

# TEMATICA INVESTING

THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES



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*Tematica Investing*, a weekly publication by Chris Versace and the Tematica team, is designed for the experienced or professional investor, providing in-depth information on real-time developing thematic strategies, economic outlook, investment trading ideas, and analysis of the most pressing developments for the market, as well as forces that drive both our thematic perspectives and thematic recommendations.

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## Economics & Expectations

*Chris Versace, Chief Investment Officer*

As we wrote about extensively in this week's [Monday Morning Kickoff](#), we have seen yet another bout of pain in the markets thus far through February with all the major indices well into the red. While the market seems to have moved off oil prices for the moment, it has remained concerned with the combination of slowing economic data that came out last week (**ISM Services and the Employment Report**, both for January) and weaker than expected outlooks this earning season from a growing number of companies.

As a Tematica Research subscriber, neither the economic slowdown, nor the weakening of earnings expectations are a surprise to you, as I personally have been yapping about both of them for months now. However to others, all of this has led to a re-think of growth expectations and valuations.

Growth stocks have been the hardest hit as evidenced by the year to date move in the Nasdaq Composite Index, down almost 13 percent compared to down 7 percent and 8 percent for the Dow Jones industrial Average and the S&P 500, respectively.

Needless to say, I continue to think the move we made a couple of weeks ago to shed almost all of our growth positions in the **Tematica Select List**, while hanging onto just the dividend strong positions was the right move. I suspect you are feeling the same way given the moves in [AT&T \(T\)](#), [Physicians Realty Trust \(DOC\)](#) and others we continue to maintain a hold on.

We have a full review of the portfolio beginning on page 8. Also in this issue, the Tematica Team has uncovered a number of confirming data points this corporate earnings season that show we continue to be on the right track with our thematic investing lens. We'll dig into these with you on pages 3-6, and then on page 7 discuss some of the companies that are on the **Tematica Contenders List** shopping list for us as the market starts to settle down.

## As painful as it is, let's recap where we are with the markets

As we've pointed out over the last few weeks, corporate outlooks are catching up to the economic data and that has led, and will likely continue to lead to reduced expectations for the S&P 500 group of companies.



