

# TEMATICA INVESTING

THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES



**Christopher Versace**  
CHIEF INVESTMENT OFFICER,  
TEMATICA RESEARCH, LLC

FOLLOW US:

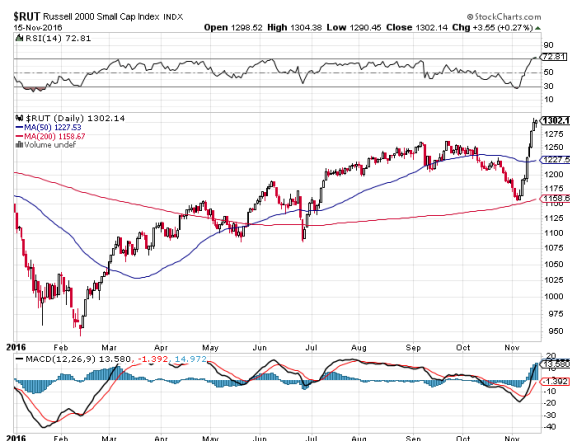


## It's been quite a week for the US stock market

The Dow Jones Industrial Average climbed nearly 5.8 percent over the last week, placing it firmly in overbought territory. Both the Nasdaq Composite Index and the S&P 500, our preferred benchmark for the domestic stock market, rose roughly 4.5 percent.

While those two indices remain out of overbought status, the small-cap heavy Russell 2000 Index is overbought after having climbed just under 9 percent over the last five days. Those are quite pronounced moves in a rather short period of time, and the likelihood the market gives some of those gains back is better than 50/50.

In the [Tematica Investment Select List](#), we saw several positions move substantially higher over the last week, including **Universal Display (OLED)**, **United Natural Foods (UNFI)**, and **Dycom Industries (DY)** as well as nice rebounds in **CalAmp (CAMP)** and **AMN Healthcare (AMN)**. We continue to see further upside ahead for each of those positions given the strength of their respective thematic tailwinds — **Disruptive Technologies**, **Food with Integrity**, **Connected Society** and **Aging of the Population** — but in some cases, we're revisiting the notion of adding protective



### INSIDE THIS ISSUE

**Heading into Holiday Sales, October Retail Sales Bode Well for Amazon (AMZN) and Alphabet (GOOGL) ..... 2**

**An ETF to Target the Connected Society Thematic ..... 3**

**A Quick Word on Costco Wholesale (COST)..... 4**

**The Restaurant-Grocery Inflation Gap Is Driving A Pick Up In Restaurant Bankruptcies..... 5**

**Tematica Select List Performance ..... 7**

**Tematica Contenders..... 8**



stop losses. That thought reflects the likelihood the overall market could cool off and move lower (worst case) or trade sideways (better, but less likely).

The pronounced upward moves in those positions over the last week were mitigated by further softness in **International Flavors & Fragrance (IFF)**, which we chalk up to investor concern over a President-elect Trump sparked trade war, and declines at both **Amazon (AMZN)** and **Alphabet (GOOGL)**. As you'll see below, the outlook for AMZN and GOOGL shares remain bright as there is no slowdown in sight for the drivers of our **Connected Society** investing theme.

## Heading into Holiday Sales, October Retail Sales Bode Well for Amazon and Alphabet

Yesterday we received the **October Retail Sales Report**, which saw the headline Retail Sales figure as well as the Retail Sales Ex-Auto come in better than expected for the month.

Reported Retail Sales for October registered a gain of 0.8 percent, beating expectations for a 0.6 percent improvement, while Retail Sales Ex-Auto for October rose 0.8 percent, outpacing expectations for 0.5 percent. Compared to October 2015, retail strength was registered at Nonstore Retailers (+12.9 percent), Health & Personal Care Stores (+8.3 percent), Building Material & Garden (+6.5 percent), which outpaced overall Retail Sales gains of +4.3 percent (+4.0 percent if we exclude autos). The two categories that continued to post year over year declines in sales were Department Stores (-7.3 percent) and Electronics & Appliance Stores (-4 percent).

