: 3.97%
- Jun-18: 3.22%
- Mar-24: 2.88%
- Mar-20: 1.23%
- Jun-20: -7.53%
- Mar-24

The long-term trend continues to weaken

Real GDP Growth

SEMWealth.com

Orange Line is Long-term growth rate (1947+)
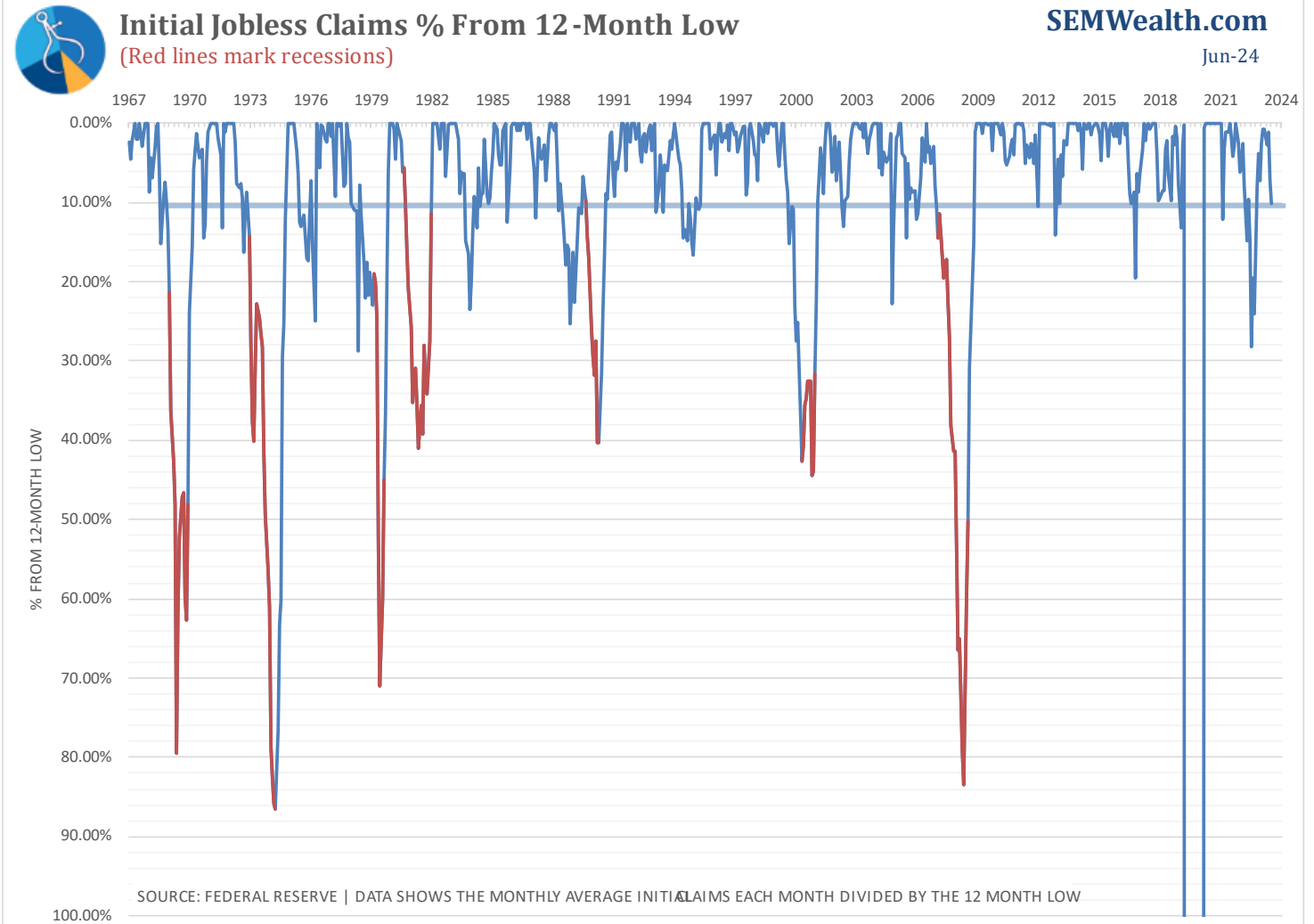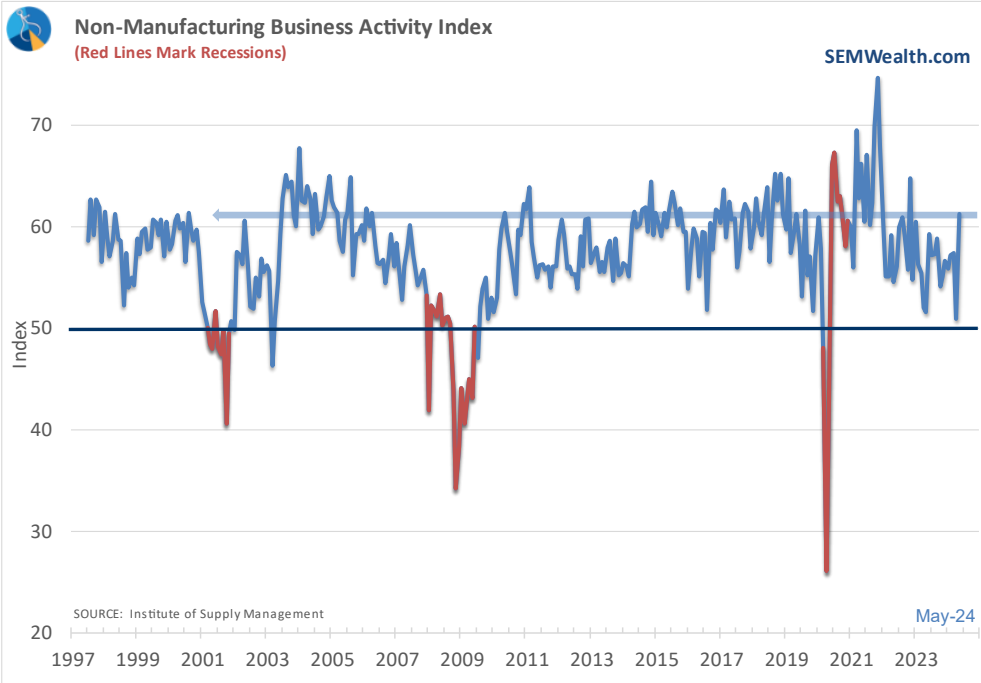Dashed Line is Linear Trend

1 Year Percent Change

SOURCE: Federal Reserve Bank of St. Louis

Mar-24

Leading Economic Indicators

Jobs / Workers

Consumer Spending / Confidence

Investment / Housing / Manufacturing

Government Activity

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Employment Indicators

Aggregate Weekly Hours - Rate of Change
(Red Lines Mark Recessions)

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Other than 1967 & late 1995 EVERY TIME the Hours Worked Index turned negative the economy was already in a recession or nearly there.

SOURCE: Federal Reserve Bank of St. Louis

NON - FARM PAYROLL MONTHLY CHANGE

SEMWealth.com

- 3 Month Avg.
- 12 Month Avg.

SOURCE: Federal Reserve Bank of St. Louis

May-24

Initial Jobless Claims % From 12-Month Low
(Red lines mark recessions)

SEMWealth.com

Jun-24

SOURCE: FEDERAL RESERVE | DATA SHOWS THE MONTHLY AVERAGE INITIAL CLAIMS EACH MONTH DIVIDED BY THE 12 MONTH LOW

SEMWealth.com

Consumer Indicators

Consumer Spending
(Red Lines Mark Recessions) Dashed line is long-term trend
SEMWealth.com

% Chg vs 1 Yr Ago

SOURCE: Federal Reserve Bank of St. Louis

Non-Manufacturing Business Activity Index
(Red Lines Mark Recessions)
SEMWealth.com

Index

SOURCE: Institute of Supply Management

May-24

Consumer Sentiment (Red Lines Mark Recessions)
SEMWealth.com

Monthly Reading

2000
2004
2007
Apr '15
Feb '18
Feb '20
Oct '16
Apr '21
Apr '20
March '24
March '82
Nov '08
Aug '11
June '22

SOURCE: University of Michigan

SEMWealth.com

Investment Indicators

ISM Manufacturers' New Orders / Deliveries / Order Backlog
SEMWealth.com
- NewOrders
- Deliveries
- Backlog

SOURCE: Institute of Supply Management May-24

Total Capacity Utilization
(Red Lines Mark Recessions)
SEMWealth.com

SOURCE: Federal Reserve Bank of St. Louis

Private Housing Building Permits
(Red Lines Mark Recessions)
Dotted line = 36 Month Trend
SEMWealth.com

Sep-12 52%
Mar-10 34%
Jun-15 37%
Mar-04 18%
Mar-17 14%
Feb-11 -17%
Mar-19 -6%
Jun-16 -12%
Nov-06 -31%

SOURCE: Federal Reserve Bank of St. Louis
May-24

SEMWealth.com

Government Indicators

M' - Adjusted Real Money Supply
(Red Lines Mark Recessions)

SEMWealth.com

SOURCE: Federal Reserve Bank of St. Louis

Yield Spread (10 Yr. vs 2 Yr.)
(Red Lines Mark Recessions)

TradersBlog.SEMWealth.com

Time to beginning of recession following 2nd consecutive month of negative spread (average 16 months):
1978 - 19 months | 1980 - 11 months | 1990 - 17 months | 2001 - 14 months | 2007 - 22 months

16 months from latest inversion = December 2023

SOURCE: Federal Reserve Bank of St. Louis (FRED)   May-24

Fed Funds Rate (Red Lines Mark Recessions)

SEMWealth.com

Note:
a.) The Fed raised rates aggressively before the last two bubbles burst
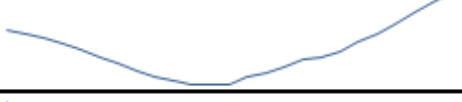b.) The Fed cut rates aggressively BEFORE the recession started, yet the recession continued for a while.

It takes 9-12 months for a change in monetary policy to filter through the entire economy

SEMWealth.com

Economic Dashboard

Leading Indicator:	24 Month Trend:	GDP Indication:
Hours Worked		↔
Jobs		↑
Consumer Spending		↔
Capacity Utilization		↔
Consumer Sentiment		↓
Money Supply		↑
Stock Prices		↑
Consumer Goods Orders		↓
Building Permits		↓
Service Business Activity		↔

Jobs / Workers

↔ ↑

Investment / Housing / Manufacturing

↓ ↓ ↔

Consumer Spending / Confidence

↑ ↔ ↓

Government Activity

↑ ↓

SEM's Dynamic Models

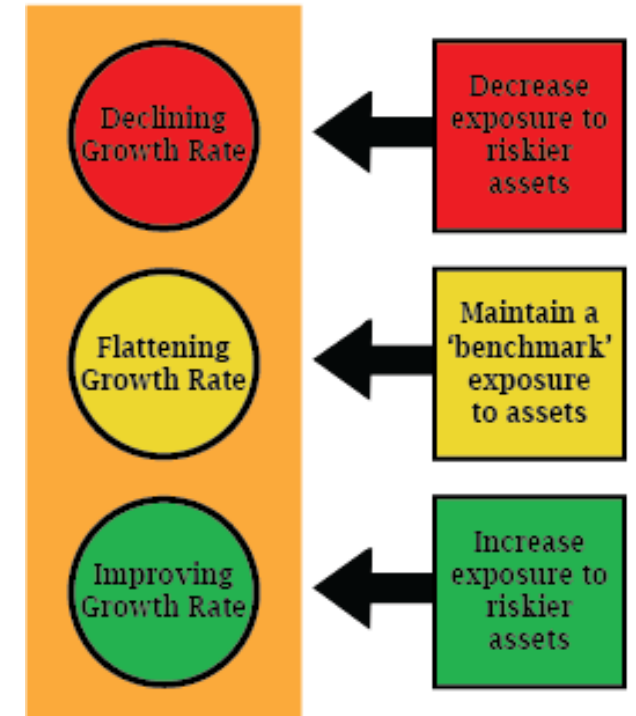**Dynamic Allocation**: Dynamic Allocation programs are monitored MONTHLY. These programs start with a core asset allocation and then increase/decrease exposure based on SEM's Economic Models.

"Strategic" Asset Allocation Models ✚ SEM's Leading Economic Indicator Index

SEM GDP Model Tracking

Informational Purposes Only; SEM's model is based on a multiple regression of historical data of 10 leading economic indicators; The purpose is to give a guide to the direction economic growth tends to be moving. SEM's Dynamic Models then use this to adjust the asset allocation between growth & defensive assets.

Economic Signal

Declining Growth Rate — Decrease exposure to riskier assets

Flattening Growth Rate — Maintain a 'benchmark' exposure to assets

Improving Growth Rate — Increase exposure to riskier assets

What about inflation?

PCE Price Index

SEMWealth.com

(Red Lines Mark Recessions)

- - - 5-Year Average   - - - 10-Year Average   - - - 20-Year Average

BULLS: Inflation is coming back down to the Fed's "target" around 2%, which is the level we enjoyed over the past 20 years / the turn-up in inflation is temporary.