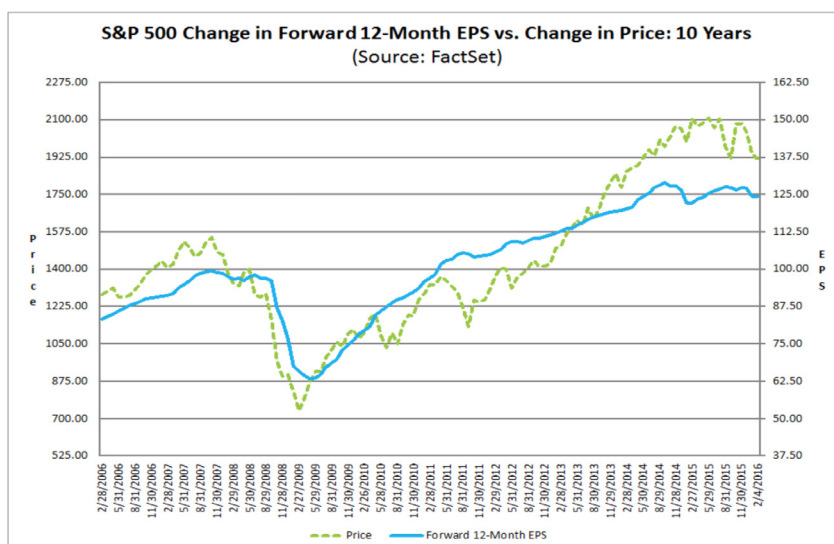
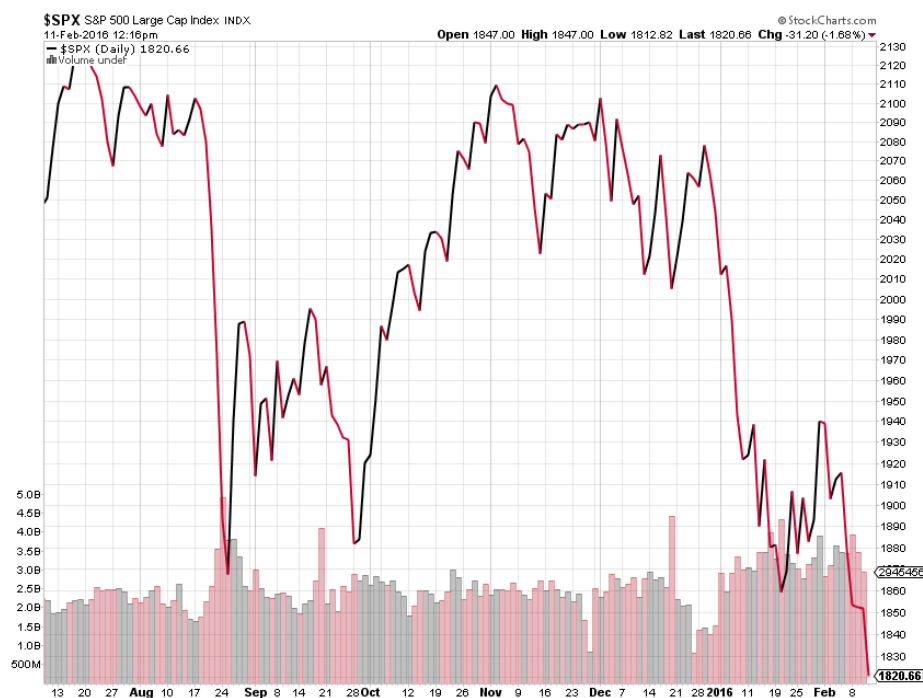
Last week, expectations for the S&P 500 earnings in 2016 continued to tick down and now sit at 122.75 per share, a reduction from \$123.32 per share last Friday and \$130.55 per share in October per data from FactSet. Year over year, that FactSet forecast calls for just 4 percent growth in collected earnings from the S&P 500 group of companies this year, but there are others that are dialing back the growth even further.

Noted economist Ed Yardeni, President of Yardeni Research has cut his 2016 expectations to \$122 per share for the S&P 500, up 3 percent, and also recast his 2017 expectations to \$128 per share, which still reflects 5 percent growth year over year.

With another 65 S&P 500 companies reporting their results this week, as well as factoring in the impact of those companies that issued results late last week, we continue to see more downside than upside with S&P 500 earnings expectations in the near-term. Digging into the revisions we've received thus far, once again analysts are calling for pronounced earnings acceleration in the back half of 2016 with 3Q 2016 up 5.5 percent and 4Q 2015 10.7 percent following declines in the first half of the year.

When we see such significant reversals, particularly several quarters out, we have to wonder about the underlying assumptions and whether or not those making them are listening to the data or if they are closing their eyes and wishing for the best. As any investor knows who has tried to wish a stock price higher, it rarely works if the fundamentals are going against you.

We'll continue to stick to digging into the data – it's worked very well for us so far, and we see no reason to deviate for something found in the Magic Kingdom.



## Corporate Earnings Calls — Confirming Our Thematic Approach

As you know, signposts for our thematic way of investing are had in all sorts of places. From official economic and demographic data, to survey findings and industry research and more, each quarter executives from more than just the S&P 500 group of companies weighs in on what's going on with their business. As they do so, they tend to share bits and pieces of information, which makes those calls invaluable.