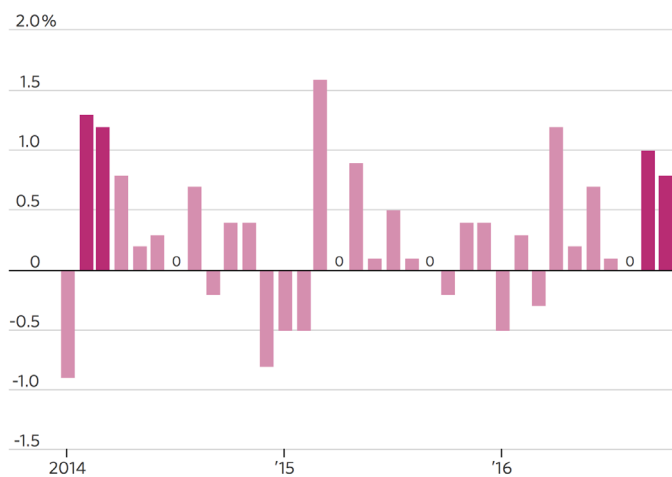
Our take on the above — and juxtaposing the performance of Nonstore Retail vs. Department Stores and Electronics & Appliances — is it's another data point for the accelerating shift toward digital commerce at the expense of brick & mortar. If we look at the trailing 3-month period that is August 2016-October 2016 vs. the August 2015-October 2015 period we see NonStore Retail Sales rose more than 12 percent year-over-year vs. declines of 6.7 percent and 4.3 percent for Department Stores and Electronics & Appliances, respectively.

We see this as not only confirming for our **Connected Society** investing theme, but also the **Amazon (AMZN)** and **Alphabet (GOOGL)** shares that are on the **Tematica Investing Select List**. While the shares of both companies have gotten a little banged up since the Election Day 2016, we see these companies as prime beneficiaries from not only the shift to digital commerce, but also digital content consumption and streaming services and to a lesser extent our **Cashless Consumption** investing theme.

**With no slowdown in sight for those thematic drivers, we continue to rate AMZN and GOOGL shares a Buy with a price target of \$975 for both stocks.**

### A Few Good Months

September and October are shaping up to be the best two-month stretch for retail sales since early 2014. Change from the previous month, with strongest two-month periods highlighted:



Note: All figures adjusted for inflation and seasonality.  
Source: Commerce Department

THE WALL STREET JOURNAL

## An ETF to Target the Connected Society Thematic

Over the last several weeks, we’ve been reaching out to subscribers and we’ve heard from more than a few that they would like ETF options as well as individual stock picks. We’re happy to oblige, provided we can suss out the right ETF, which in our view means it’s benefitting from the same thematic tailwind and has enough upside to be had that allows us to get behind the shares. Our subscriber conversations also led to something else that we’ll share with you in a few paragraphs.

In this instance, the ETF that we are adding to the **Tematica Investing Select List** is **PowerShares NASDAQ Internet Portfolio ETF (PNQI)**, which closed last night at \$83.14. For an ETF that invests in companies like Amazon, Alphabet, and **Facebook (FB)** as well as **Baidu (BIDU)** and **Priceline (PCLN)** among its top holdings, it’s well off its 52-week high.

Much like AMZN, GOOGL and FB shares, PNQI shares have come under pressure over the last week, but the thematic tailwind behind its core holdings — the **Connected Society** — remains intact.

### Bottomline on POWERSHARES NASDAQ INTERNET ETF (PNQI)

- **We are adding PNQI shares to the Select List with a price target of \$90.**
- **Because this is a new position, we’re inclined to use additional weakness in the shares to build out our position size.**



### POWERSHARES NASDAQ INTERNET ETF (PNQI)

Theme: **Connected Society**

Price on 09/13/16: **\$83.14**

The PowerShares NASDAQ Internet Portfolio is \$40k based on the NASDAQ Internet Index®. The Fund will normally invest at least 90% of its total assets in common stocks that comprise the \$30k Index. The Index is designed to track the performance of the largest and most liquid US-listed companies engaged in internet-related businesses and that are listed on one of the major US stock exchanges. The Underlying Index employs a modified market capitalization-weighted methodology based on the market capitalization ranking of the Underlying Index \$0 securities. The Fund and the Index are rebalanced and reconstituted quarterly.

