

MONDAY MORNING KICKOFF

YOUR MARKET PRIMER FOR THE WEEK AHEAD

WEEK OF OCTOBER 24, 2016



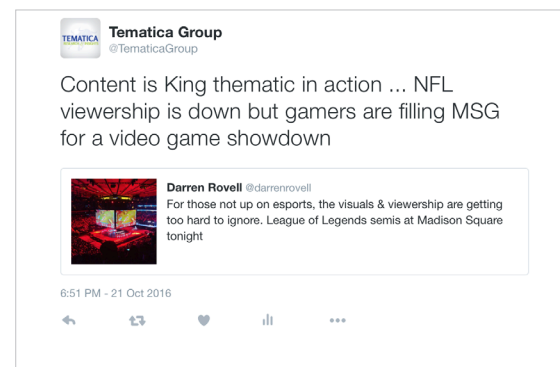
Last week we navigated the first real week of September quarter earnings, the third presidential debate and a host of other items, the combination of which left the market relatively unchanged compared to the prior week. Truth be told, the market's lack


of movement could be the result of post-traumatic stress effects from the series of Clinton-Trump debates as most of the country wondered "what just happened?"

All in all, more than 300 companies reported quarterly results last week, and as expected the results were rather spotty with a number of shortfalls and misses being reported. That's not to say it was all bad news, but as the velocity picked up later in the week, it became evident the market is going to move based on the tone of earnings. The net result left the S&P 500 up 0.4 percent for the week, but still down more than 1 percent October to date.

As of Friday (with 23 percent of the companies in the S&P 500 reporting earnings for 3Q 2016), 78 percent have reported earnings above the mean estimate and 65 percent have reported sales above the mean estimate. Leading the pack were the Financials and Utilities sector, and dragging behind are the Energy and Industrials. Given the rash of negative pre-announcements from **Honeywell (HON)**, **Dover Corp. (DOV)** and Friday's results from **General Electric (GE)**, it's not surprising to see the industrial aspect of our **Economic Acceleration & Deceleration** investment theme called out.

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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 shape the market in the near-term, and in-turn impact our tematics.

As the data shows, thus far more companies have reported better than expected results, helped in part by rampant corporate buyback programs rather than actual performance. Nevertheless, this has led to an upward move in earnings expectations for the September quarter, which now sits at -0.3 percent for the S&P 500 — still in negative territory, but much better than the forecasted decline of 2 percent from just a few weeks ago. Keep in mind this is based on 23 percent of the 500 S&P companies, which means we have more than 75 percent to go over the next few weeks.

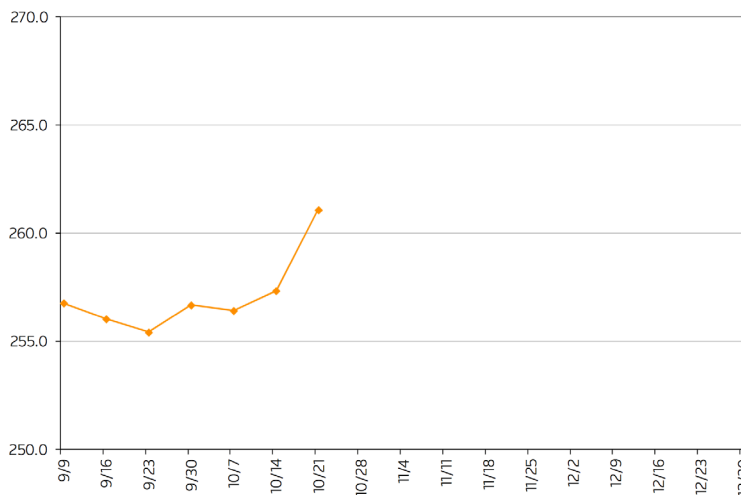
Odds are we will see some more back and forth among those S&P 500 September quarter earnings forecasts, as well as some re-jiggering for the current quarter as well. This week, 178 S&P 500 companies — roughly 36 percent of the those in the index — are scheduled to report quarterly results. It's going to be frenetic for sure, but exiting the week, with almost 60 percent of the index having reported, we should have a much clearer picture on reported earnings growth as well as earnings expectations for what lies ahead.