At Tematica, we listen to the conference calls not only for the company's currently in the ***Tematica Select List*** as well as those on our Watch List, but also those companies that offer insight and more importantly data into our investing thematics. We'll listen to calls such as:

- Companies that fit within one of our thematics, but not ones we currently recommend for one reason or another. We may not want to own IBM shares, but given its growing position in cyber security we sure want to hear what it is seeing for our ***Safety & Security*** theme.
- Companies that are either customers or suppliers to Tematica Select List companies so we can get as close to a 360° view on what's really going on. While **Avago Technologies (AVGO)** will have its hands full digesting its acquisition of **Broadcom (BRCM)**, it's industry comments help us understand what is going on with **Skyworks Solutions (SWKS)** and **Qorvo (QRVO)**.
- We may not be interested in shipping companies AP Moller-Maersk (a global shipping firm that handles roughly 15% of all consumer goods transported by sea), but it's a bellwether for global trade and when it warns it is facing conditions significantly worse than at the height of the 2008 financial crisis we have to factor that into our ***Economic Acceleration/Deceleration*** thinking.
- While we continue to question what's **Nokia's (NOK)** post mobile phone strategy is, it warned that it expects a slowdown in the telecommunications equipment market, citing China as a region of particular concern, as companies asses, and perhaps reassess, their capital expenditure plans during the first quarter of 2016.

During the current earnings season for the December quarter, we've listened to many earnings calls, and have heard a number of confirming data points for the thematic lens we use to guide our investing hand. Here are just a handful of those nuggets:

### ALWAYS ON, ALWAYS CONNECTED

#### Netflix (NFLX) CEO Reed Hastings:



"We launched in Japan in early September and Spain, Portugal and Italy in mid-October and let's say they've gone very well as we said in the letter. In terms of the outperformance, it was pretty broad based, many different contributors around the world to that. Now what we are seeing basically is that this **on-demand Internet TV, watch wherever and whenever you want**, it's very popular wherever you go in the world."



### Facebook (FB) CEO Mark Zuckerberg:

"More than **950 million people** received a notification that a friend or a loved one was safe in a crisis. Millions of people supported the people of Nepal after the earthquake and the people of France after the Paris attacks. More than **8 million people used 35,000 groups and pages** on Facebook to support refugees. And people from all over the world connected around moments from Star Wars to the U.S. presidential election, from the Indian Super League to the Cricket World Cup."



### Alphabet (GOOG) CEO Sundar Pichai

"Our research shows that **30 percent of all online shopping purchases** now happen on mobile phones."

"On YouTube, we have great momentum. We have over **a billion users watching hundreds of millions of hours**. And in fact, 80 percent of YouTube's views are from outside of the U.S."

### Under Armour (UA) CEO Kevin Plank:

"In the U.S., **mobile has grown to almost 50 percent of the traffic** to our site and represented 23 percent of e-commerce revenues in the fourth quarter."



### Verizon Communications (VZ) CFO Fran Shammo

"... we are starting to see more and **more customers coming into FiOS on a broadband-only basis**, so just a single play strictly with broadband... Most customers are depleting the voice side of the product and keeping the broadband and video side of the product at this point."

## CASHLESS CONSUMPTION



### Tim Cook, CEO of Apple (AAPL)

"Consumers have spent billions of dollars with Apple Pay. In the second half of 2015, we saw a significant acceleration in usage, with a growth rate 10 times higher than in the first half of the year. **There are now over 5 million contactless payment ready locations in the countries where Apple Pay is live today** and it's soon to be accepted at thousands of Exxon and Mobil branded stations across the U.S. via their Speedpass+ app."

### Visa's (V) CEO Charlie Scharf

"More than **25 percent of all spending** on Visa Cards during November and December **was online** up from less than 20 percent just three years ago."

## CONTENT IS KING

### Ted Sarandos, Chief Content Officer of Netflix

"We've been on the trajectory accelerate original programming. I mentioned a couple weeks ago, we're **going to launch 600 hours of new original programming** this year alone. So it is a function of as our budget continues to grow, as our subscriber base grows, we are licensing programming and we are creating programming."



### Alphabet CEO Sundar Pichai

"And as you saw at Sundance, a **big push on YouTube Originals** with a focus from our top creators to create exclusive content for YouTube Red users. And so I'm really excited about all the new investments we are doing there, and users are responding very positively. And so I think it's going to be an exciting 2016 for YouTube."