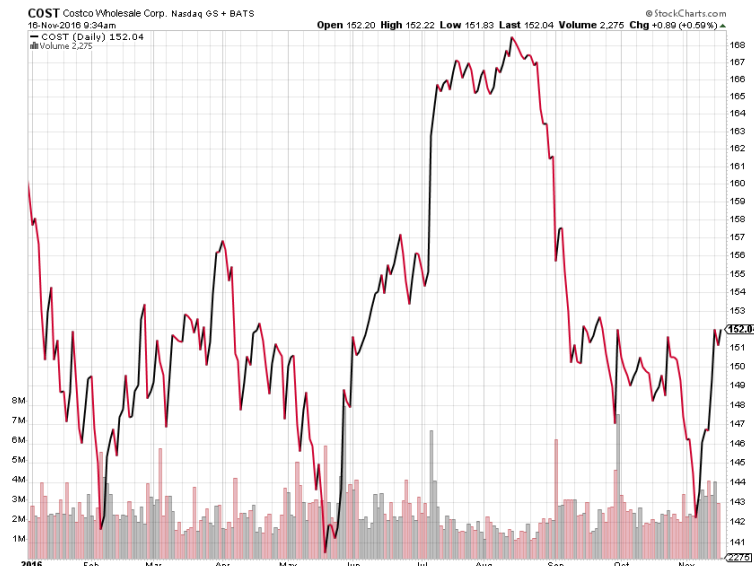
#### Top 10 PNQI Holdings

COMPANY	SYMBOL	% ASSETS
The Priceline Group Inc	PCLN	8.11%
Facebook Inc A	FB	8.09%
Amazon.com Inc	AMZN	8.00%
Alphabet Inc C	GOOG	7.97%
Baidu Inc ADR	BIDU	7.76%
Netflix Inc	NFLX	4.99%
JD.com Inc ADR	JD	3.98%
NetEase Inc ADR	NTES	3.88%
Yahoo! Inc	YHOO	3.79%
Equinix Inc	EQIX	3.78%

## A Quick Word on Costco Wholesale (COST)

As expected the October Retail Sales Report showed a -0.7 percent decline in General Merchandise Stores, which compares to the 4 percent sales increase Costco reported for October. We continue to see Costco taking consumer wallet share this holiday season with its high margin membership revenue improving as it opens additional warehouse locations and benefits from renewed credit card marketing efforts.

**We continue to rate COST shares a Buy with a \$170 price target.**



After canvassing several ETFs, there are few that have any meaningful exposure to COST shares — the largest is **Consumer Staples Select Sector SPDR Fund (XLP)** at 3.87 percent of assets. While some may consider that enough to “give it a go” we find such a recommendation rather contrived, and we’ve seen too many folks make those kinds of recommendations and rarely see them work out well. We’ll pass on that “opportunity.”

## This brings us to the other revelation from our subscriber conversations.

In addition to the thematic lens through which we view the investing world as well as the larger world around us, they like new stock ideas. Especially ones that aren’t exactly mainstream ones like current holdings **United Natural Foods (UNFI)**, **Dycom Industries (DY)** and **CalAmp Corp. (CAMP)**, as well as past positions in **American Water Works (AWK)**, **USA Technologies (USAT)**, **Pilgrim’s Pride (PPC)** and Measurement Specialties.

We hear you and from here on out, we will be sharing two new stocks per month with subscribers, and more detailed portfolio updates once per month. Should there be a big move in position during the week, rest assured we’ll address it as well as what we’ll be doing about it. In breaking down each of the two new stocks per month, each will have at least one of our thematic tailwinds at its back, however, depending on the upside in the stock price and other factors the shares could wind up on the **Select List** to take an immediate position or the **Contender List** where we’ll continue to watch for the right time to make a move. We’ll kick this off next week .