Over the next five days, more than 980 companies are issuing quarterly results. Making the week even more frenetic is the transaction between **AT&T (T)** and **Time Warner (TWX)**. We've seen this coming together between **Connected Society** and **Content is King** players before with **Comcast (CMCSA)** when it purchased NBC Universal from **General Electric (GE)** and when **Walt Disney (DIS)** purchased ABC Capital Cities. From a strategic perspective, we like the combination of T and TWX as it adds a protective content moat around AT&T mobile

SECTION A: EARNINGS OUTLOOK

Q3 2016: EARNINGS REVISIONS

EXHIBIT 1A. S&P 500: Q3 2016 SHARE-WEIGHTED EARNINGS (\$B)



Source: Thomson Reuters I/B/E/S

Q3 2016: EARNINGS SCORECARD

EXHIBIT 2A. S&P 500: Q3 2016 EARNINGS VS. EXPECTATIONS

Sector	Above %	Match %	Below %	Surprise Factor %	Reported Total #	Index Total #
Consumer Discretionary	61%	17%	22%	7.9%	18	83
Consumer Staples	89%	-	1%	4.4%	9	37
Energy	60%	20%	20%	18.3%	5	36
Financials	100%	-	-	11.0%	27	64
Health Care	86%	-	14%	2.6%	7	59
Industrials	71%	5%	24%	2.9%	21	67
Materials	25%	25%	50%	2.8%	4	27
Real Estate	67%	-	33%	3.9%	3	28
Technology	86%	5%	10%	6.9%	21	66
Telecom Services	100%	-	-	2.5%	1	5
Utilities	-	-	-	-	0	28
S&P 500	79.3%	6.0%	14.7%	7.0%	116	500

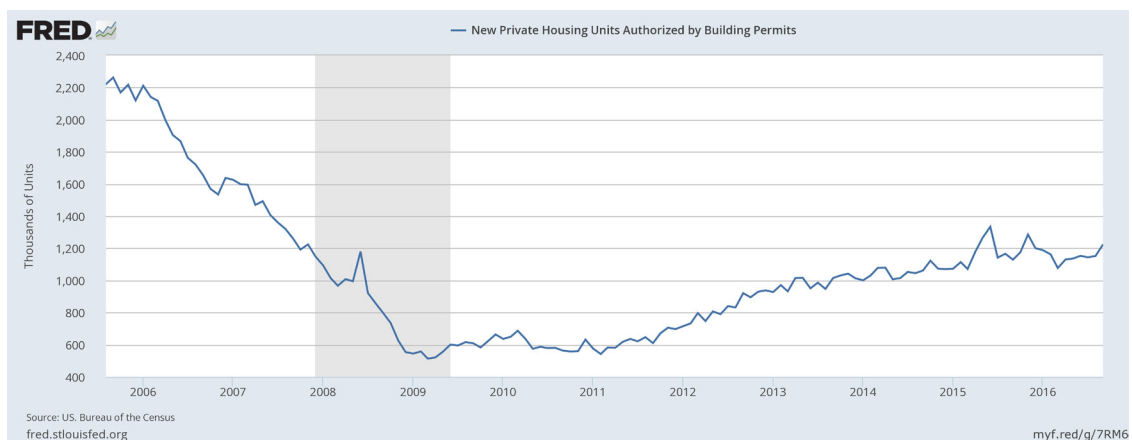
Source: Thomson Reuters I/B/E/S



business, while also adding fuel to it soon to be released DirecTV Now video streaming service. Of course, the devil will be not only the details of the transaction, but also in the final purchase price and how AT&T will fund it.

That was not the only high-profile M&A transaction that was kicked around last week. We also saw similar action in the Guilty Pleasure space as **British Tobacco (BTI)** made an offer to buy the remaining 59 percent of **Reynolds American (RAI)** that it doesn't already own. That was followed by **Rockwell Collins (COL)** announcing its intent to acquire **B/E Aerospace (BEAV)**, one of the largest makers of aircraft seats and aircraft interiors.

Stepping back from the M&A news flow, we're not surprised to see a pick up in companies putting the massive amounts of cash on their balance sheets to work by seeking to acquire revenue and potential merger synergies given that organic revenue growth has been slowing over the last several quarters. While the news of such transactions can be exciting, particularly if they could alter the acquirers business model as in the case with AT&T-Time Warner, the M&A response by competitors can lead to more M&A transactions that could be smart or disastrous. We've seen more than both in our time, which means each M&A deal needs to be evaluated on its own merits and the new business model could change the thesis behind owning the buyer. As we've said in the past, the only thing better than a company having one thematic tailwind pushing at its back is to two have two or more of those tailwinds — that is how we see the coming together of AT&T and Time Warner, again subject to the finer details and funding question.



Before we close the books on last week, we'd note several favorable data points for the domestic housing market in the form of **September Housing Starts & Building Permits and September Existing Home Sales**. While the media tended to downplay the September Housing Starts report given a wide miss with multi-family housing starts, September building permits for multifamily dwellings rose more than 17 percent year over year and month over month. This suggests the September housing starts weakness for multifamily housing is likely to be a blip. Single-family housing permit activity was up modestly month over month, but rose 4.4 percent year over year. Overall building permit activity in September was the highest we've seen since November 2015.