% Chg vs 1 Yr Ago

14%
12%
10%
8%
6%
4%
2%
0%
-2%

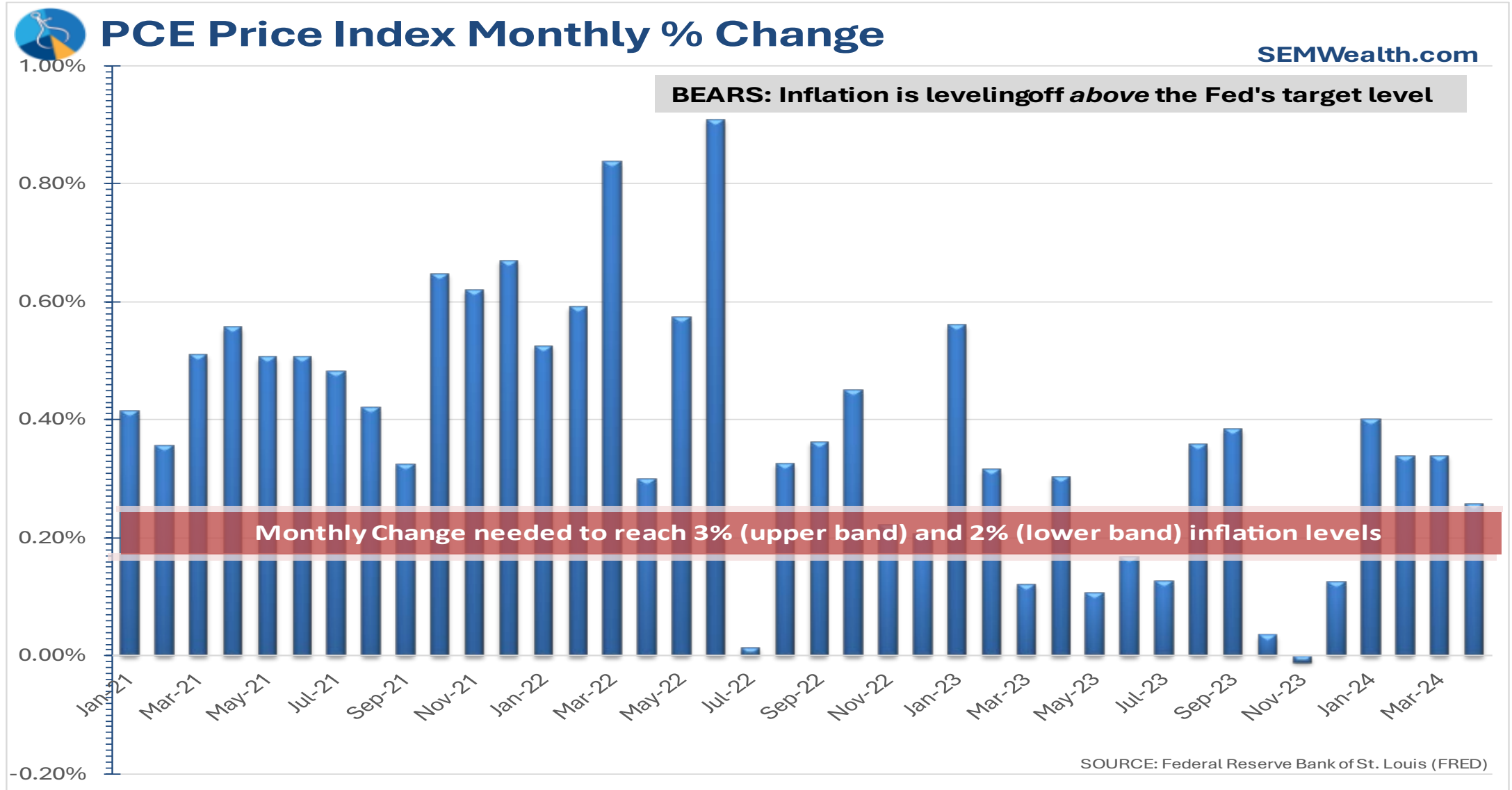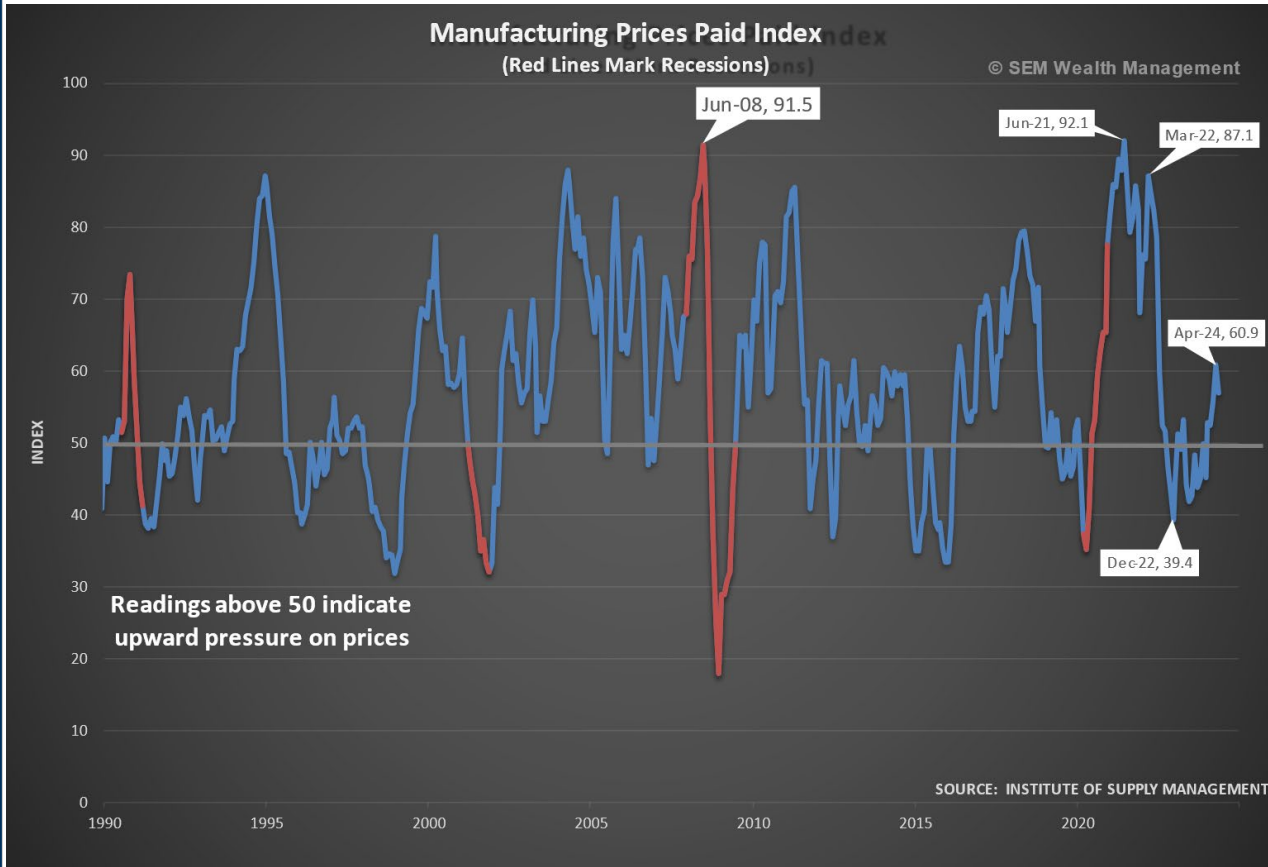1980   1985   1990   1995   2000   2005   2010   2015   2020
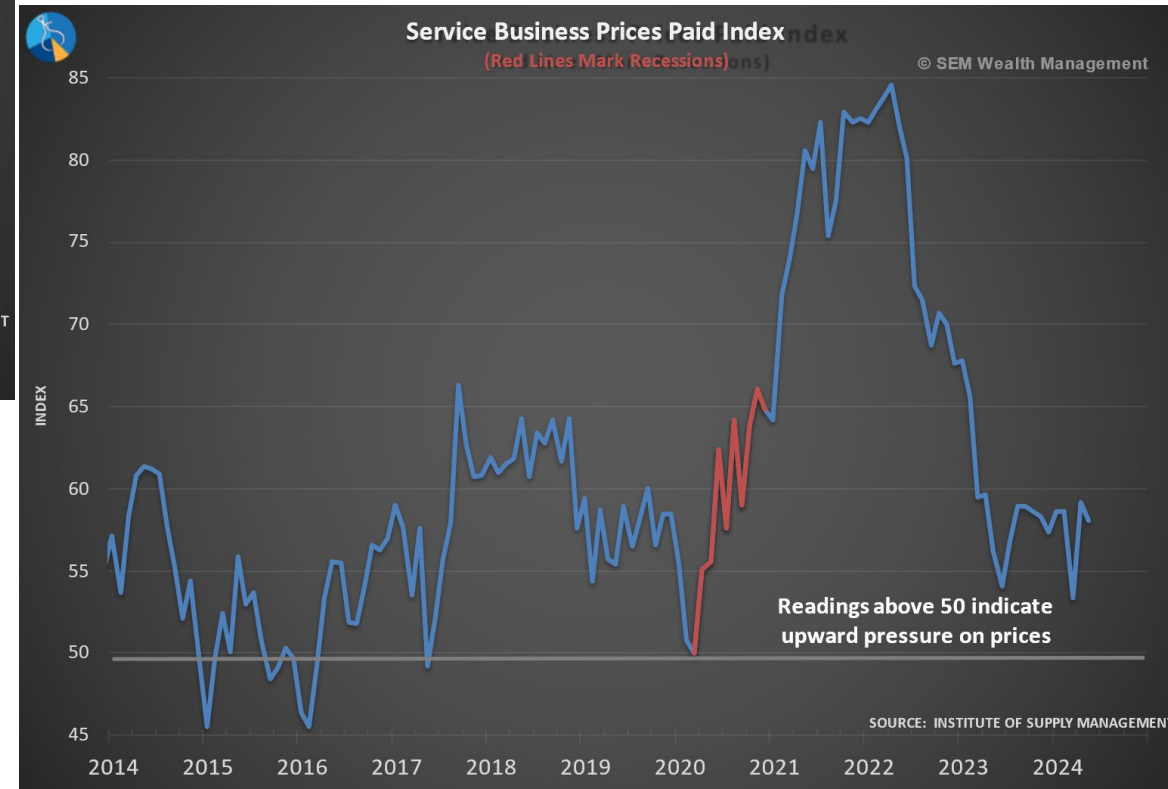
Apr-24

SOURCE: Federal Reserve Bank of St. Louis

What about inflation?

Manufacturing Prices Paid Index
(Red Lines Mark Recessions)
© SEM Wealth Management

Jun-08, 91.5
Jun-21, 92.1
Mar-22, 87.1
Apr-24, 60.9
Dec-22, 39.4

Readings above 50 indicate upward pressure on prices

SOURCE: INSTITUTE OF SUPPLY MANAGEMENT

Inflationary pressure is building in both the manufacturing and services sectors.

Service Business Prices Paid Index
(Red Lines Mark Recessions)
© SEM Wealth Management

Readings above 50 indicate upward pressure on prices

SOURCE: INSTITUTE OF SUPPLY MANAGEMENT

The "K-Shaped" Economy

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Stimulus Checks

Fed Cuts Interest Rates

Congress $5T Stimulus

US Borrows $5T − Wall Street Buys $5T = $0 in circulation

$10T = Wall Street Receives $5T ← Fed Reserve QE $5T
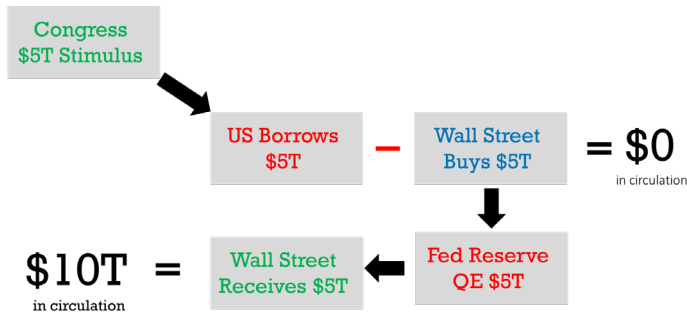
Inflation Escalates

Fed Hikes Interest Rates

Fed Rate HIKES
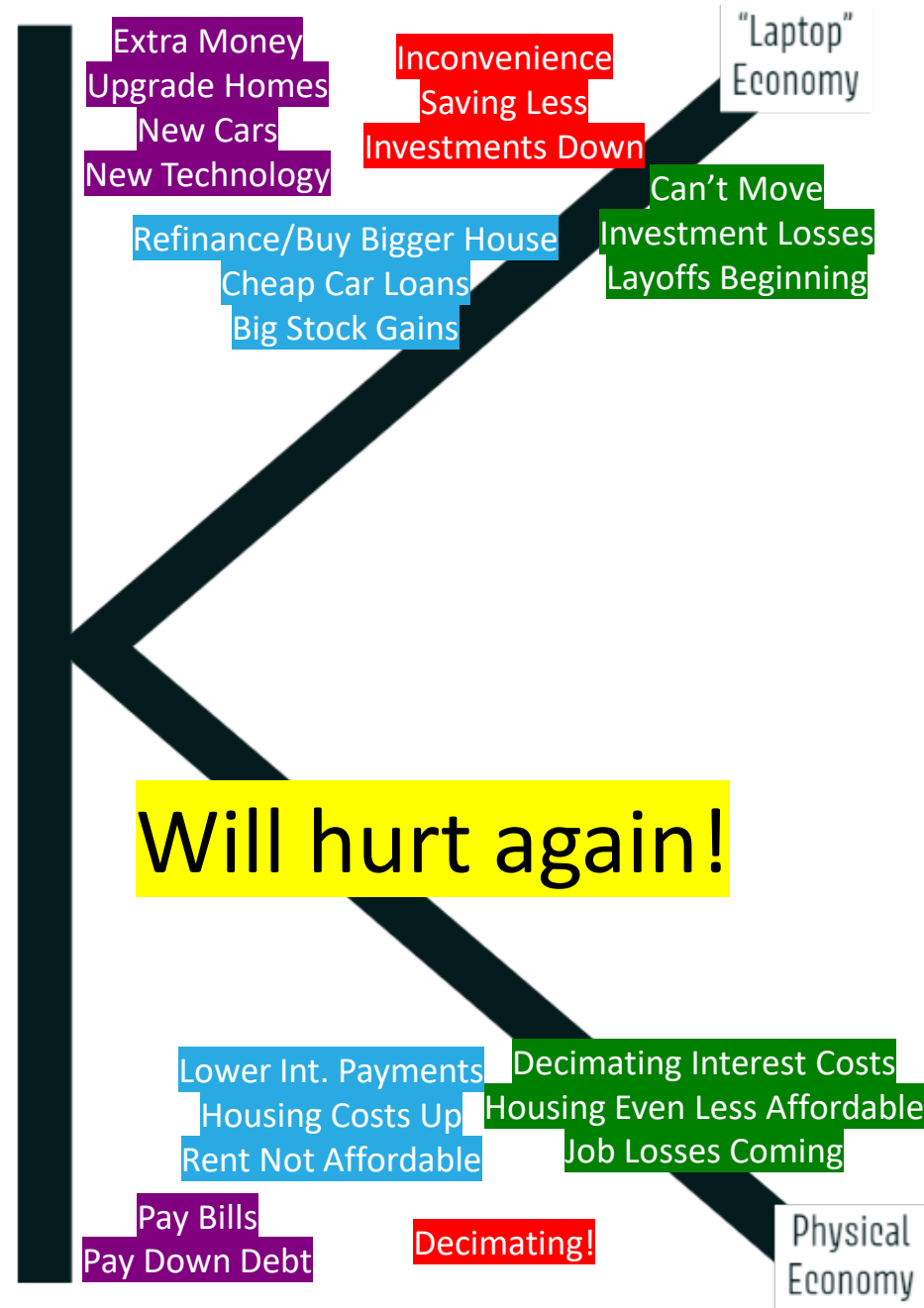
"Laptop" Economy

Extra Money
Upgrade Homes
New Cars
New Technology

Inconvenience
Saving Less
Investments Down

Can't Move
Investment Losses
Layoffs Beginning

Refinance/Buy Bigger House
Cheap Car Loans
Big Stock Gains

Will hurt again!

Lower Int. Payments
Housing Costs Up
Rent Not Affordable

Decimating Interest Costs
Housing Even Less Affordable
Job Losses Coming

Pay Bills
Pay Down Debt

Decimating!