## The Restaurant-Grocery Inflation Gap Is Driving A Pick Up In Restaurant Bankruptcies

We've long said that thematic data points can be easily observed in the world around us in our day to day lives. Some are more obvious, and others need to be noodled on, but those data points are there and we are not only looking for them but listening to what they have to tell us as well. Here's an example:

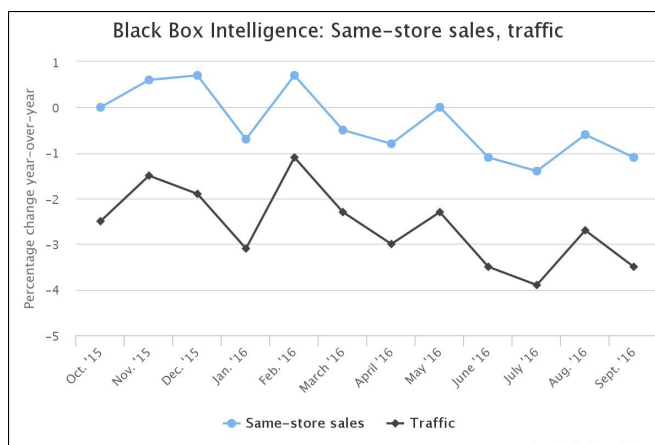
For its September 2016 quarter, **Sonic Corp. (SONC)**, the largest chain of drive-in restaurants in the US, reported its same-store sales decreased 2.0 percent year over year, with a 1.8 percent same-store sales decrease at franchise drive-ins and a decrease of 3.0 percent at company drive-ins.



Similar year on year declines have been reported at **Red Robin Gourmet Burgers (RRGB)**, which experienced a 3.6 percent fall in same store comp sales year over and **Chipotle Mexican Grill (CMG)**, which continues to be impacted by its E.Coli crisis several quarters ago. Despite that lingering crisis impact, Chipotle's 3Q 2016 monthly comps were as follows:

- **July down 23.8 percent**
- **August down 21.7 percent**
- **September down 20.1 percent**

Despite the kick-off of the new National Football League season, even **Buffalo Wild Wings (BWLD)** reported a 1.8 percent drop in same-store sales for the September quarter.



Pulling the lens back, we find that these year-over-year declines are far more pervasive than at just these three companies. Per Black Box Intelligence, same-store restaurant sales were negative for the fourth consecutive month in September, with a drop of 1.1 percent. All told, for 3Q 2016 at -1.0 percent same-store sales growth and -3.4 percent in traffic, was the weakest quarter since the second quarter of 2010.

Casual-dining traffic has fallen for each of the past 14 months, according to data from the MillerPulse index. And it has fallen at least 2.3 percent in each of the past five.

### The question is why restaurants are taking it so hard on the chin during a time of lower unemployment and modestly better wages... at least according to the official government statistics?

The answer can be found in the restaurant-grocery inflation gap. Over the past year, restaurant prices have increased 2.4 percent, according to federal data, while grocery prices have fallen 2.2 percent on average. There are far greater price declines found in the grocery store, like those for meat, which have fallen 6.3 percent over the last year.

*“The gaps are widest it’s been in the last 15 years. But the environment is somewhat anomalous in that food deflation is not coinciding with the recession or at least not a consumer recession.*

*In the immediate term, our view is that this deflation is impacting consumer buying patterns and channel preferences, but it’s also heightening the depth and frequency of competitive activity as well as consumer sensitivity to discounting. And this persistent upward pressure on labor costs, in our view, will continue to make this environment that much more difficult to manage in the near-term... We need to cycle through the next six months of commodity deflation and difficult comparisons.”*

J. Clifford Hudson, Sonic Corp (SONC)

October 24, 2016

*“Wage for sure, right, I think we’re operating in an environment Jeff where wage inflation is the reality, it’s the biggest source of inflation in our industry, it’s certainly the biggest source of inflation in our P&L and it’s unprecedented. Again, I think if we had 5 percent food cost inflation, everyone would be kind of really flipping out, but 5 percent labor inflation is significant.”*

- Michael J. Bufano, Panera Bread Co. (PNRA)

October 26, 2016

The cold hard reality that restaurants are dealing with is despite lower input costs, higher labor and benefit costs, are resulting in higher prices that has consumers voting with their feet to eat more at home to take advantage of lower food prices.