Looking at the above data, despite the disappointing September housing starts headline, the underlying data still points to a firmer housing market in the coming months. That was further affirmed by the "under construction" category in today's housing report, which showed that single-family homes under construction rose to 433,000 units in September, up modestly month over month, but a more pronounced 8.8 percent year over year. The

same goes for multifamily homes under construction during September, which climbed just shy of 13 percent year over year.

Once again, it pays to decode these reports and comb through all the data in order to gain the proper perspective and see what is really going on, rather than rely on a quick headline, Twitter post, or a trite comment by a talking head.

Turning to the Week Ahead

While we've got a bunch of economic data on tap, we first have to digest the fact that we're faced with a Chicago Cubs vs. Cleveland Indians World Series kicking off tomorrow night in the Rock & Roll Capital of the World. Get ready for the onslaught of media features on both team's decades of misery and defeat (or in the case of the Cubs more than a century). At least for one of these teams and their legions of fans, their fortunes will take a turn over the next 10 days or so. Should be fun.



But of course, we'll have one eye on the Series and the other on the economic data coming down the pipe this week, including several additional pieces of housing data, including **September New Home Sales**, and the **Durable Orders Report for September**. We'll also get the **October Flash PMI** reports for both manufacturing and services next week, with both hitting the tape ahead of Friday's first reading on GDP for 3Q 2016. What this means is, after a relatively quiet week when it came to what the Fed may or may not do in December, we can expect that conversation to resume next week. We expect the initial reading on 3Q 2016 GDP will set the tone for that conversation, and we suspect it will not be a calm one, given the differing opinions to be had at the Fed.

Just last week, Fed Chairwoman Janet Yellen talked about the benefits of letting inflation run a little hotter than normal while allowing the unemployment rate to drop below the point that historically would trigger Fed tightening action. Keep in mind, inflation runs well below the Fed's target and the vector on 3Q 2016 GDP is not likely to help muster the case to boost interest rates near-term. We'd note as more economic data has come



Yellen questioned whether damage to U.S economic potential can be undone "by temporarily running a 'high-pressure economy,' with robust aggregate demand and a tight labor market. One can certainly identify plausible ways in which this might occur."

in during the quarter, the Atlanta Fed's over enthusiastic GDP Now report currently sits at 2.0 percent, down from 3.6 percent in early August. As we exit the week, we can already envision more "will they, won't they?" confusion in the market. Another reason to stay cautious near-term.

As we said above, in the coming week we have nearly 1,000 companies reporting quarterly results, with more than 300 on Thursday alone. Take it from us, it is going to be fast and it is going to be furious, which is why we plucked the key reports and sorted them thematically for you below.

The bottom line is our strategy remains the same — we'll continue to follow the data, letting it speak to us and use our thematic investing approach as our north star instead of twisting the data to validate what we want it to say like so many do. As we do, we will continue to scale selectively into existing positions on the **Tematica Investing Select List** while looking to pick off new ones, too.

ECONOMIC CALENDAR		OCT 24 - 28, 2016
DATE	REPORT / SPEECH	DATA
25-Oct	Case-Shiller 20-city Index	Aug
25-Oct	FHFA Housing Price Index	Aug
25-Oct	Consumer Confidence	Oct
26-Oct	MBA Mortgage Index	22-Oct
26-Oct	International Trade in Goods	Sep
26-Oct	New Home Sales	Sep
26-Oct	Crude Inventories	22-Oct
27-Oct	Initial Claims	22-Oct
27-Oct	Continuing Claims	15-Oct
27-Oct	Durable Orders	Sep
27-Oct	Durable Orders, Ex-	Sep
27-Oct	Pending Home Sales	Sep
27-Oct	Natural Gas Inventories	22-Oct
28-Oct	Chain Deflator-Adv.	Q3
28-Oct	GDP-Adv.	Q3
28-Oct	Chain Deflator-Adv.	Q3
28-Oct	Employment Cost Index	Q3
28-Oct	Michigan Sentiment - Final	Oct

AFFORDABLE LUXURY

- Luxottica (LUX)
- VF Corp. (VFC)
- Coach (COH)
- Deckers Outdoor (DECK)
- Daimler AG (DDAIF)
- Ruth's Hospitality (RUTH)

AGING OF THE POPULATION

- Avalon Bay Community (AVB)
- Vascular Solutions (VASC)
- Ameriprise Financial (AMP)
- TD Ameritrade (AMTD)
- Carriage Services (CSV)
- Novartis (NVS)
- USANA Health Sciences (USNA)
- Dentsply Sirona (XRAY)
- Bristol Myers (BMY)
- Stericycle (SRCL)