Physical Economy

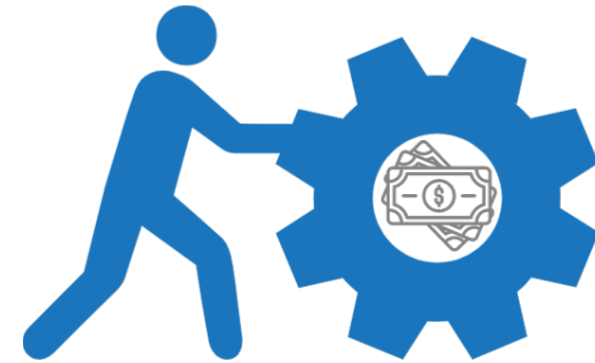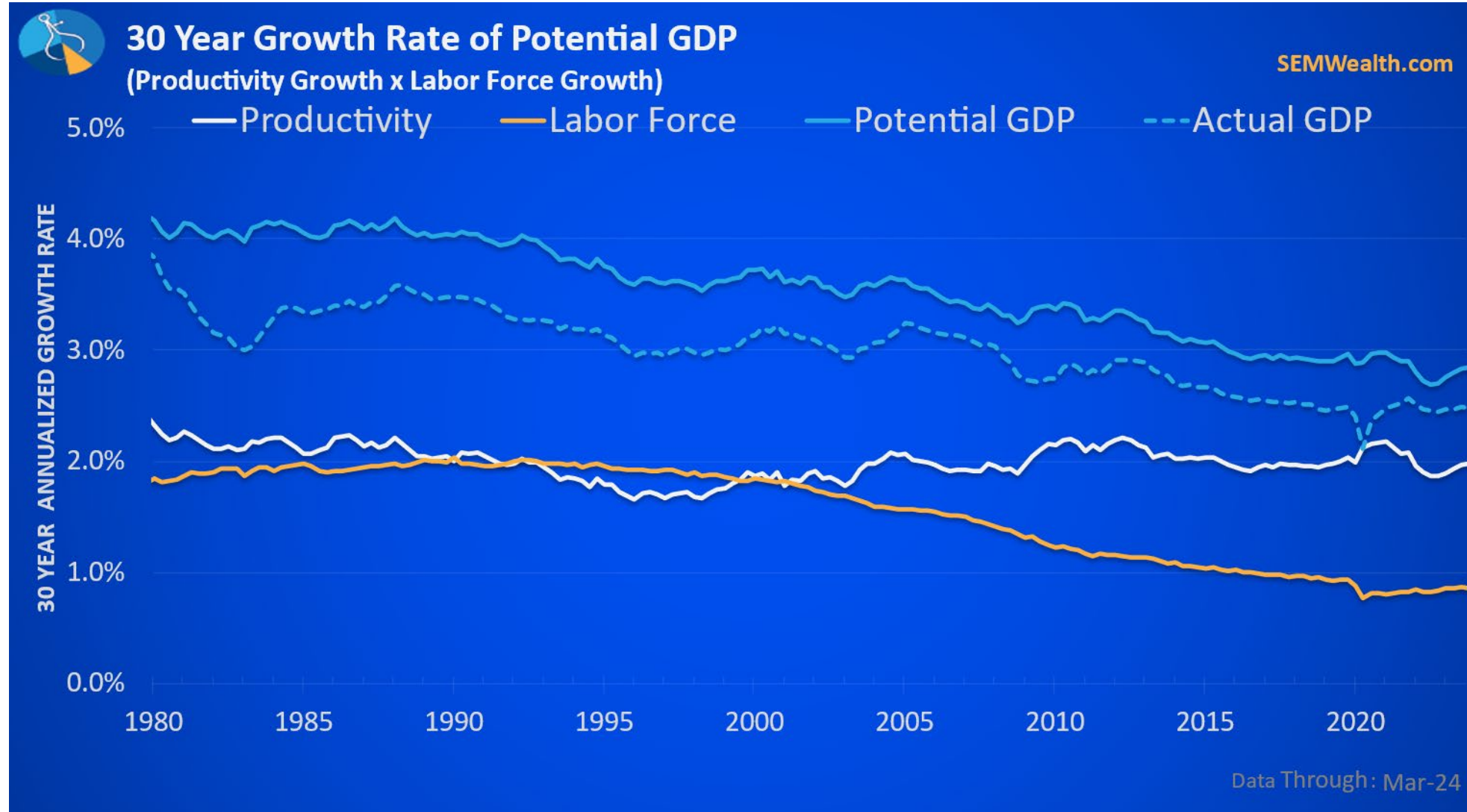# Revisiting the Potential GDP Equation

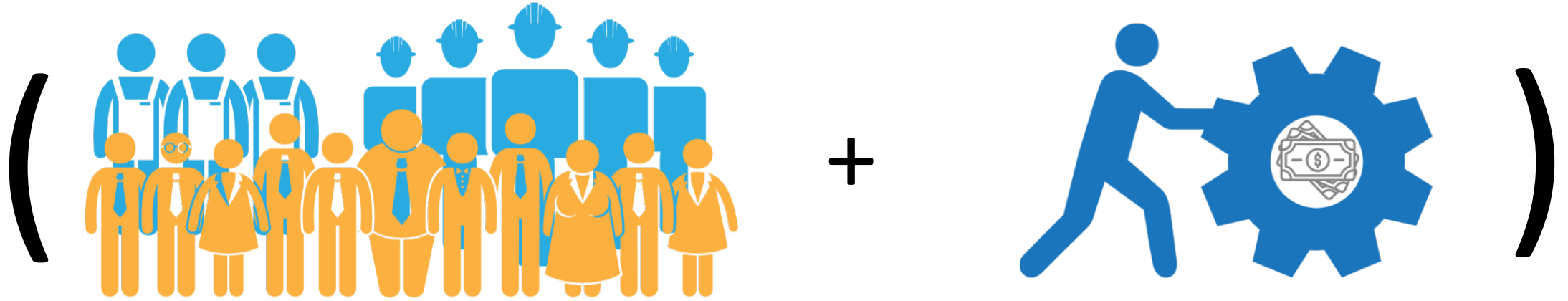How many people are working?

+

How much are they producing?

Revisiting the Potential GDP Equation

30 Year Growth Rate of Potential GDP
(Productivity Growth x Labor Force Growth)

SEMWealth.com

Legend: —— Productivity —— Labor Force —— Potential GDP - - - Actual GDP

Y-axis: 30 YEAR ANNUALIZED GROWTH RATE — 0.0%, 1.0%, 2.0%, 3.0%, 4.0%, 5.0%

X-axis: 1980, 1985, 1990, 1995, 2000, 2005, 2010, 2015, 2020

Data Through: Mar-24

Bar chart:
- Long-term: Potential 3.5%, Actual GDP 3.1%
- 30 Year: Potential 2.8%, Actual GDP 2.5%

Legend: ■ Potential ■ Actual GDP

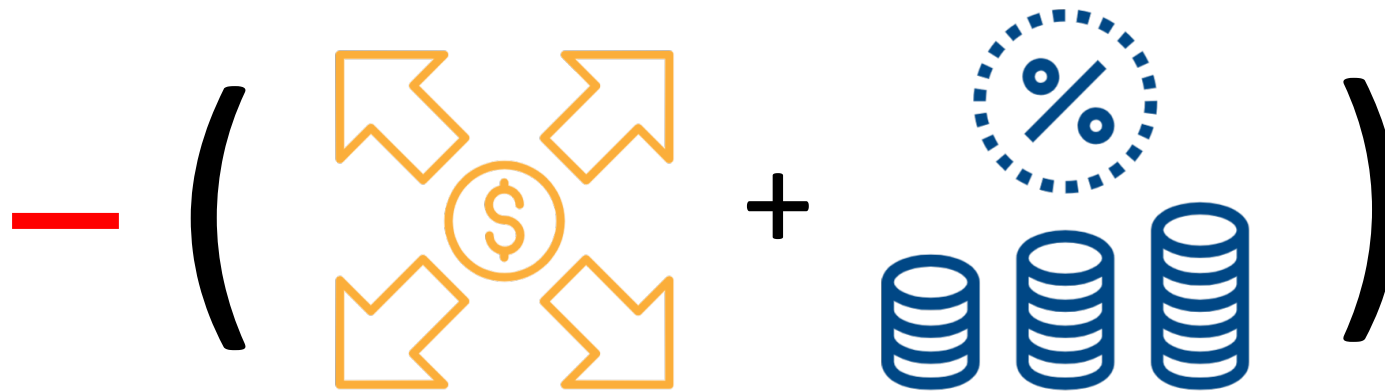GDP has consistently grown below potential
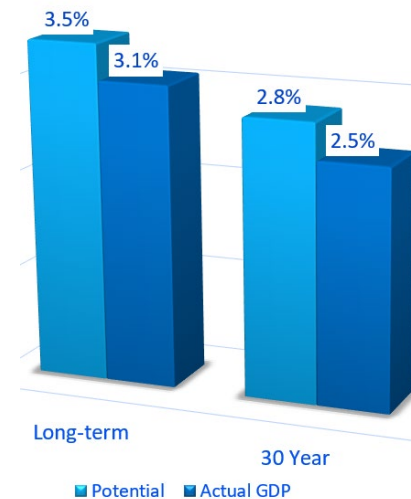
Revisiting the Potential GDP Equation

How many people are working?
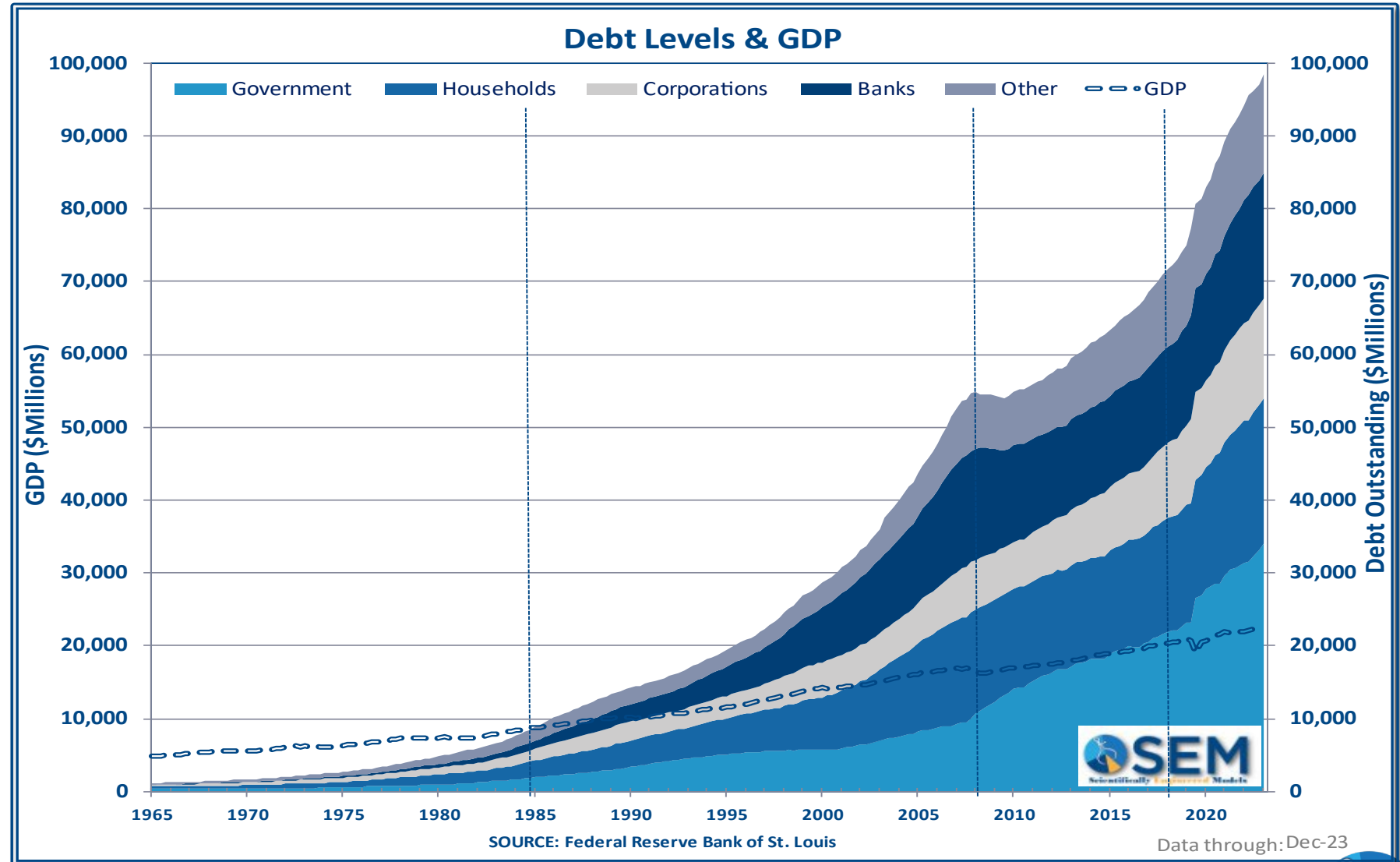
How much are they producing?

Net Exports

Interest Expense

Debt = Future Spending Brought Forward

- Debt is useful if used to INVEST in areas which will increase the growth rate

- If used for current spending, it is a drag on future growth
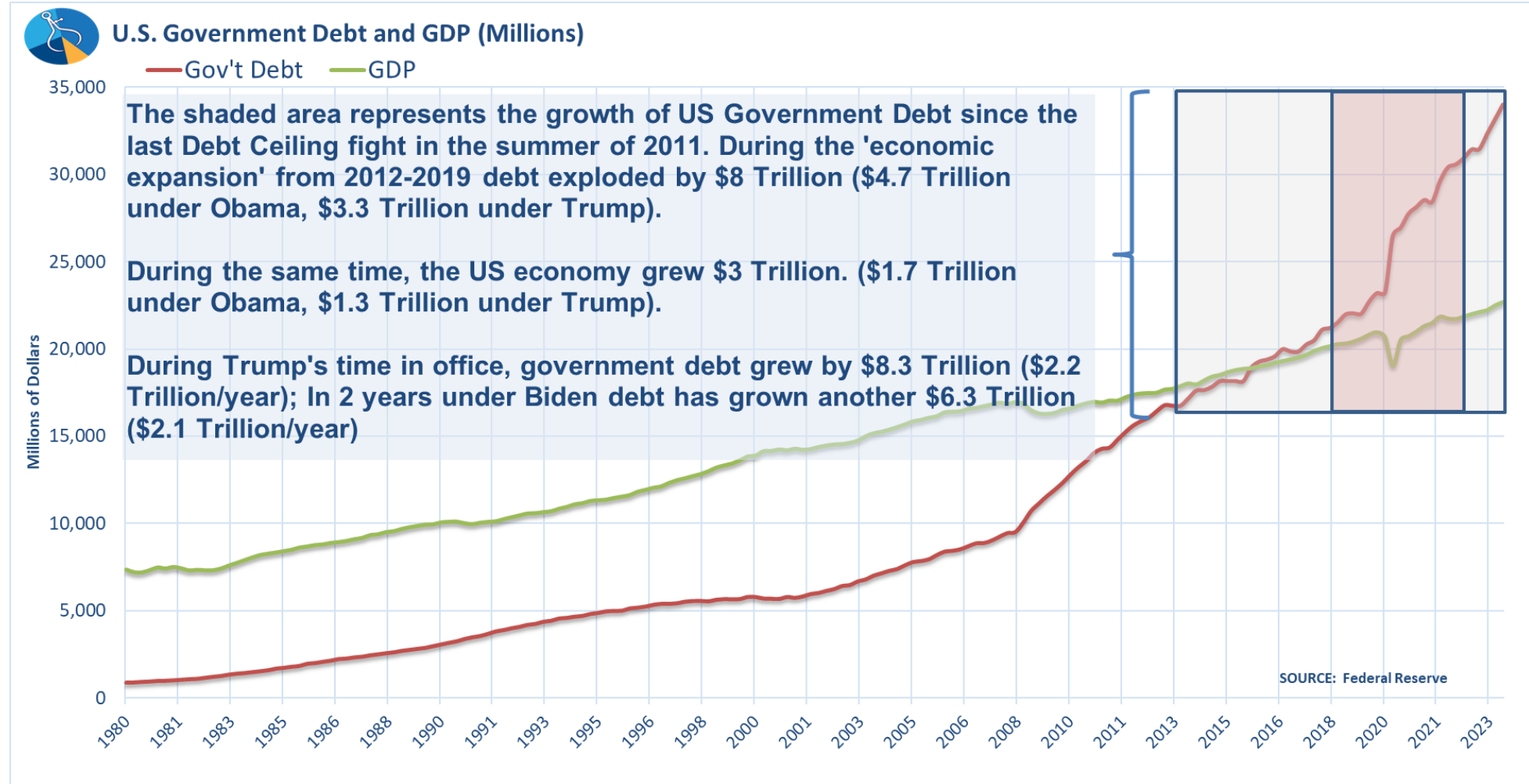
- Key turning points: 1984, 2009, 2012, 2018