## **Why is this important?**

Thus far in 2016, more than 8 restaurant chains repressing a dozen chains have filed for bankruptcy including — Logan’s Roadhouse, Fox & Hound, Champps, Bailey’s, Old Country Buffet, HomeTown Buffet, Ryan’s, Johnny Carino’s, Quaker Steak & Lube, Zio’s Italian Kitchen, Black-eyed Pea, Cosí, and Don Pablo’s Mexican Kitchen among others.

This wave of bankruptcies is largely due to a decline in sales at restaurant chains that is particularly harmful to companies that are already walking a balance-sheet tightrope. These bankruptcies have led to job losses in the domestic economy, and with the odds high that more bankruptcies are likely to be had, it means more job losses. According to the National Restaurant Association (NRA), the restaurant industry employs 14.4 million people in the US and is expected to create another 1.7 million jobs by 2026. Perhaps the National Restaurant Association may need to recast those figures as we head into 2017.

## **The Thematic Bottom Line**

We continue to receive data points that reveal continued weakening of restaurant traffic as consumers take advantage of food price deflation to return to grocery stores and eating in. This bodes well for **United Natural Natural Food’s (UNFI)** expanding footprint as consumers continue to shift toward natural, organic and similar products.

**Even after climbing more than 16 percent over the last week, we continue to rate UNFI shares a Buy and our price target remains \$65.**

## TEMATICA SELECT LIST PERFORMANCE

POSITION	DATE ADDED	ADD PRICE	CURRENT PRICE	DIV. PAID	STOP PRICE	RETURN (%)	TARGET	RATING
<b>ALPHABET, INC. (GOOGL)</b> <i>Asset-Lite</i>	6/15/16	\$733.94	\$775.16	--	--	5.62%	\$900.00	(BUY)
<b>AMAZON.COM (AMZN)</b> <i>Connected Society</i>	5/24/16	\$709.53	\$743.24	--	--	4.75%	\$950.00	(BUY)
	10/28/16	\$781.59	\$743.24	--	--	-4.91%	\$950.00	(BUY)
<b>AMN HEALTHCARE SERV. (AMN)</b> <i>Scarce Res. / Aging of Population</i>	8/17/16	\$33.80	\$31.85	--	--	-5.77%	\$47.00	(BUY)
	10/5/16	\$31.18	\$31.85	--	--	2.15%	\$47.00	(BUY)
<b>AT&amp;T (T)</b> <i>Connected Society</i>	10/12/16	\$39.29	\$36.77	--	--	-6.18%	\$45.00	(HOLD)
<b>CALAMP CORP (CAMP)</b> <i>Connected Society</i>	8/09/16	\$15.37	\$14.80	--	--	-3.71%	\$21.00	(BUY)
	10/05/16	\$13.70	\$14.80	--	--	8.03%	\$21.00	(BUY)
<b>COSTCO WHOLESALE (COST)</b> <i>Cash-strapped Consumer</i>	9/28/16	\$149.67	\$151.15	--	--	1.29%	\$170.00	(BUY)
<b>WALT DISNEY CO. (DIS)</b> <i>Content is King</i>	4/20/16	\$102.16	\$97.70	\$0.71	\$87.00	-3.67%	\$125.00	(BUY)
	5/11/16	\$101.78	\$97.70	\$0.71	\$87.00	-3.31%	\$125.00	(BUY)
<b>DYCOM INDUSTRIES (DY)</b> <i>Connected Society</i>	9/14/16	\$80.47	\$90.61	--	--	12.60%	\$115.00	(BUY)
	10/29/16	\$72.89	\$90.61	--	--	24.31%	\$115.00	(BUY)
<b>INTER. FLAVORS &amp; FRAGRANCES (IFF)</b> <i>Rise &amp; Fall of the Middle Class</i>	10/19/16	\$129.23	\$118.06	--	--	-2.45%	\$145.00	(BUY)
<b>PROSHARES SHORT S&amp;P 500 (SH)</b>	1/14/16	\$45.10	\$37.66	--	--	-16.50%	\$24.00	(BUY)
	3/23/16	\$41.12	\$37.66	--	--	-8.41%	\$24.00	(BUY)
<b>STARBUCKS (SBUX)</b> <i>Guilty Pleasures</i>	6/01/16	\$54.90	\$54.59	\$0.20	--	-0.19%	\$74.00	(BUY)
<b>UNDER ARMOUR (UA)</b> <i>Rise &amp; Fall of Middle Class</i>	7/27/16	\$39.26	\$31.94	--	--	-18.64%	\$55.00	(BUY)
	11/2/16	\$30.74	\$31.94	--	--	3.90%	\$55.00	(BUY)
<b>UNITED NATURAL FOODS (UNFI)</b> <i>Foods with Integrity</i>	8/31/16	\$47.00	\$49.39	--	--	5.09%	\$232.00	(BUY)
	9/14/16	\$38.91	\$49.39	--	--	26.93%	\$232.00	(BUY)
<b>UNIVERSAL DISPLAY (OLED)</b> <i>Disruptive Technology / Connected Society</i>	10/5/16	\$53.09	\$60.55	--	--	14.03%	\$68.00	(BUY)