ASSET-LITE BUSINESS MODELS

- Rambus (Inc. (RMBS)
- Rocky Brands (RCKY)
- Dolby Labs (DLB)
- Acacia Research (ACTG)
- InterDigital (IDCC)
- DigitalGlobe (DGI)

CASHLESS SOCIETY

- Visa (V)
- Discover Financial Services (DFS)
- MasterCard (MA)

CASH-STRAPPED CONSUMER

- Tanger Factory Outlets (SKT)
- Groupon (GRPN)
- Pricemart (PSMT)

CONNECTED SOCIETY

- Apple Inc. (AAPL)
- Akami Technology (AKAM)
- PetMeds Express (PETS)
- Sprint Corp. (S)
- AT&T (T)
- Comcast Corp. (CMCSA)
- NXP Semiconductors (NXPI)
- VMware (VMW)
- Amazon (AMZN)
- Alphabet (GOOGL)
- Dupont Fabros (DFT)
- Digital Realty Trust (DLR)
- Twitter (TWTR)
- United Parcel Service (UPS)
- Yandex (YNDX)

CONTENT IS KING

- Nielsen Holdings (NLSN)
- Shutterstock (SFLY)
- Regal Entertainment (RGC)

DISRUPTIVE TECHNOLOGIES

- Corning (GLW)
- II-VI Corp. (IIVI)
- Medidata Solutions (MDSO)
- Sensata Technologies (ST)
- Tesla Motors (TSLA)
- Proto Labs (PRLB)
- Express Scripts (ESRX)
- Cirrus Logic (CRUS)

**ECONOMIC ACCELERATION/
DECELERATION**

- Crane Co (CR)
- Swift Transport (SWFT)
- Wabash National (WNC)
- Caterpillar (CAT)
- 3M (MMM)

FATTENING OF THE POPULATION

- Restaurant Brands (QSR)
- Sonic Corp. (SONC)
- Buffalo Wing Factory (BWLD)
- Coca-Cola (KO)
- Mondelez International (MDLZ)
- NutriSystem (NTRI)
- Dr. Pepper Snapple (DPS)
- Bloomin Brands (BLMN)

FOOD WITH INTEGRITY

- Chipotle Mexican Grill (CMG)
- Brinker International (EAT)
- Panera Brands (PNRA)
- Pinnacle Foods (PF)

FOUNTAIN OF YOUTH

- Cynosure (CYNO)
- GNC Holdings (GNC)

GUILTY PLEASURE

- Dover Downs Gaming (DDE)
- Dover Motorsport (DVD)
- Penn National Gaming (PENN)
- Anheuser Busch (BUD)
- The Hershey Company (HSY)

RISE & FALL OF THE MIDDLE CLASS

- B/E Aerospace (BEAV)
- Kimberly Clark (KMB)
- Big 5 Sporting (BGFV)
- Ethan Allen (ETH)
- Fiat Chrysler (FCAU)
- General Motors (GM)
- Jetblue Airways (JBLU)
- Proctor & Gamble (PG)
- Sherwin Williams (SHW)
- Under Armour (UA)
- Whirlpool (WHR)
- Boeing (BA)
- Pilgrims Pride (PPC)
- Colgate Palmolive (CL)
- Carters (CRI)
- Expedia (EXPE)
- Ford Motor Company (F)
- Hanesbrands (HBI)
- Mead Johnson Nutrition (MJN)
- Potash (POT)
- Regis Corp. (RGS)
- Senomyx Inc. (SNMX)
- Autonation (AN)
- Royal Caribbean (RCL)

SAFETY & SECURITY

- Lockheed Martin (LMT)
- Zix Corp. (ZIXI)
- Brinks Co. (BCO)
- CACI International (CACI)
- Fortune Brands Home & Security (FBHS)
- Flir Systems (FLIR)
- General Dynamics (GD)
- Fortinet (FTNT)
- Fortive Corp. (FTV)
- Logmein Inc (LOGM)
- Raytheon (RTN)

SCARCE RESOURCES

- Waters Corp. (WAT)
- Barrick Gold (ABX)
- California Water (CWT)
- Flowserve (FLS)
- Mobile Iron (MOBL)
- Chevron (CVX)
- Exxon Mobil (XOM)

TOOLING & RE-TOOLING

- American Campus City (ACC)
- Hedrick & Struggles (HSII)
- Capella Education (CPLA)
- K12 (LRN)
- Robert Half International (RHI)
- Strayer Education (STRA)
- On Assignment (ASGN)

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