Debt Levels & GDP

Legend: Government, Households, Corporations, Banks, Other, GDP

SOURCE: Federal Reserve Bank of St. Louis

Data through: Dec-23

Politics & the Economy

Preparing your portfolio for the results of the election

Post 2012 Economy fueled by debt

U.S. Government Debt and GDP (Millions)

— Gov't Debt — GDP

The shaded area represents the growth of US Government Debt since the last Debt Ceiling fight in the summer of 2011. During the 'economic expansion' from 2012-2019 debt exploded by $8 Trillion ($4.7 Trillion under Obama, $3.3 Trillion under Trump).

During the same time, the US economy grew $3 Trillion. ($1.7 Trillion under Obama, $1.3 Trillion under Trump).

During Trump's time in office, government debt grew by $8.3 Trillion ($2.2 Trillion/year); In 2 years under Biden debt has grown another $6.3 Trillion ($2.1 Trillion/year)

Millions of Dollars

35,000
30,000
25,000
20,000
15,000
10,000
5,000
0

1980 1981 1983 1985 1986 1988 1990 1991 1993 1995 1996 1998 2000 2001 2003 2005 2006 2008 2010 2011 2013 2015 2016 2018 2020 2021 2023

SOURCE: Federal Reserve

Who is responsible for the debt?

Annualized Rate of Change During Last 7 Presidencies

SEMWealth.com

■ Reagan ■ H.W.Bush ■ Clinton ■ G.W.Bush ■ Obama ■ Trump ■ Biden

PublicDebt

ANNUALIZED CHANGE DURING PRESIDENTIAL TERM

14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%

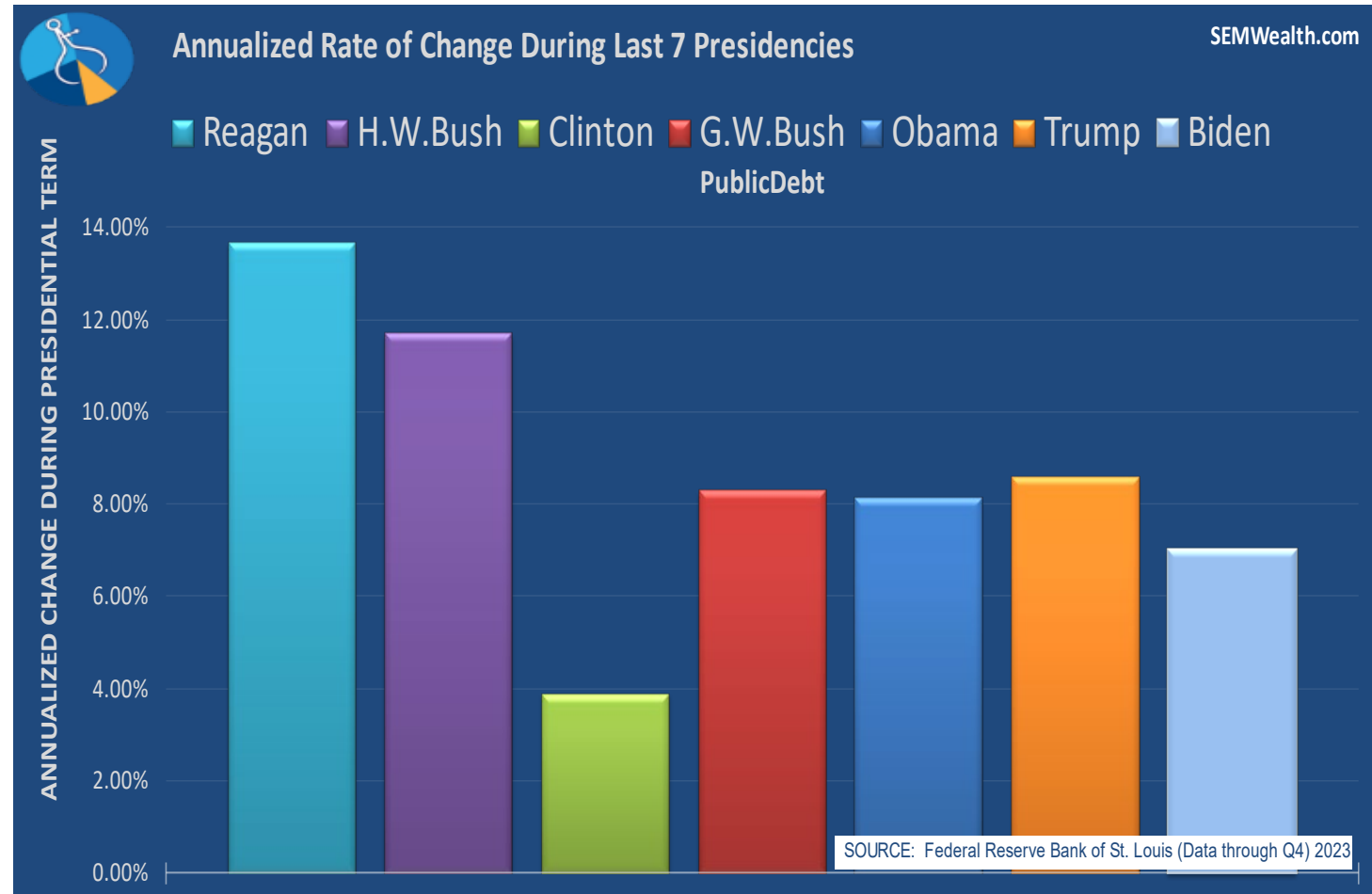SOURCE: Federal Reserve Bank of St. Louis (Data through Q4) 2023
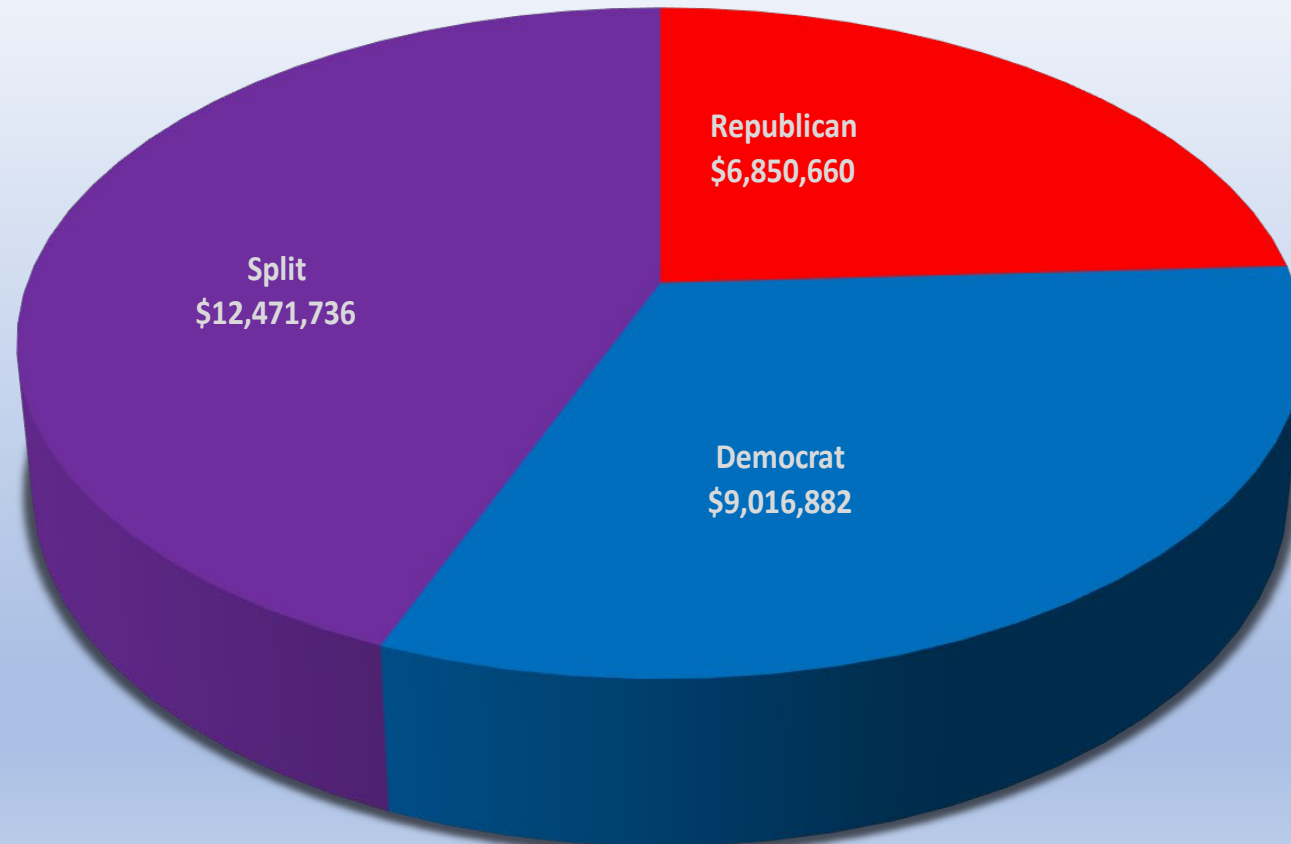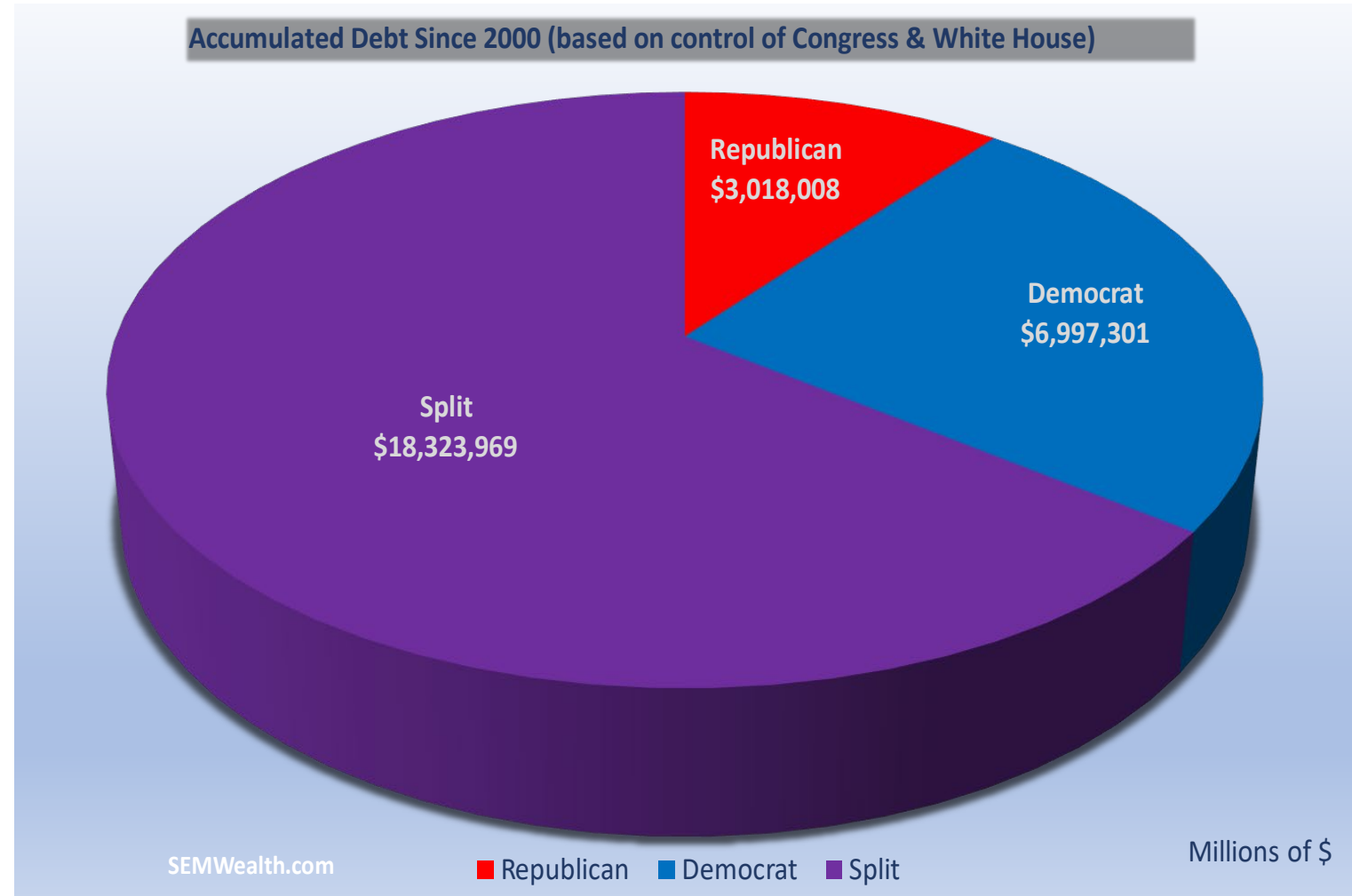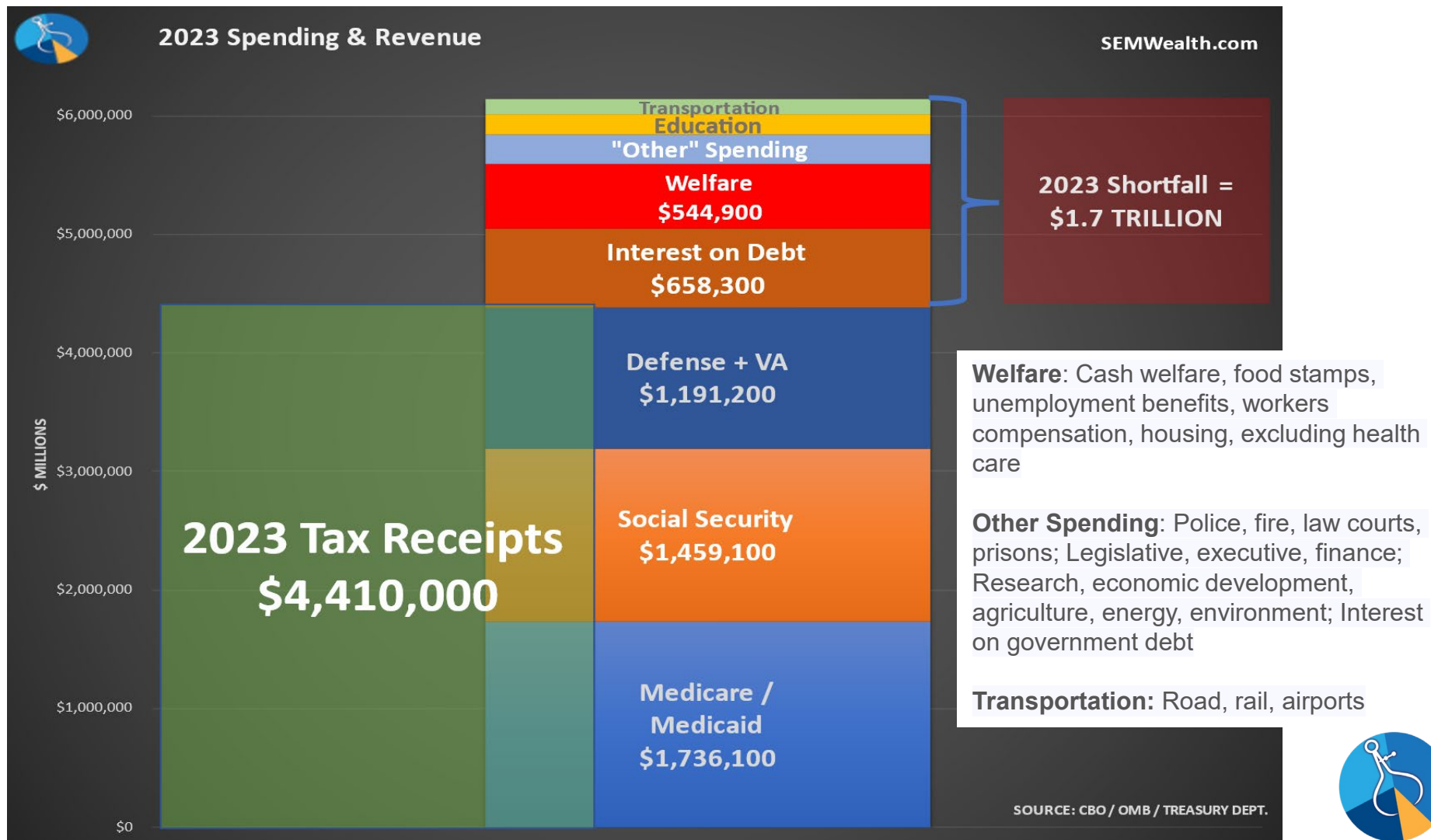
What is responsible for the debt?

