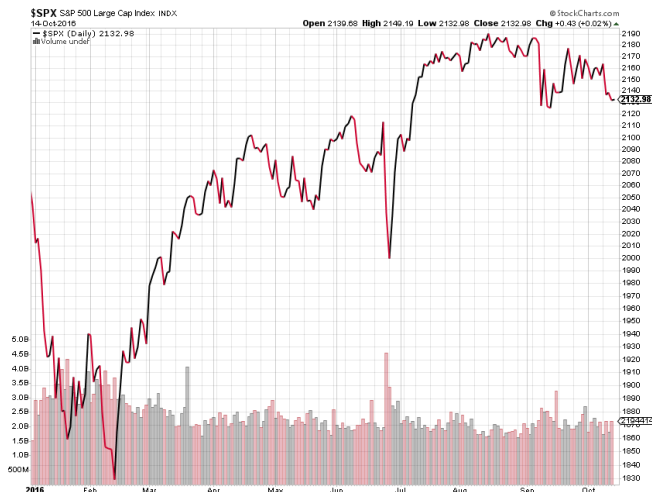


MONDAY MORNING KICKOFF

YOUR MARKET PRIMER FOR THE WEEK AHEAD

WEEK OF OCTOBER 17, 2016

The market turbulence continued last week as more negative earnings pre-announcements and data spooked the market, which led the S&P 500 to fall nearly 1 percent —the third consecutive weekly decline in the index. Joining the S&P 500 in its move lower were both the **Dow Jones Industrial Average (DJIA)** and the **Nasdaq Composite Index (COMP)**, as well as the small and mid-cap heavy **Russell 2000 Index (RUT)**.



Digging into what drove last week’s step backward, at the top of the list was China’s disappointing September trade balance report, which showed a 10 percent year-over-year decline in exports and a 1.9 percent declines in imports. Falling exports to that degree don’t bode well for the rebound in the China economy that some had been calling for as of late. With the Chinese yuan already at a six-year low relative to the U.S. dollar, there are already musings that China could further devalue its currency in order to attract export demand to goose its economy.

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ABOUT THE MONDAY MORNING KICKOFF

In order to get ready for the week ahead, the team at Tematica traces the key happenings of the past week and looks at the economic and earnings calendars slated to come out for the coming week in order to identify key catalysts that are bound to the shape the market in the near-term, and in-turn impact our tematics.

That news came ahead of this week's meeting of the Governing Council for the European Central Bank, and it is possible there is some tweaking to be had in its stimulative bond buying in response. If so, the sum of these actions could strengthen the U.S. dollar further, which would be good for shareholders of **PowerShares DB US Dollar Index Bullish Fund (UUP)**, but it also means currency headwinds will again blow for corporate America. We'll continue to monitor export order growth not only in the US but also in China and the eurozone.

Politics Playing a Role Across the Pond

While presidential politics are at fever pitch here in the United States, political uncertainty, thanks to Brexit, is also causing problems across the Atlantic. Recently, **Tesco PLC (TSCDY)**, Britain's largest online retailer, and **Unilever (UL)**, a multinational that is the country's biggest groceries manufacturer, got into quite the kerfuffle. Unilever wanted to raise prices in response to the ongoing devaluation of the pound. Tesco was having none of it and responded by pulling Unilever products, including staples of the British diet such as Marmite, from its website. We haven't seen any other rumblings — such as **Mondelēz International (MDLZ)** raising the prices on Toblerone — but we suspect we will see more of this type of secondary impact in the months to come.

Back to Last Week's Economic Data

Thursday's weekly jobless claims were unchanged week over week, but the four-week moving average fell to 249,250 from 252,750, the lowest level since November 1973. Turning to continuing claims, its four-week moving average of 2.07 million was the lowest since July 8, 2000. While the herd-think is likely to chalk this up to a better economy and use it as fuel for the Fed hawks like Philadelphia Fed President Patrick Harker, who supports a rate hike by the end of the year, Friday's **August Jobs Opening and Labor Turnover Survey (JOLTS)** report offered another view — U.S. job openings dropped by 388,000, falling to an eight-month low in August.