## ECONOMIC ACCELERATION / DECELERATION

### Apple CEO Tim Cook

"We're seeing **extreme conditions unlike anything we've experienced before** just about everywhere we look. Major markets, including Brazil, Russia, Japan, Canada, Southeast Asia, Australia, Turkey and the eurozone, have been impacted by **slowing economic growth, falling commodity prices and weakening currencies.**"

### American Express (AXP) CEO Ken Chenault

"I would say the segment that I've been **most disappointed in has been the corporate segment**...the easiest expense category to cut is T&E that's the first thing you see...as I evaluate 2015, that was an area that...we saw a pretty consistent decline. And certainly what we've seen in my 30 plus years' experience with the Company is cut backs in T&E tends to be an early indicator for a slowdown."



### Fastenal Company (FAST) CEO Dan Florness

"We sell across the continent around the planet, most of our business is in North America and we sell to a lot of different industries. And when you start looking through the list, of lot of names that you recognize standout and **you can see the pain they are feeling in their business.**"

## FOOD WITH INTEGRITY

### Unilever (UL) CEO Paul Polman

"At the same time we're responding to the changing consumer preferences and **growing demand for more authentic, fresh, natural and sustainably sourced foods.** Like our new range of naturally tasty mealmakers which are made with 100 percent natural ingredients."



### McCormick's (MKC) CEO Alan Wilson

"Consumer demand for flavor is on the rise. It's driving growth for McCormick. Our geographic presence and product portfolio are expanding and aligned with **the move towards healthier eating, fresh ingredients, ethnic cuisine, and bold taste.**"

## NEW DEMAND, NEW SOLUTIONS

### iRobot Corp. (IRBT) CEO Colin Angle

"iRobot sees **significant growth opportunities in the consumer robotic technology** market, particularly in light of the successful Roomba 980 launch and the potential presented by the connected smart home."



## RISE & FALL OF THE MIDDLE CLASS

### Amin J. Khoury, co-founder and executive Chairman of B/E Aerospace (BEAV)

"Airline traffic growth in China was way above GDP growth. So I think traffic growth was somewhere in excess of 11 percent in China, as compared to GDP growth claimed at a 7 percent rate. Who knows what it was actually. But I think there's a disconnect there, because **so many people in the developing world are moving into the middle-class** and getting to the point where they're able to travel for the first time."



### Tim Cook, CEO of Apple

"In India, India is also incredibly exciting. **India's growth, as you know, is very good.** It's quickly becoming the fastest growing BRIC country. It's the third largest smartphone market in the world, behind China and the United States. The population of India is incredibly young. The median age there is 27. I think of the China age being young, at 36, 37 and so 27 is unbelievable. **Almost half the people in India are below 25.** And so I see the demographics there also being incredibly great for a consumer brand and for people that really want the best products."

### Unilever (UL) CEO Paul Polman

"...the U.S. is a great example...GDP growth goes to a very small amount of people and they're not eating more products. **The middle market is disappearing which is the bulk of the business.** That's why you see a lot of retailers struggling. But the prestige segment is continuing to grow amongst that target and we're very well positioned for that . . . We've been reshaping and adapting our portfolio to meet emerging consumer needs and this was reflected in a return to growth with underlying sales up 1.5 percent."

## SAFETY & SECURITY

### ADT (ADT) CEO Naren Gursahaney

"We announced the launch of ADT Canopy, our new Security-as-a-Service offering that **allows us to secure more residences as well as mobile on-the-go customers.** This service integrates ADT's professional monitoring services with many popular IoT devices, including life safety products, wearables and connected home hubs."



## SCARCE RESOURCES

### Kimberly Clark (KMB) CEO Tom Falk

"It is going to be the year of the monkey in China, which is a good year, and so you typically have a little bit of an uptick in the birth rate...**the birth rate in the U.S. is actually ticking up.**"



### Xylem's (XYL) CEO Patrick Decker

"I am encouraged by the fundamentals and underlying trends impacting our business today and in the years ahead. External factors such as steadily **increasing spend on water infrastructure**, growing demand for intelligent monitoring and control systems, and climate related initiatives that require our water expertise and ingenuity..."