What is responsible for the debt?
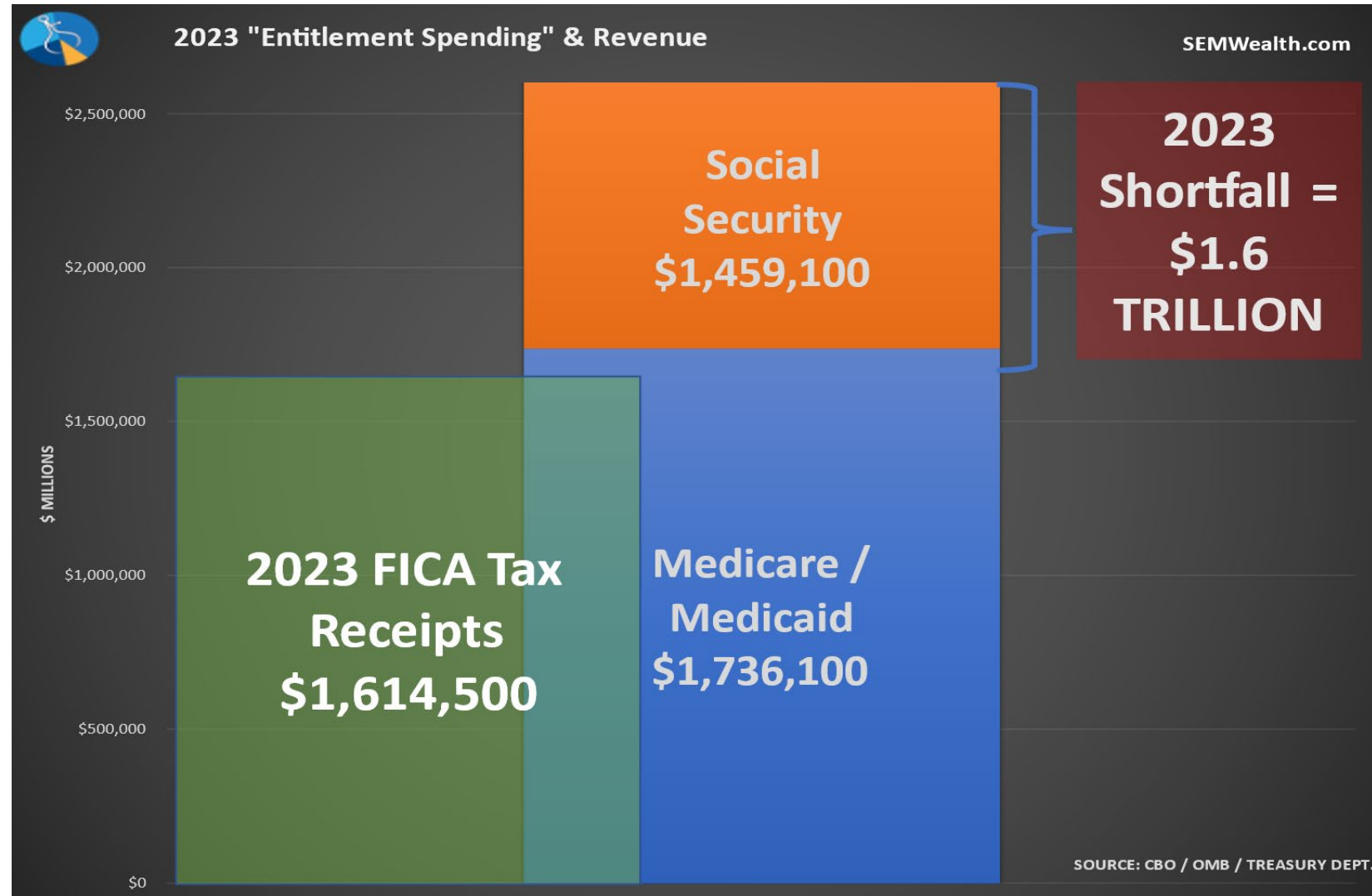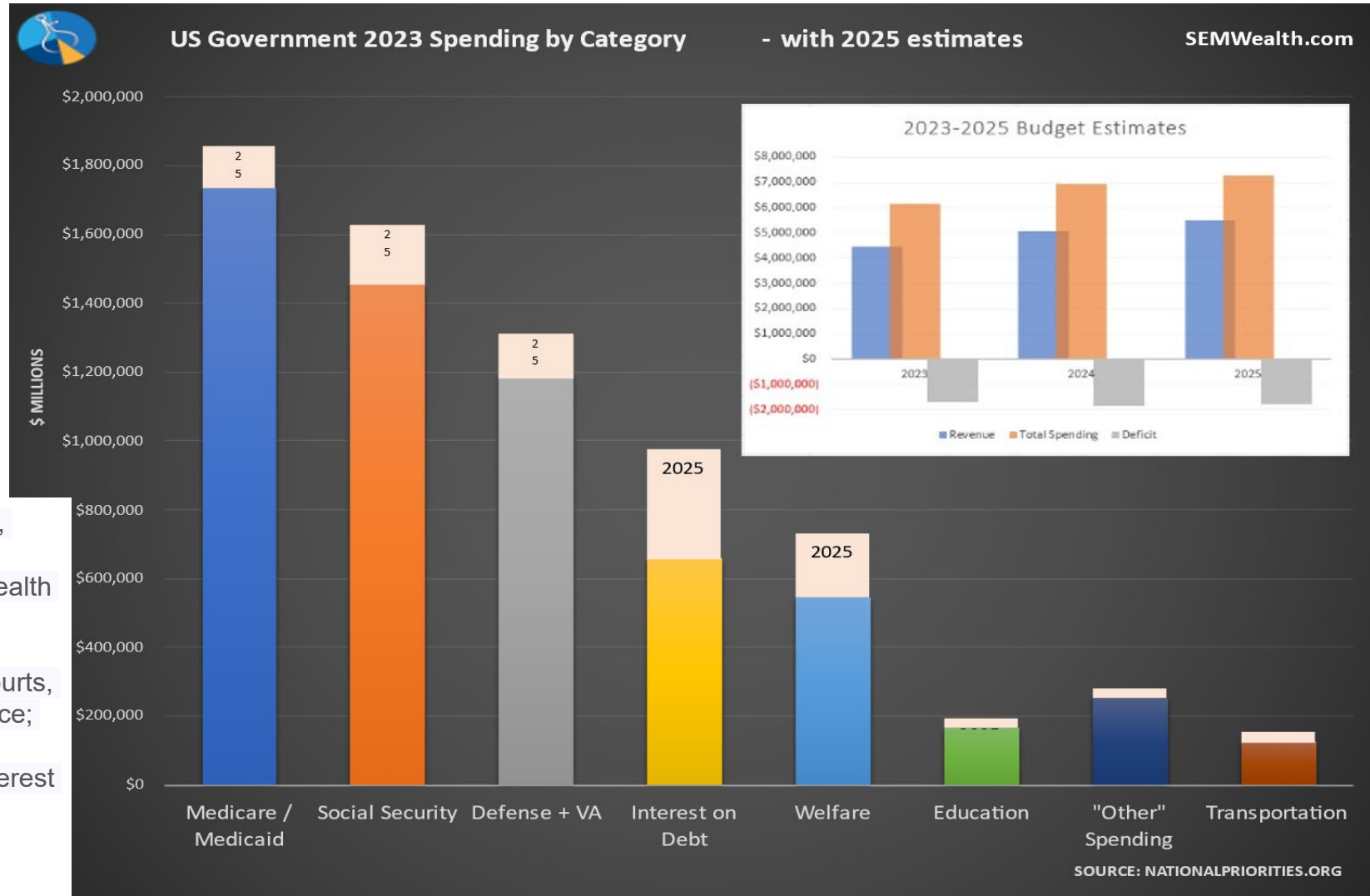
What is responsible for the debt?
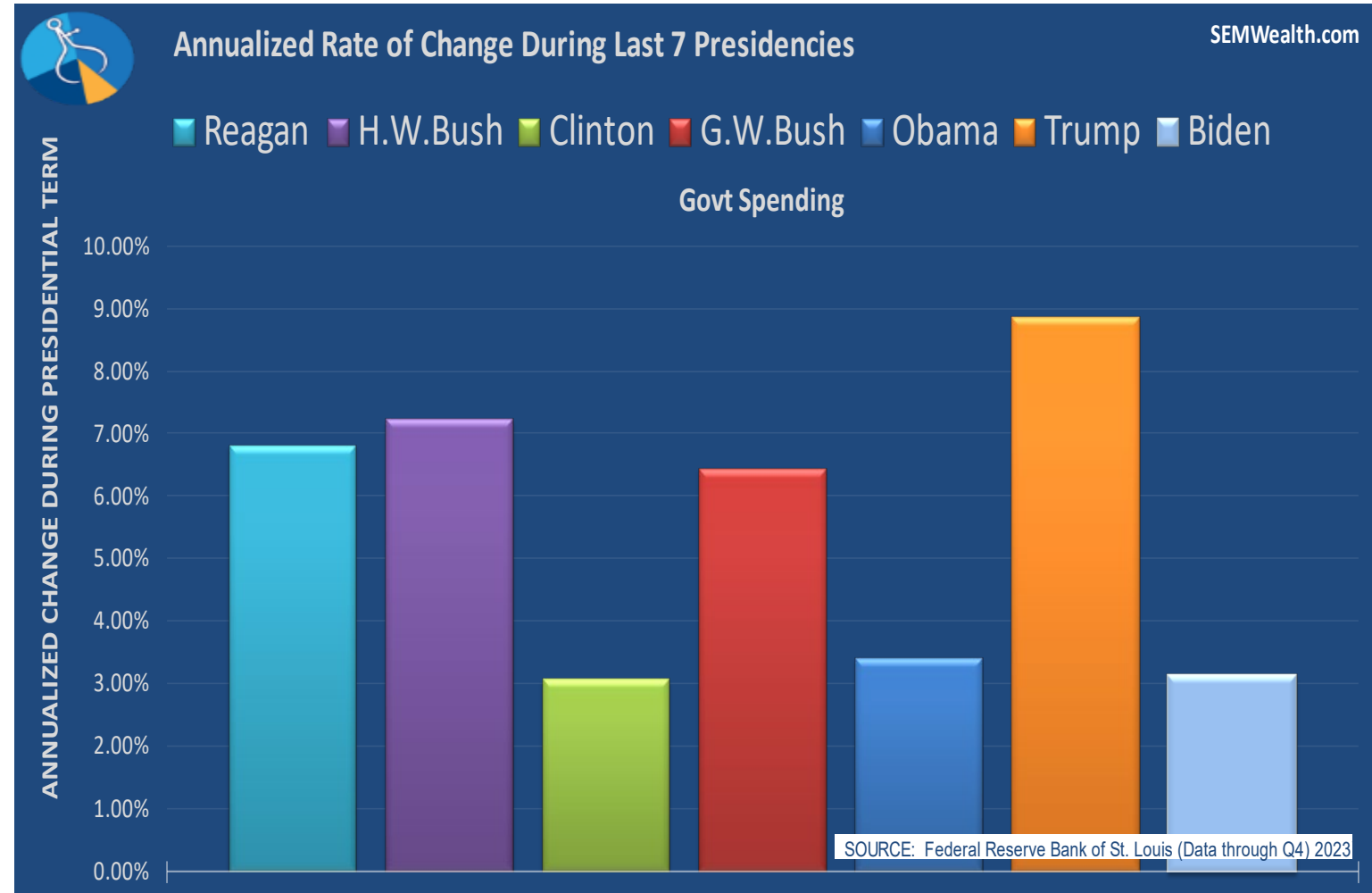
What is responsible for the debt?