Looking at job openings over the longer term, we see indications that it may be rolling over. The recent September Employment Report also showed slower job growth in higher-wage industries. So far this year, employment growth has averaged 178,000 jobs per month, down from an average gain of 229,000 positions per month in 2015. On the plus side, nearly two-thirds of job separations were voluntary, which indicates the job market is still relatively strong, albeit still lower than we'd like with respect to wages. Hammering home that wage point is the number of part-time jobs created in recent months compared to full-time jobs.

Getting back to that "better economy" sentiment, last week brought a number of sobering earnings pre-announcements from the likes of **Honeywell (HON)**, **Dover (DOV)**, **Illumina (ILMN)** and a weaker-than-expected outlook from **Alcoa (AA)**. Even though it reported a solid September quarter, we can add **CSX (CSX)** to that bunch, given not only volume declines reported during the quarter, but expectations for current-quarter volumes to be flat year over year, primarily



Philadelphia Fed President Patrick Harker
"Between now and December, to me I think we'll have enough (data) that if things continue on the trajectory that I anticipate that December would be an appropriate time for a rate increase . . ."

due to an extra week in the quarter. Stripping out that extra week, it means volumes will be down year-over-year. Checking on the industry data for railcar traffic, we find that for the first week of October, total U.S. weekly rail traffic was 521,789 carloads and intermodal units, down 6.1 percent year over year. As we have said before, if “stuff” isn’t moving around the country, it does not bode well for manufacturing and demand drivers for the economy.

It Wasn’t Just The Manufacturing Sector That’s Challenged.

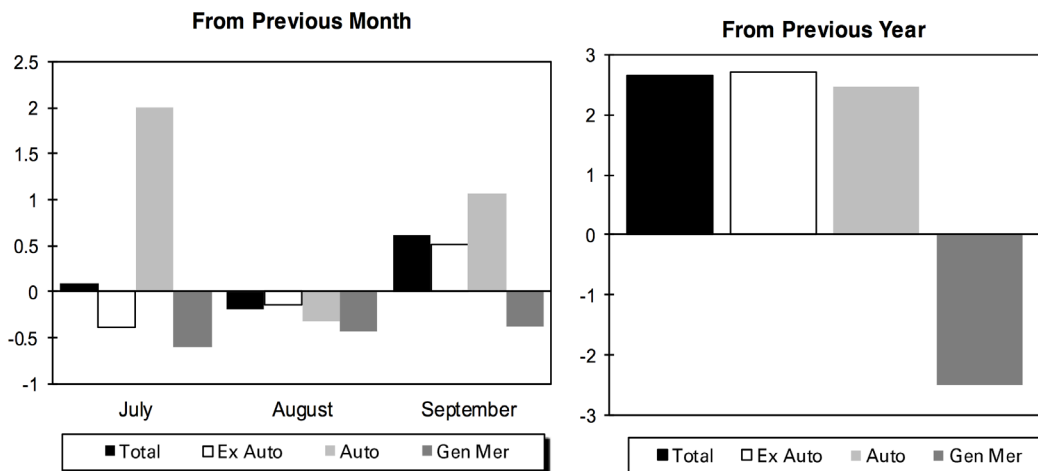
According to the National Federation of Independent Business, uncertainty among small-business owners is at its highest level in 42 years, with more small-business owners than ever before saying they don’t know where the economy is headed. We also suspect the new federal overtime rules, which raise the salary threshold for overtime-exempt employees from \$23,660 to \$47,476, that are going into effect in December are also weighing on the minds of many. Adding fuel to the notion it’s not just manufacturing getting hit, we’re started to see technology companies like **Smith Micro Software (SMSI)** and **Aerohive Networks (HIVE)** join the ranks of companies pre-announcing weaker than expected September quarter results.

Rounding out the week’s data, we had the September reports on the **Producer Price Index (PPI)** and **Retail Sales** — two metrics the Fed is likely to be focused on in the month’s to come given their view on inflation and the consumer-powered economy. On an unadjusted basis, September PPI was up 0.7 percent year-over-year, the biggest increase since advancing 0.9 percent in December 2014, but still way below the Fed’s 2 percent inflation target. Even after excluding food and energy, the index still fell short of the Fed’s target at 1.2 percent year-over-year.