## Building Our Tematica Shopping List

As you read in the executive comments across the previous several pages, we are spot on when it comes to identifying the pronounced tailwinds that will propel companies forward over the coming quarters. Now we just need the market to settle down. Candidly, we don't see a leveling out of the market until we exit the December quarter earnings season and expectations sync up with economic reality of the global economy.

Given the slowing glide path, we are looking at the kinds of businesses that will weather a slower economy given their inelastic natures. What do we mean by inelastic? Well the things that will continue no matter what is happening in the market or economy. There are some questions we know the answer to no matter what:

- Will people stop searching on the Internet? (**Connected Society**)
- Will people slow down your use of social media or streaming video? (**Content is King**)
- Will people stop eating? (**Food with Integrity**)
- Will the fountain of youth finally be discovered, and people stop aging? (**Aging Population**)
- Will hackers and malware coders have a change of heart and turn their talents to world peace rather than identity theft and maliciousness? (**Safety & Security**)



Catch our drift?

Sure, as economic conditions ebb and flow, we may slow down on discretionary spending and the amount spent on these things could curtail. Odds are however, those kinds of services and actions will see modest disruption at worst. We can add another — hopefully you will continue to clean both your house and yourself, just as I plan on doing.

As we exit the earnings storm, we expect calmer waters will start to emerge. At that time, we'll be putting some cash to work, looking to take advantage of the drop in stocks to buy in at much better prices than we saw several weeks ago.

Which companies are on that shopping list? Several that you saw over the last pages, including Netflix, Facebook, Apple, McCormick & Co., iRobot and others as well as companies we've owned in the past such as **Costco Wholesale (COST)**, **Lifelock (LOCK)**, **Cisco Systems (CSCO)**, **Chipotle Mexican Grill (CMG)**, and **Skyworks Solutions (SWKS)**.



### Upcoming Media Appearances by Chris Versace:

- Each Monday, Chris joins Sonoma County's Morning News with Melanie Morgan's "Big Story" of the week to talk about the latest in the economy, stock market and more.
- Each Friday, Chris joins Matt Ray, the host of America's Morning News, to talk about the latest on the economy, stock market and more. With the show broadcast in more than 170 markets, be sure to tune in.

## Tematica Select List Updates

### American Capital Agency Corp. (AGNC) ..... Tooling & Retooling America

Recently, the company reported December quarter results that fell shy of expectations coming in at \$0.54 per share, a \$0.03 per share miss. Book value continued to dip reaching \$22.59 per share at the end of the quarter, down \$(0.41) per share than at the end of the September quarter. Given the deep discount to book value, AGNC repurchased \$161 million, or 2.6 percent, of its outstanding common stock, during the quarter and management stated that if current conditions persist and the shares continue to trade at such a “significant discount” the company would continue to actively buyback shares. While green shoots are appearing in the company’s core MBS business, the continued drop in 10-year Treasury yields has been a boon to REITS and other high yielding securities.

With more economic data pointing toward a dramatic slowdown, we see investors continuing to shift toward stocks like AGNC. **Given all of that and the current dividend yield of 13.9 percent, AGNC shares are a buy at current levels.**



### AT&T(T) ..... Connected Society

This telecommunications company reported December quarter results that were largely in line with expectations. We continue to see the company’s wireless offering as very inelastic, which was unscientifically confirmed with a poll of Chris Versace’s undergraduate and graduate students now that the spring semester is underway. Nearly all of his students said they would trade eating out, buying shoes or some other purchase if it meant having enough money to pay their mobile phone bill.

Should the economy continue to slow, the nature of AT&T’s business along with the current 5.2 percent dividend yield, make the shares a must own.