Welfare: Cash welfare, food stamps, unemployment benefits, workers compensation, housing, excluding health care

Other Spending: Police, fire, law courts, prisons; Legislative, executive, finance; Research, economic development, agriculture, energy, environment; Interest on government debt

Transportation: Road, rail, airports

US Government 2023 Spending by Category — with 2025 estimates

2023-2025 Budget Estimates
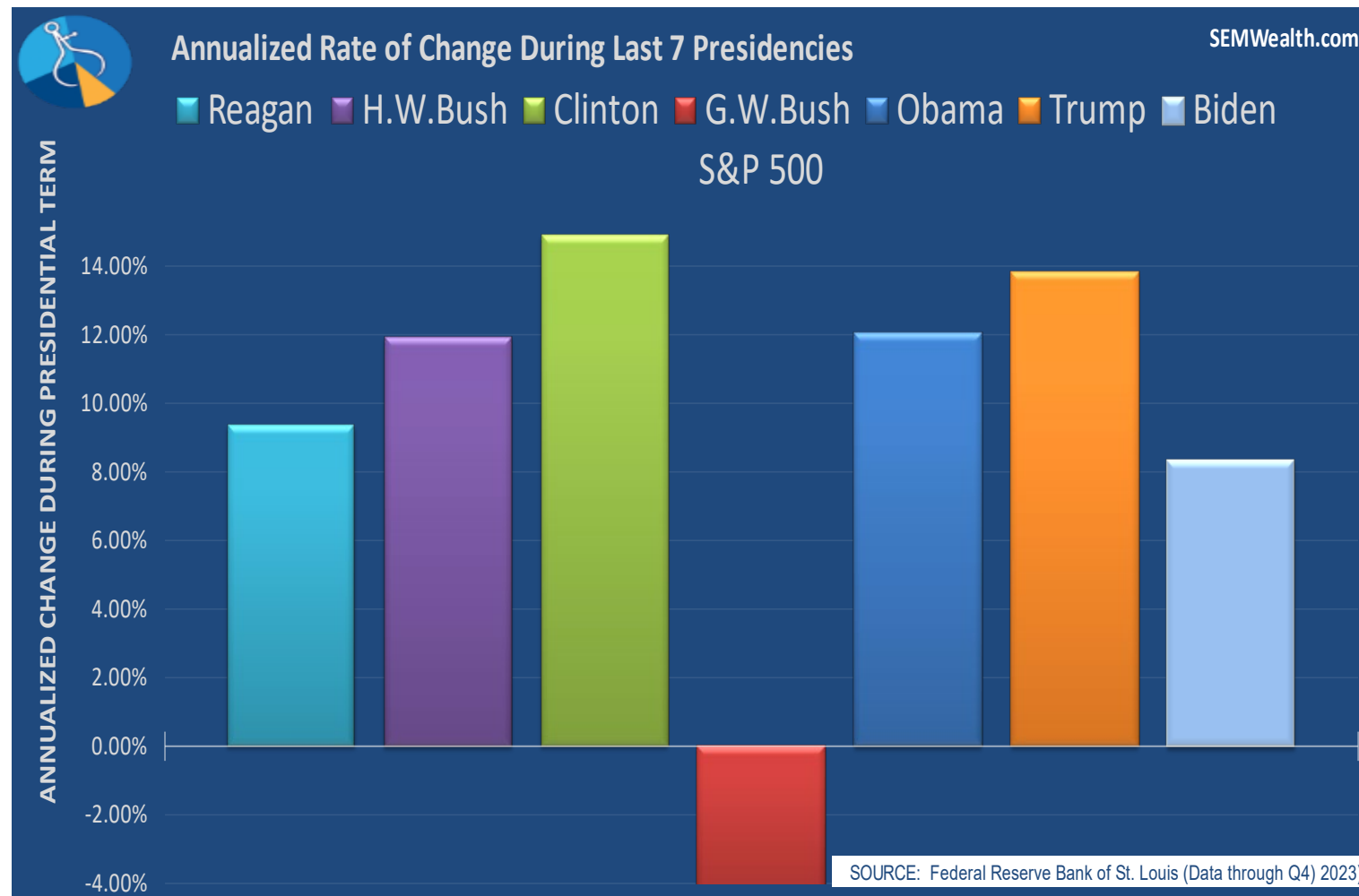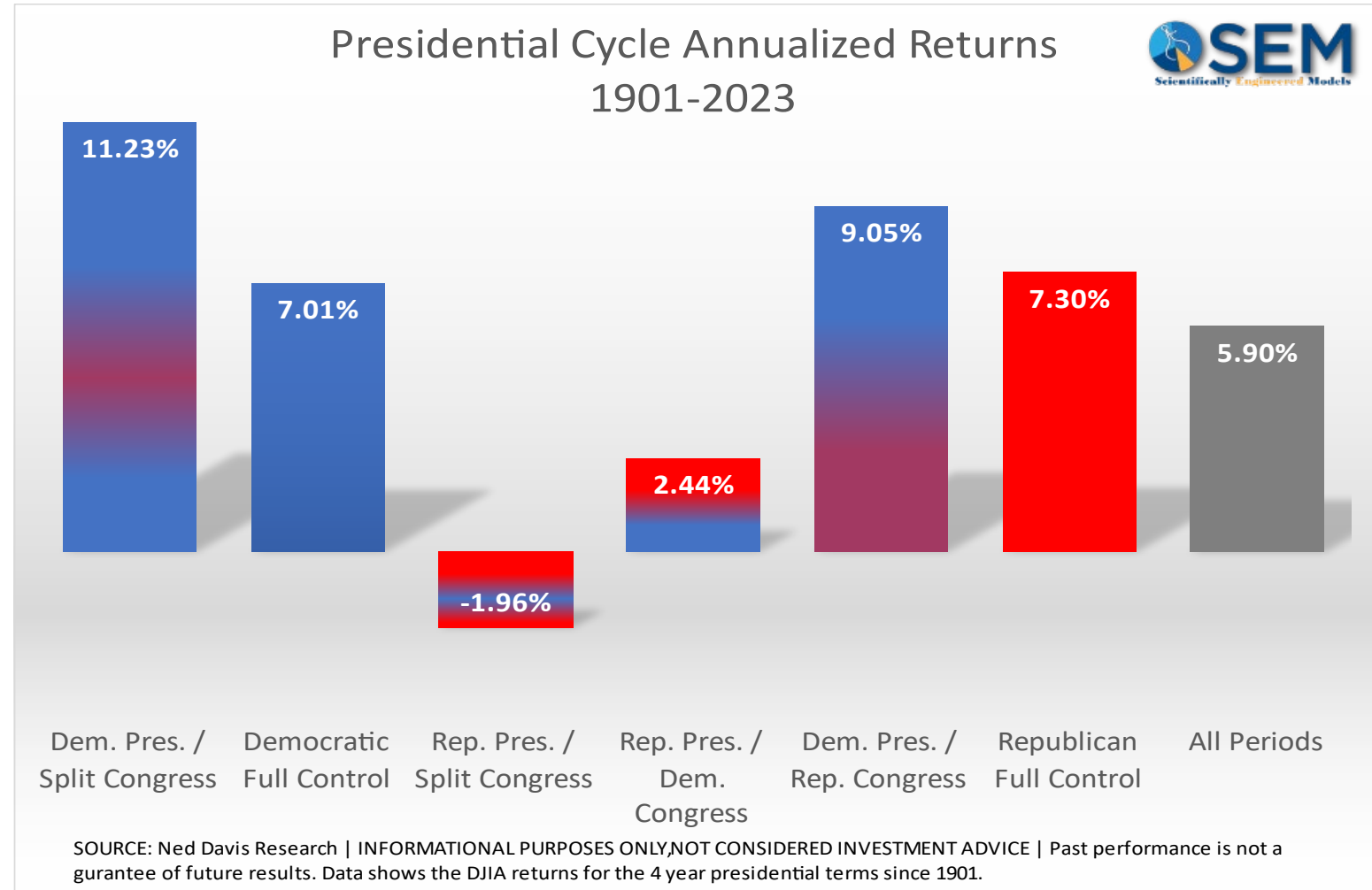
SOURCE: NATIONALPRIORITIES.ORG

Politics & Stocks

Preparing your portfolio for the results of the election

Which party does the market love the most?

Which party does the market love the most?
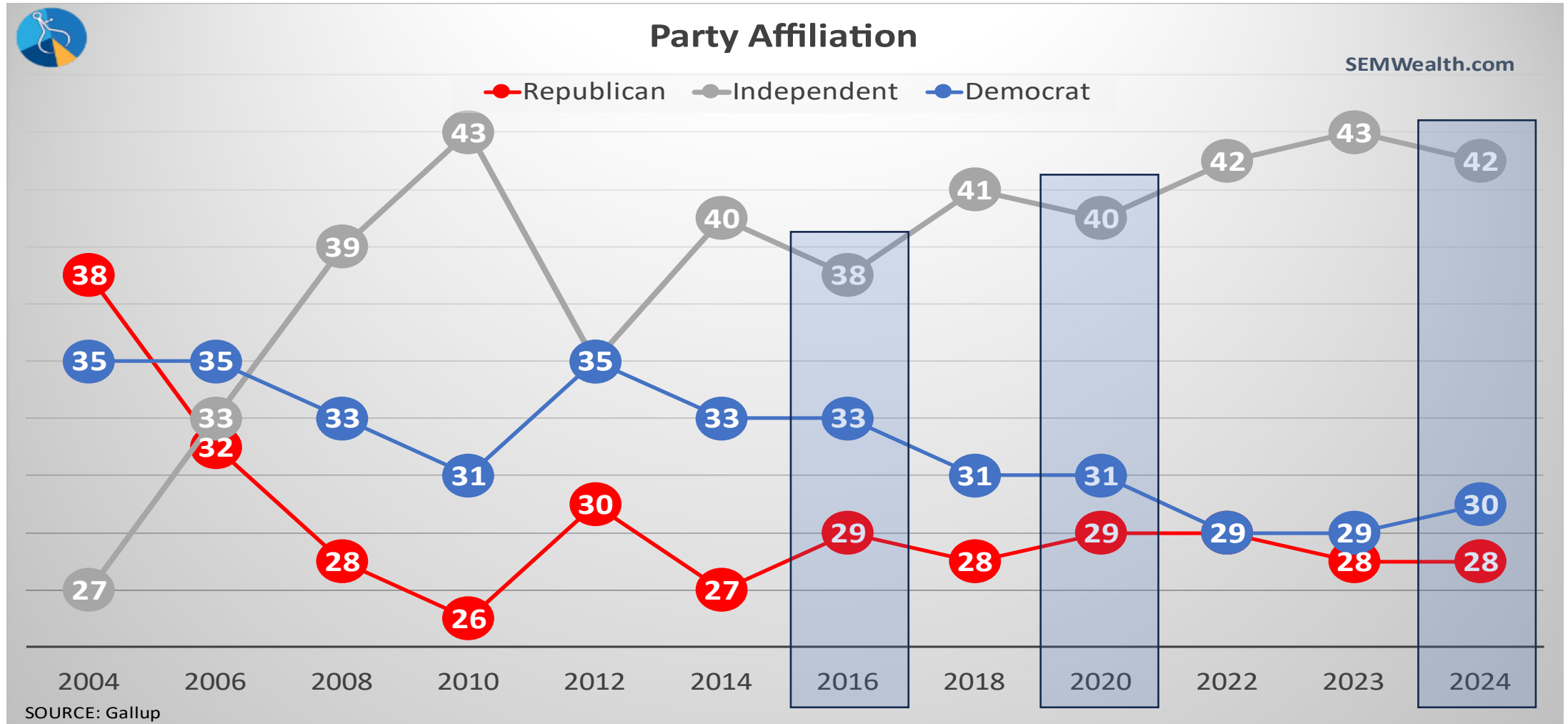
Presidential Cycle Annualized Returns 1901-2023

Category	Return
Dem. Pres. / Split Congress	11.23%
Democratic Full Control	7.01%
Rep. Pres. / Split Congress	-1.96%
Rep. Pres. / Dem. Congress	2.44%
Dem. Pres. / Rep. Congress	9.05%
Republican Full Control	7.30%
All Periods	5.90%

SOURCE: Ned Davis Research | INFORMATIONAL PURPOSES ONLY,NOT CONSIDERED INVESTMENT ADVICE | Past performance is not a gurantee of future results. Data shows the DJIA returns for the 4 year presidential terms since 1901.

Which party does the market love the most?

Presidential Cycle Annualized Returns
1933-2022

All Elections	Republican Sweep	Democratic Sweep	Rep. Pres / Divided Congress	Dem. Pres / Divided Congress
9.50%	8.90%	9.00%	13.70%	13.60%

SOURCE: Fidelity | INFORMATIONAL PURPOSES ONLY,NOT CONSIDERED INVESTMENT ADVICE | Past performance is not a gurantee of future results. Data shows the S&P 500 returns for the 4 year presidential terms since 1933.

We must understand…..