Per Department of Commerce, September Retail and Food Services sales rose 0.6 percent in September (0.5 percent excluding motor vehicles and parts) compared to August. With the September retail sales report we now have a fuller picture as to how it performed in 3Q2016, that view shows September Retail & Food Service sales rose 2.7 percent year over year (also 2.7 percent if we exclude motor vehicles and parts). For 3Q 2016, Retail & Food Service sales rose 2.4 percent; 2.3 percent excluding motor vehicle and parts sales and 1.9 percent if we exclude Food services.

Percent Change in Retail and Food Services Sales

(Estimates adjusted for seasonal variation and holiday and trading-day differences, but not for price changes)



Digging beneath the surface of the Retail Sales Report, we find several confirming data points for our thematic approach:

- **Aging of the Population:** Health & personal care stores up 5.4 percent year over year in September, bringing the year over year performance in 3Q 2016 to up 7.4 percent for the category.
- **Rise & Fall of the Middle Class:** Furniture & home furnishing store sales were up 2.7 percent year over year in September, up 1 percent vs. August 2016; up 2.2 percent year over year in 3Q 2016. When we look at this category, we see it as an indicator of the housing market as well as repair and remodel spending, both of which are key aspects of this investing them.
- **Cash-strapped Consumer:** Sales at General Merchandise Stores were down 2.5 percent year over year in September, which showed **Costco Wholesale (COST)** captured consumer wallet share during the month. Remember, Costco's US same-store-sales were flat year over year in September.
- **Connected Society:** September sales at Non-store retailers (Commerce Department speak for e-tailers like **Amazon (AMZN)**, **eBay (EBAY)** and **Wal-mart (WMT)** bought jet.com) rose 10.6 percent year over year and 11.3 percent in 3Q 2016 on the same basis. We'd also note the year over year drop of 6.4 percent for Department Store Sales in September that pulled that year over year comparison for 3Q 2016 to a drop of almost 6 percent. Putting these two together, it's clear that in-store department store traffic continues to be under pressure and set's the stage for what could be another painful bout of quarterly earnings for predominantly brick & mortar retailers.

Turning to the Week Ahead

We've got several economic data reports on tap, including September reports on **Housing Starts and Building Permits, Industrial Production** and **Capacity Utilization**. We also get the October reading for the NAHB Housing Market Index and the next iteration of the Fed's Beige Book. Rest assured, as more look to what the Fed's next move will be, that Beige Book report will be a central focus next week.

On the earnings front, there are more than 300 companies reporting their September quarter results. We'll be keeping our eyes and ears open for those that could weigh on or prop up our positions on the **Tematica Select List** investments higher. It's all about connected the dots during earnings season.

Earlier we cited several companies that have already

ECONOMIC CALENDAR		OCT 17 - 21, 2016
DATE	REPORT / SPEECH	DATA
17-Oct	Empire Manufacturing	Oct
17-Oct	Industrial Production	Sep
17-Oct	Capacity Utilization	Sep
18-Oct	CPI	Sep
18-Oct	Core CPI	Sep
18-Oct	NAHB Housing Market Index	Oct
18-Oct	Net Long-Term TIC Flows	Aug
19-Oct	MBA Mortgage Index	15-Oct
19-Oct	Housing Starts	Sep
19-Oct	Building Permits	Sep
19-Oct	Crude Inventories	15-Oct
19-Oct	Fed's Beige Book	Oct
20-Oct	Initial Claims	15-Oct
20-Oct	Continuing Claims	8-Oct
20-Oct	Philadelphia Fed	Oct
20-Oct	Existing Home Sales	Sep
20-Oct	Leading Indicators	Sep
20-Oct	Natural Gas Inventories	15-Oct

pre-announced to the downside relative to expectations, which to us signals the next few weeks are likely to be volatile. Below we've sorted the key reports according to our thematic lens. From a stock market valuation perspective, there are 91 companies in the S&P 500 reporting this week, almost 20 percent of the overall index. This means we'll start to get our first real look at earnings expectations for the S&P 500 group of companies for the current quarter.