**To us that’s why T shares have climbed 5.1 percent year to date compared to the -10.2 percent drop in the S&P 500.**



### Philip Morris International (PM) ..... Rise & Fall of the Middle Class

PM shares have been a good performer as investors have shifted back toward higher dividend yielding stocks. Over the last month, PM shares are up just shy of 1 percent vs. the 10% drop in the S&P 500. Recently, Philip Morris reported its December quarter earnings of \$0.80 per share vs. \$1.03 a share in the year ago quarter. Excluding non-recurring items, however, earnings for the quarter were in line with expectations of \$0.81 for the quarter. As expected, revenues continue to



be on a slow glide lower, but the company continued to take share during the quarter as it leveraged its key brands including Marlboro, L&M, Parliament, and others. Like many domestic companies that derive a meaningful portion of their revenue from outside the US, persisting currency headwinds will weigh on the reported results.

As such, we will need to dig into the results to better understand the true health of the business. For example, while the company guided 2016 earnings to \$4.25-\$4.35 per share vs. consensus expectations of \$4.42 per share, it's forecasts includes \$0.60 per share in expected currency headwinds. That's a big adjustment in FX headwinds compared to the impact of \$0.27 per share the company forecasted would impact 2016 this past October.

We suspect analyst models were not updated to reflect in the last few months to account for currency. Adjusting for that, earnings are slated to grow 10-12 percent in 2016, not fall as the headlines would suggest.

**To us that means the odds of another dividend bump in 2016 are looking rather good and for that reason we continue to keep PM shares on the Tematica Select List.**

## Physicians Realty Trust (DOC)

During its December quarter results, the company shared that it acquired 19 healthcare properties in 11 transactions, as well as 3 condominium units, located in 11 states for an aggregate of \$142.6 million. To us this means despite the current tone of the economy or even the volatility of the stock market, Physicians Realty continues to execute on its business model. As it chewed through those transactions, the company reloaded its transaction gun with an upsized offering of 18.5 million shares that added roughly \$290 million to its coffers. Those developments resulted in a near 7 percent move in DOC shares over the last few weeks.

As the company continues to execute, we will benefit from the dividend policy associated with its REIT structure as well as the long-term tailwind that is the **Aging of the Population**.

**Given that powerful combination, we'll continue to keep DOC shares on the Tematica Select List.**



## Aging Population

**PayPal Holdings, Inc. (PYPL)****Cashless Consumption**

Our **Cashless Consumption** play, PayPal, saw its shares pop more than 20 percent over the last few weeks following better than expected December quarter results on both the bottom and top lines. More specifically, PayPal delivered EPS of \$0.36 per share, \$0.02 ahead of consensus expectations on \$2.56 billion in revenue (ahead of the \$2.51 consensus expectation). While the company guided in line with Wall Street expectations for the current quarter, given the current environment that is not to be taken lightly.

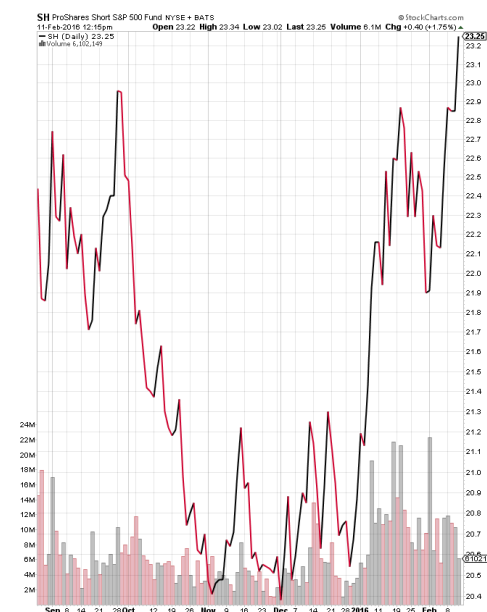
We continue to see PayPal taking share as payments shift online and onto mobile devices, and it's behind the scenes business that powers Apple Pay, Uber and others are humming. Given the company's pure play status for our Cashless Consumption investing theme and the tailwind at its back, we are not at all surprised that RBC Capital Markets reiterated its outperform and \$42 price target on the shares and that Wedbush upgraded its view on them to Outperform from Neutral with a new \$40.