- Major **economic policies** do not change on day 1 (only regulatory guidance as allowed…..after legal challenges)
- Campaign **talking points** do not always become priorities once the election is won
- It is difficult to pass **economic polices** which both sides do not agree with
- The stock market is a 'forward-looking mechanism', meaning it will **anticipate changes BEFORE they happen**
- The stock market historically **prefers a SPLIT** in Washington
- A president not running for re-election could be a scary president, creating more volatility and possible 'unknown' risks
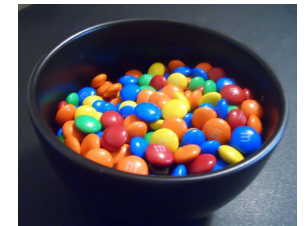
Drs. Daniel Kahneman & Amos Tversky

Your Two Brains
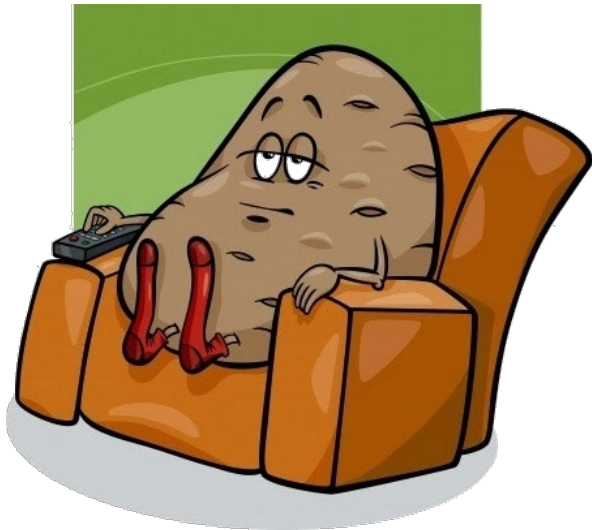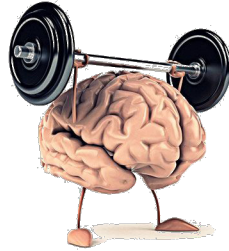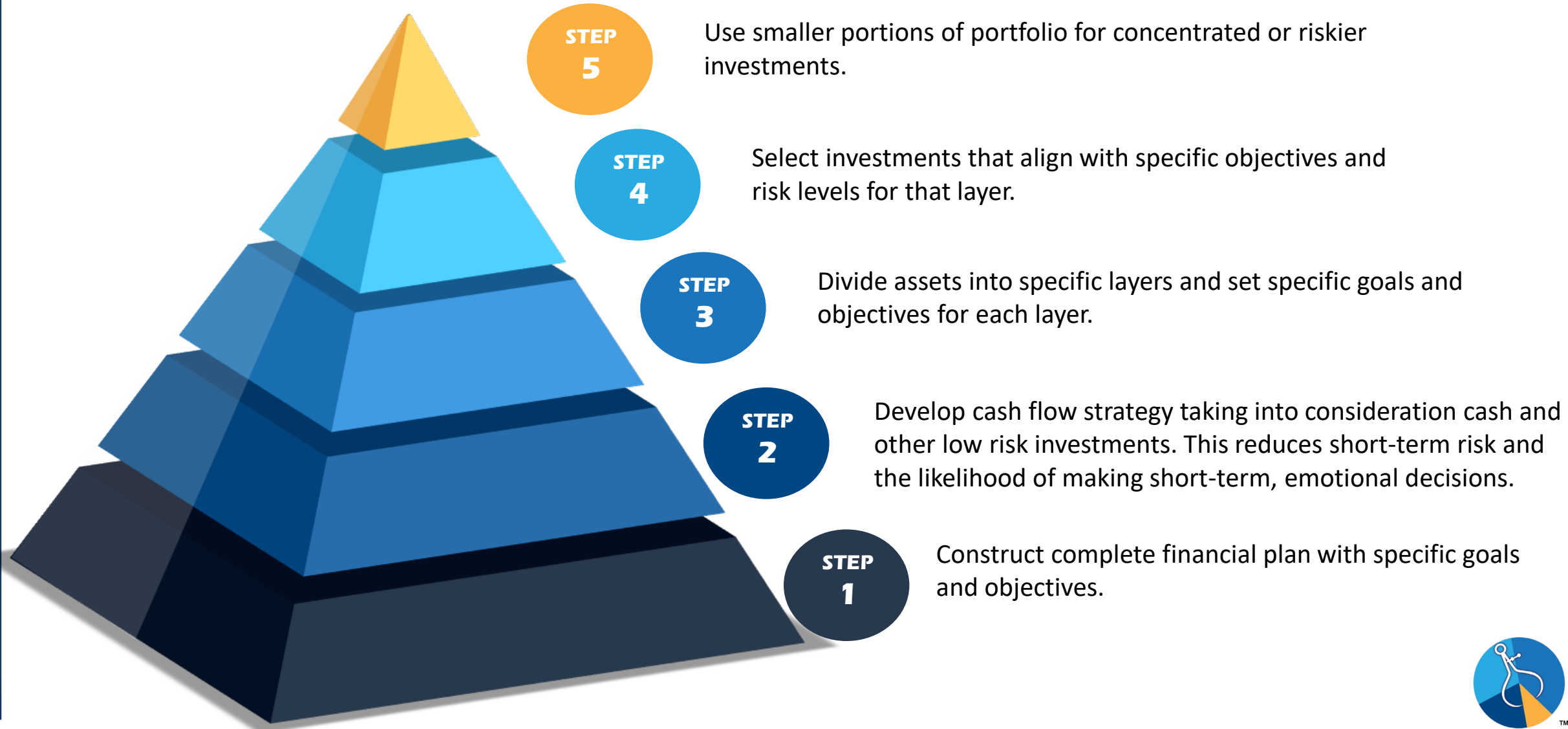

Dr. Richard Thaler

Econs (Robots) vs Humans

Key of Behavioral Finance:

1.) Our brains use short-cuts to make difficult decisions

2.) Our actions do not match the economic models

A Behavioral Portfolio Approach

STEP 5 — Use smaller portions of portfolio for concentrated or riskier investments.

STEP 4 — Select investments that align with specific objectives and risk levels for that layer.

STEP 3 — Divide assets into specific layers and set specific goals and objectives for each layer.

STEP 2 — Develop cash flow strategy taking into consideration cash and other low risk investments. This reduces short-term risk and the likelihood of making short-term, emotional decisions.

STEP 1 — Construct complete financial plan with specific goals and objectives.

Advisor Biases in Selecting Investments

For Financial Planners, the investment allocation process can be the most difficult aspect. Mistakes in this phase can disrupt both the financial plan and cash flow strategies. Model platforms have created additional decisions that tend to accentuate our personal biases
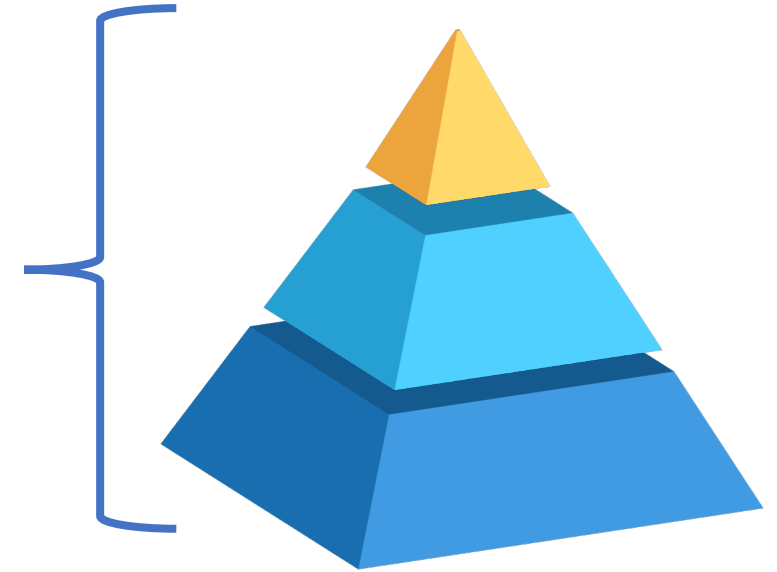
Advisors are expected to:

1. Calculate probabilities of all future events & know impact of said events on investments / strategies
2. Understand cross correlations & event / environment specific correlations for each strategy
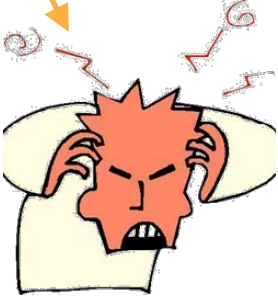
Common Advisor Cognitive Errors :
- Conservatism
- Confirmation
- Representativeness
- Illusion of Control
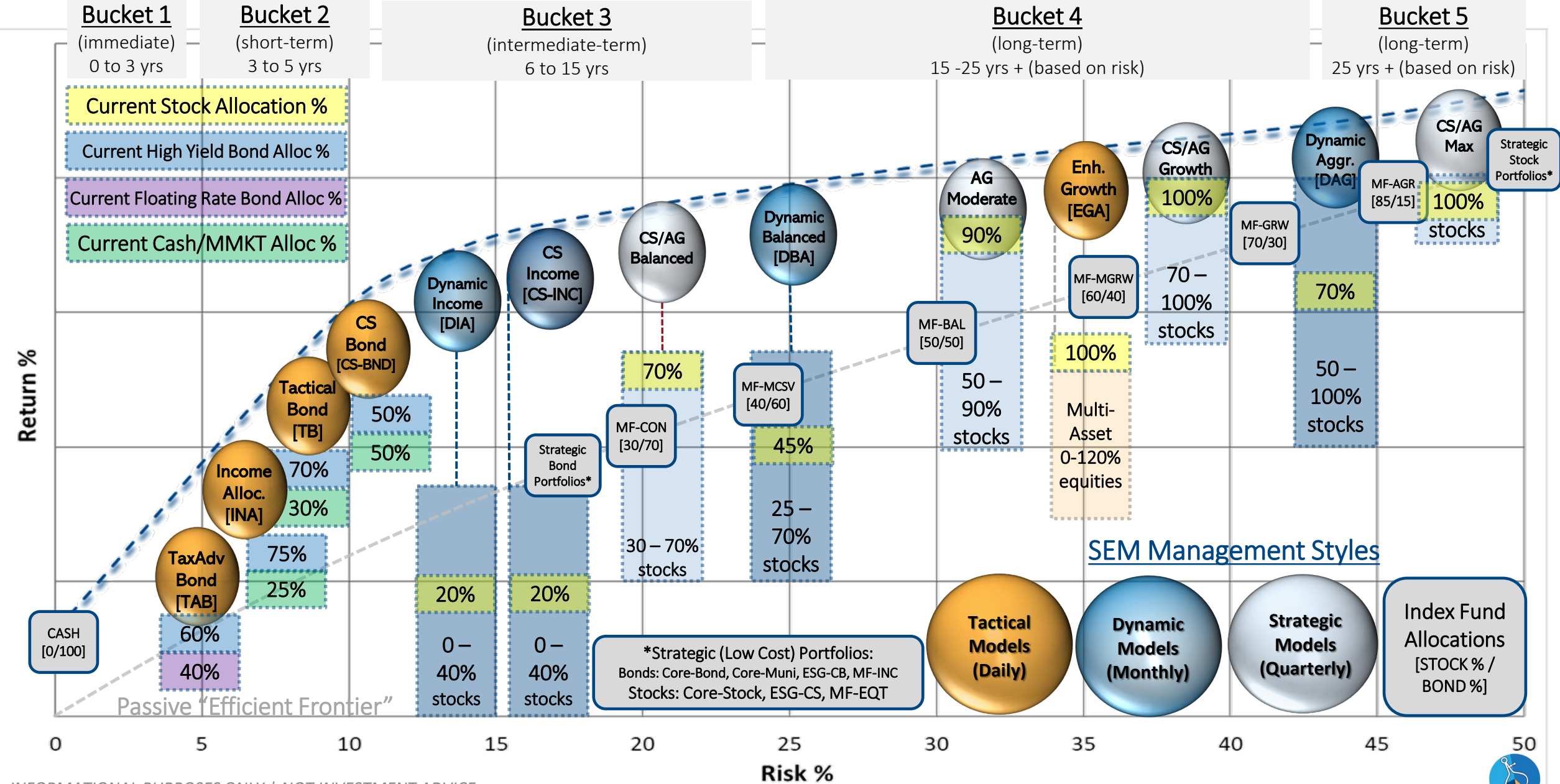- Availability
- Hindsight

Common Advisor Emotional Biases:
- Overconfidence
- Self-control
- Status Quo
- Regret / Loss Aversion

Process in Motion – Allocations as of 6/7/2024

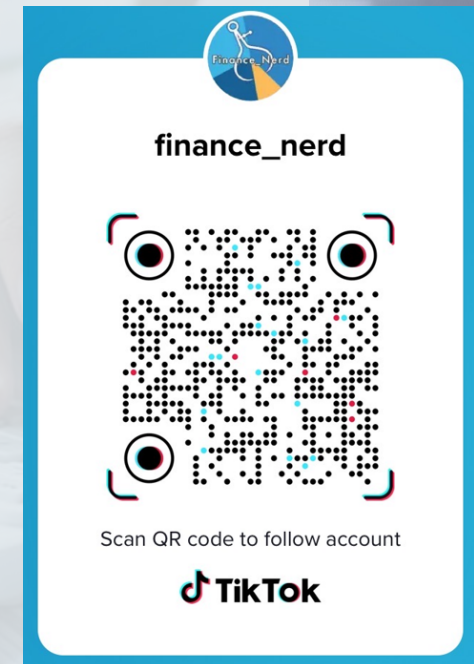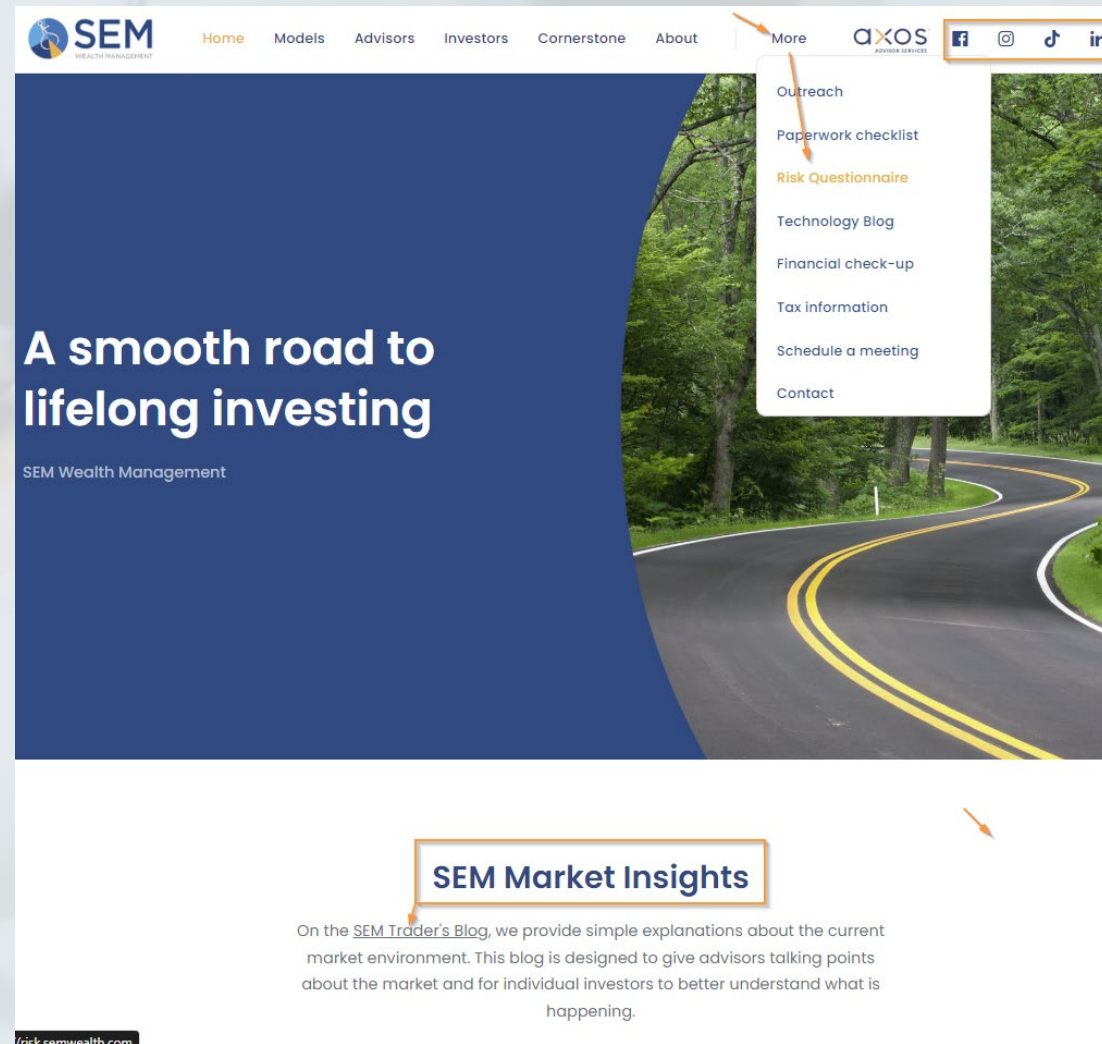INFORMATIONAL PURPOSES ONLY | NOT INVESTMENT ADVICE
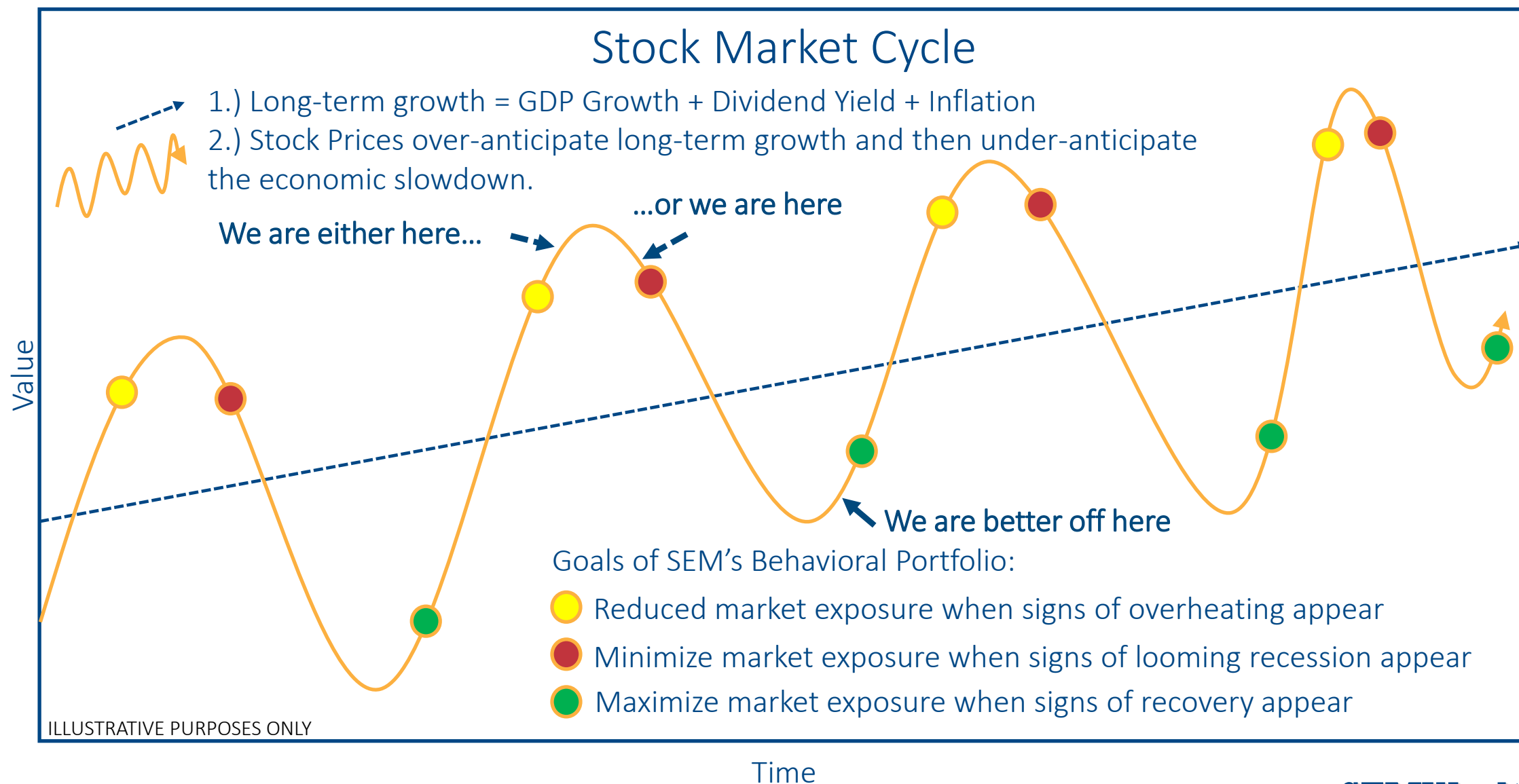
SEM Wealth Management