We've been on record saying the 6 percent quarter over quarter increase in December earnings expectations has been overly robust given a variety of factors, including the fact that earnings for the S&P 500 have recorded six consecutive quarters of year-over-year declines since 2008. In our view, the economic data of late that has dropped the Atlanta Fed's GDPNow forecast to 1.9 percent from more than 3.5 percent in August, along with those negative earnings pre-announcements add credence to our view. Again, it's going to be an interesting few weeks as those earnings expectations will more than likely get reset lower.

Amid all of this, we are again seeing Fed jawboning for what seems like the umpteenth time over the last several quarters about what it may do in terms of interest rates. We'll continue to follow the data, letting it speak to us and be our north star for the coming weeks instead of twisting the data to validate what we want it to say. As we do that we will continue to selectively scale into existing positions while looking to pick off new ones as well.

Thematic Earnings To Watch This Week

The following are the earnings announcements and conference calls we will be paying close attention to in order to glean any confirming data points for our 17 different investing themes.

AFFORDABLE LUXURY

- Aging of the Population
- HealthStream Inc (HSTM)
- Johnson & Johnson (JNJ)
- United Health Group (UNH)
- Charles Schwab (SCHW)
- Morgan Stanley (MS)
- Abbot Labs (ABT)
- Walgreens Boots Alliance (WBA)
- E-Trade Financial Corp (ETFC)

ASSET-LITE BUSINESS MODELS

- Celestica Inc. (CLS)
- Syntel, Inc. (SYNT)
- DST Systems (DST)

CONNECTED SOCIETY

- IBM (IBM)
- Intel Corp. (INTC)
- Angie's List (ANGI)
- Citrix Systems (CTXS)

- eBay (EBAY)
- Xilinx Inc. (XLNX)
- Microsoft Corp. (MSFT)
- Verizon Communications (VZ)
- Advanced Micro Devices (AMD)
- Ericsson (ERIC)

CASHLESS CONSUMPTION

- American Express (AXP)
- PayPal Holdings (PYPL)
- Euronet Worldwide (EFTT)
- Synchrony Financial (SYF)

CASH-STRAPPED CONSUMER

- Skechers Inc. (SKX)

CONTENT IS KING

- Netflix (NFLX)
- Rocky Brands (RCKY)
- IMAX Corp. (IMAX)

DISRUPTIVE TECHNOLOGIES

- Cree Inc. (CREE)
- Intuitive Surgical (ISRG)
- Hexcel Corp. (HXL)

ECONOMIC ACCELERATION/DECELERATION

- JB Hunt Transportation (JBHT)
- Lennox International (LII)
- WW Grainger (GWW)
- Kansas City Southern (KSU)
- Terex Corp. (TEX)
- United Rentals (URI)
- General Electric (GE)
- Honeywell (HON)

FATTENING OF THE POPULATION

- Del Taco Restaurant (TACO)
- Domino's Pizza (DPZA)
- BJ's Restaurant (BJRI)
- Dunkin Brands (DNKN)
- McDonald's (MCD)

GUILTY PLEASURE

- Harley Davidson (HOG)
- Reynolds America (RAI)
- Las Vegas Sands (LVS)
- Boston Beer (SAM)
- Wynn Resorts (WYNN)

RISE & FALL OF THE MIDDLE CLASS

- United Continental Holdings (UAL)
- Tupperware Brands (TUP)
- Natus Medical (BABY)
- Select Comfort (SCSS)
- American Airlines (AAL)
- Alaska Air (ALK)
- Pulte Corp. (PHM)
- Sensient Technologies (SXT)

SAFETY & SECURITY

- Proofpoint Inc. (PFPT)
- Textron (TXT)

SCARCE RESOURCES

- Core Labs (CLB)
- Haliburton Co. (HAL)
- Schlumberger (SLB)

TOOLING & RE-TOOLING

- Robert Half International (RHI)
- Trueblue Inc. (TBI)
- Manpower (MAN)

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