Since adding PYPL to the Tematica Select List the shares are up more than 1 percent, and given this volatile market, we're being prudent and setting a protective stop loss at \$31 with a goal of stepping it up as PYPL shares move higher.

**ProShares Short S&P 500 ETF (SH)****Economic Acceleration / Deceleration**

Over the last month, SH shares have moved up, down and sideways in response to the moves in the S&P 500. With more data pointing toward a manufacturing recession and far slower growth in the services sector, we see further negative revisions to 2016 earnings expectations for the S&P 500 group of companies.

**As such we're going to continue to keep this insurance position in place.**



## Regal Entertainment Group (RGC)

## Content is King

Over the last 30 days, RGC shares have slipped roughly 2 percent. While the stock market may be turbulent, the movie box office is off to a strong start in 2016. Year to date, the box office is up 2 percent year over year, and up double digits compared to prior years. We chalk this is up to follow through on Star Wars: The Force Awakens, but also a strong showing for Ride Along 2, 13 Hours: The Secret Soldiers of Benghazi, and Kung Fu Panda 3. It seems there is something for everyone when you hit the movies these days, including for us The Big Short, which we highly recommend. With ticket sales up, sales of high margin snacks and drinks are sure to follow.



## Tematica Contenders

As we roll up our sleeves each week we add companies and discard others to our list of Tematica Select Contenders. These are companies that we're doing more work on and in some cases we're waiting for the risk to reward tradeoff to reach more appetizing levels.

AMZN	Amazon.com	Connected Society
CHGG	Chegg Inc.	Tooling & Retooling
CMG	Chipotle Mexican Grill	Foods that Are Good for You
GLW	Corning Inc.	Disruptive Technologies
IMMR	Immersion Corp.	Disruptive Technologies
KIM	Kimco Realty	Rise & Fall of the Middle Class
LOCK	Lifelock	Safety & Security
MRK	Merk & Co.	Aging of the Population
PANW	Palo Alto Networks	Safety & Security
SYNA	Synaptics Inc.	Disruptive Technologies
SBUX	Starbucks Inc.	Rise & Fall the Middle Class
UNFI	United Natural Foods	Foods with Integrity
VZ	Verizon Communications	Content is King / Connected Society
XYL	Xylem, Inc	Scare Resources

## Companies Mentioned

**ADT (ADT)**  
**Alphabet (GOOG)**  
**American Capital Agency Corp. (AGNC)**  
**American Express (AXP)**  
**AT&T (T)**  
**Avago Technologies (AVGO)**  
**B/E Aerospace (BEAV)**  
**Broadcom (BRCM)**  
**Chipotle Mexican Grill (CMG)**  
**Cisco Systems (CSCO)**  
**Costco Wholesale (COST)**  
**Facebook (FB)**  
**Fastenal Company (FAST)**  
**iRobot Corp. (IRBT)**  
**Kimberly Clark (KMB)**  
**Lifelock (LOCK)**  
**McCormick's (MKC)**  
**Netflix (NFLX)**  
**Nokia (NOK)**  
**PayPal Holdings, Inc. (PYPL)**  
**Philip Morris International (PM)**  
**Physicians Realty Trust (DOC)**  
**ProShares Short S&P 500 ETF (SH)**  
**Qorvo (QRVO)**  
**Regal Entertainment Group (RGC)**  
**Skyworks Solutions (SWKS)**  
**Tim Cook, CEO of Apple (AAPL)**  
**Under Armour (UA)**  
**Unilever (UL)**  
**Verizon Communications (VZ)**  
**Visa (V)**  
**Xylem (XYL)**

## Analyst Positions

At the time of publication, Mr. Versace, Chief Investment Officer of Tematica Research had no positions in the shares of companies mentioned in this issue.

## Important Disclosures and Certifications

**Analyst Certification** - The author certifies that this research report accurately states his/her personal views about the subject securities, which are reflected in the ratings as well as in the substance of this report. The author certifies that no part of his/ her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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