as of market close November 15, 2016

## 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 trade-off to reach more appetizing levels.

AWK	American Water Works	Scarce Resources
WTR	Aqua America	Scarce Resources
CHGG	Chegg Inc.	Tooling & Retooling
CMG	Chipotle Mexican Grill	Foods with Integrity
SCOR	Comscore	Connected Society
GLW	Corning Inc.	Disruptive Technologies
EPR	EPR Properties	Content is King
IMMR	Immersion Corp.	Disruptive Technologies
KIM	Kimco Realty	Rise & Fall of the Middle Class
LOCK	Lifelock	Safety & Security
MKC	McCormick & Co.	Cashstrapped Consumer / Middle Class
MRK	Merk & Co.	Aging of the Population
NLSN	Nielson NV	Connected Society
OME	Omega Protein Corp.	Fountain of Youth
PANW	Palo Alto Networks	Safety & Security
SYNA	Synaptics Inc.	Disruptive Technologies
VZ	Verizon Communications	Content is King / Connected Society
XYL	Xylem, Inc	Scarce Resources

## STOCKS / FUNDS MENTIONED

- Alphabet (GOOGL)
- Amazon (AMZN)
- American Water Works (AWK)
- AMN Healthcare (AMN)
- Baidu (BIDU)
- Buffalo Wild Wings (BWLD)
- CalAmp (CAMP)
- Chipotle Mexican Grill (CMG)
- Costco Wholesale (COST)
- Dycom Industries (DY)
- Facebook (FB)
- International Flavors & Fragrance (IFF)
- Panera Bread Co. (PNRA)
- Pilgrim's Pride (PPC)
- PowerShares Internet ETF (PNQI)
- Priceline (PCLN)
- Red Robin Gourmet Burgers (RRGB)
- Sonic Corp. (SONC)
- United Natural Foods (UNFI)
- United Natural Foods (UNFI)
- Universal Display (OLED)
- USA Technologies (USAT)

## 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.

This research report is provided for informational purposes only and shall in no event be construed as an offer to sell or a solicitation of an offer to buy any securities. The information described herein is taken from sources, which we believe to be reliable, but the accuracy and completeness of such information is not guaranteed by us. The opinions expressed herein may be given only such weight as opinions warrant. This firm, its officers, directors, employees, third party data providers or members of their families may have positions in the securities mentioned and may make purchases or sales of such securities from time to time in the open market.