- Founded in 1992 by Richard Gage a metallurgical engineer

- Co-owner and Chief Investment Officer, Jeff Hybiak, CFA joined in 1998
  - Background in accounting and traditional portfolio management (MPT)

- Outsourced Chief Investment Officer (OCIO) for Financial Planners throughout the country (~2700 accounts)

- Total AUM = $725M as of 3/31/2024

- Primary Custodian is Axos Advisor Services
  - Select models also available on
    - Adhesion/FlexUMA
    - Axiom (Geneos Wealth Management)
    - Via subscription services

- Systematic, data-driven process designed to remove behavioral biases from all areas of the investment process

- 3 Distinct Management Styles – Tactical, Dynamic, and Strategic

SEMWealth.com

For more information go to
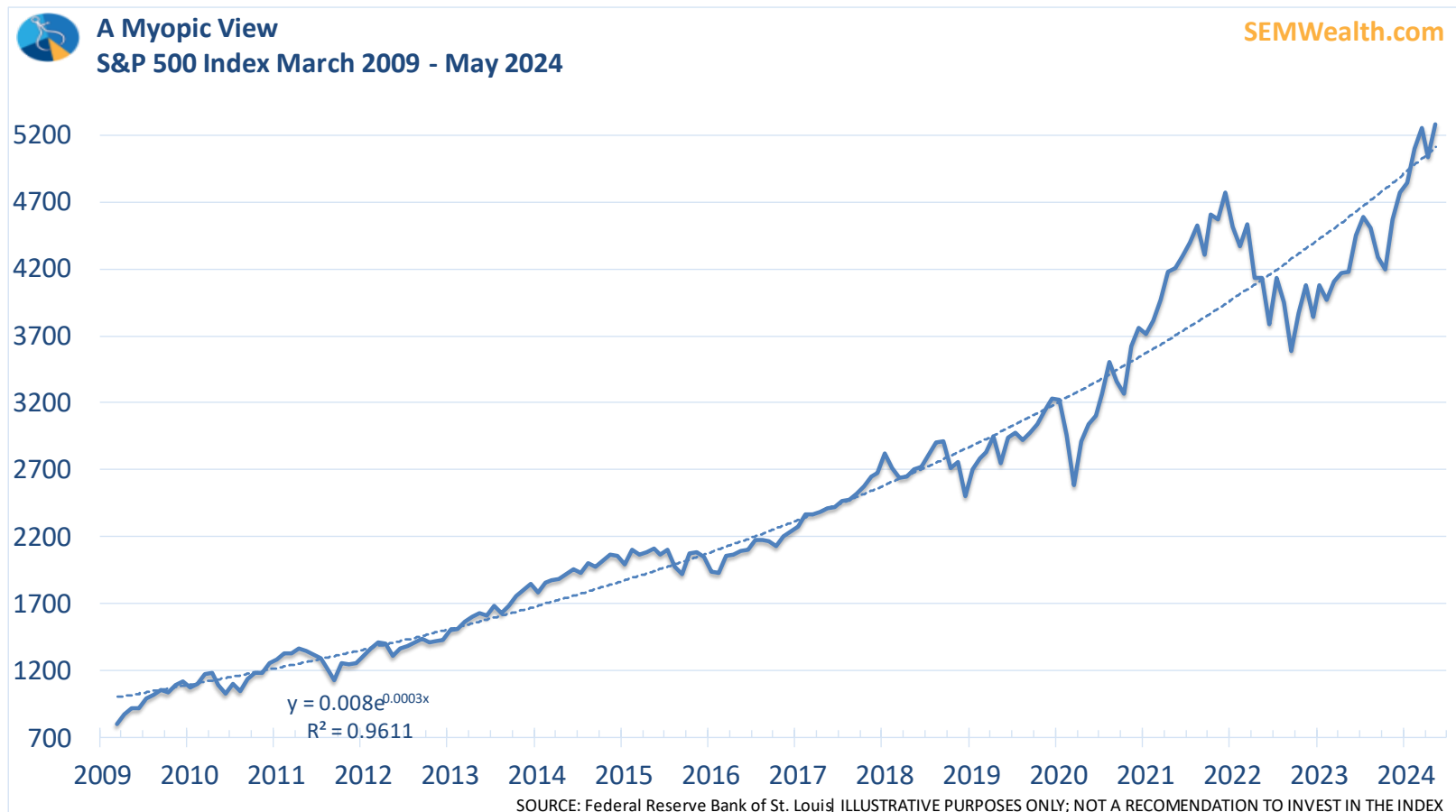## SEMWealth.com

Why use a Behavioral Approach?

Stock Market Cycle

1.) Long-term growth = GDP Growth + Dividend Yield + Inflation

2.) Stock Prices over-anticipate long-term growth and then under-anticipate the economic slowdown.

We are either here...

...or we are here

We are better off here

Goals of SEM's Behavioral Portfolio:

🟡 Reduced market exposure when signs of overheating appear

🔴 Minimize market exposure when signs of looming recession appear

🟢 Maximize market exposure when signs of recovery appear

Value

Time

ILLUSTRATIVE PURPOSES ONLY

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Short-Term Outlook

During bull markets, investors are conditioned to <mark>believe all dips are to be bought</mark> and <mark>fail to adapt to new information</mark> that could cause the bull market to end.
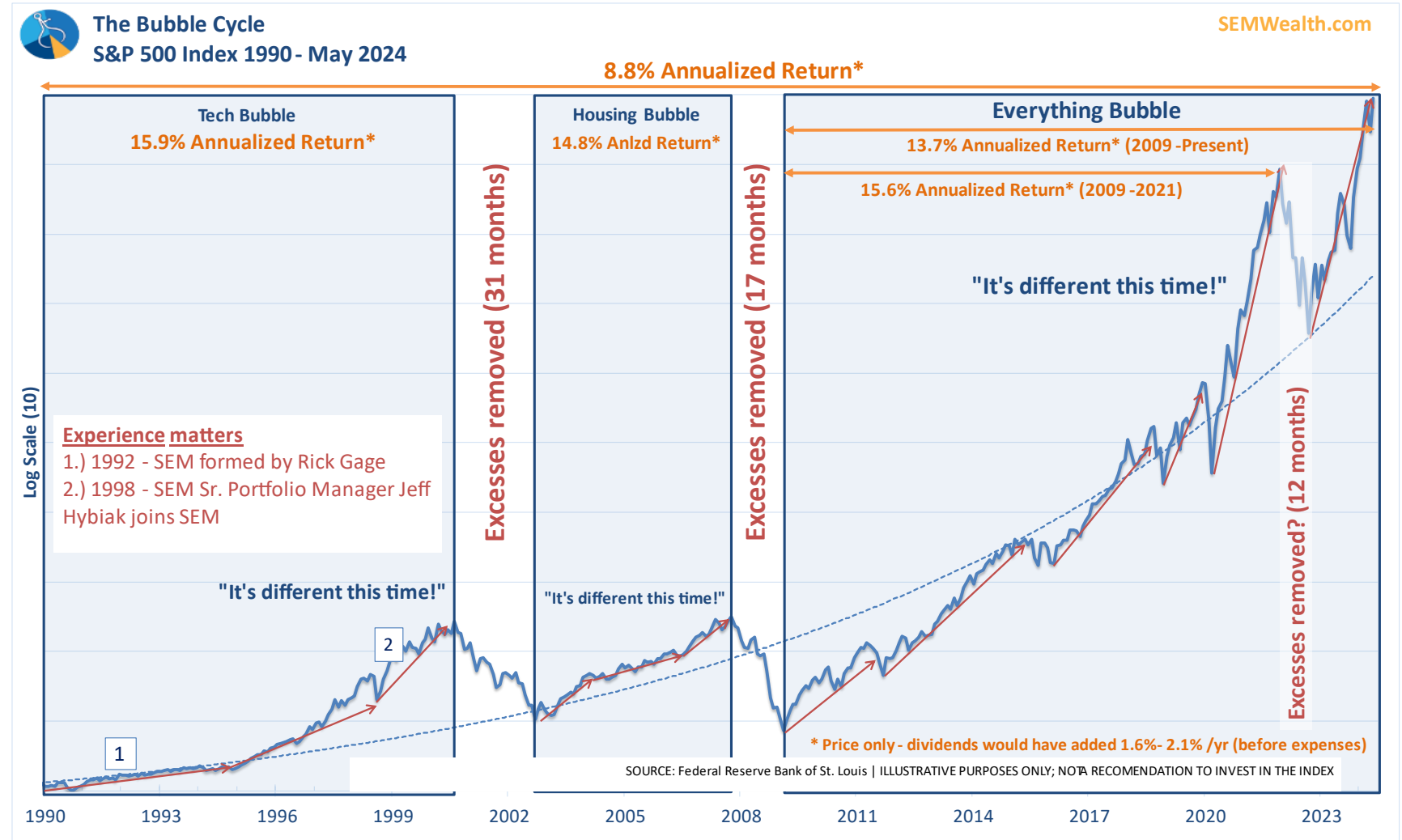
The longer the bull market, the more likely they are to <mark>believe they will be able to see the end coming</mark> and reduce their exposure to risky assets.

A Myopic View
S&P 500 Index March 2009 - May 2024

SEMWealth.com

$$y = 0.008e^{0.0003x}$$
$$R^2 = 0.9611$$

SOURCE: Federal Reserve Bank of St. Louis| ILLUSTRATIVE PURPOSES ONLY; NOT A RECOMENDATION TO INVEST IN THE INDEX

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Long-Term Outlook

Investors often look at the past bear markets and with hindsight believe they could have avoided it. This leads to overconfidence in their ability to recognize the next looming bear market. In addition, the longer the market moves higher the more likely conservative investors are going to abandon their lower risk investments and move into riskier assets.

Stocks are a "mean-reverting" asset, meaning after prolonged periods above the long-term average, they will go through a sharp correction.

The Bubble Cycle
S&P 500 Index 1990 - May 2024

SEMWealth.com

8.8% Annualized Return*

Tech Bubble
15.9% Annualized Return*

Housing Bubble
14.8% Anlzd Return*

Everything Bubble
13.7% Annualized Return* (2009 -Present)
15.6% Annualized Return* (2009 -2021)

Excesses removed (31 months)

Excesses removed (17 months)

Excesses removed? (12 months)

"It's different this time!"

Experience matters
1.) 1992 - SEM formed by Rick Gage
2.) 1998 - SEM Sr. Portfolio Manager Jeff Hybiak joins SEM

"It's different this time!"

"It's different this time!"

* Price only - dividends would have added 1.6%- 2.1% /yr (before expenses)

SOURCE: Federal Reserve Bank of St. Louis | ILLUSTRATIVE PURPOSES ONLY; NOT A RECOMMENDATION TO INVEST IN THE INDEX

Log Scale (10)

1990   1993   1996   1999   2002   2005   2008   2011   2014   2017   2020   2023

Disclaimer