

# TEMATICA INVESTING

THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES

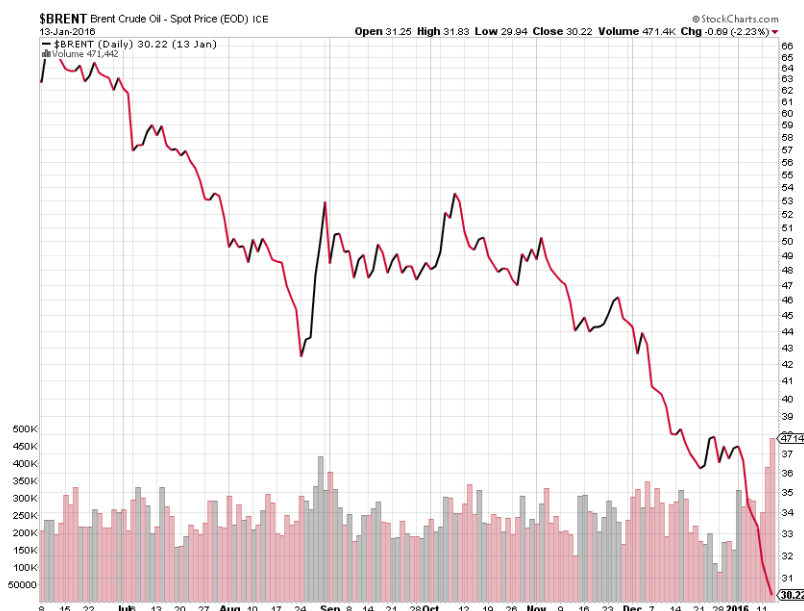


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*Tematica Investing*, a weekly publication by Chris Versace, is designed for the experienced or professional investor, providing in-depth information on real-time developing thematic strategies, economic outlook, investment trading ideas, and analysis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

## Is Now the Time to “Buy the Dips” on FIT Shares?

In the January 11 edition of **Monday Morning Kickoff** (MMKO) we covered the growing number of concerns that are hitting the market and are likely to continue doing so over the next few weeks as corporate earnings for the December quarter kick into high gear. If you missed it that weekly Monday missive, [we highly recommend you read it now](#), for in the coming paragraphs we are going to focus on falling oil prices, which has taken center stage in the markets as the week has progressed, reigniting the selling pressure that began last week.



not expect OPEC production cuts anytime soon.

The wind up on all of this has us expecting oil prices to remain significantly lower year-over-year, which while good for the consumer, will likely lead to reduced earnings expectations, capital spending cuts and, in all likelihood, some degree of industry consolidation in the coming months.

While the market is catching a bit of a bounce today, looking out over the next few days brings not only a long weekend, but the real kickoff to December quarter earnings. To us this suggests traders will be taking cover heading into the long weekend given concerns over what they may walk into Tuesday morning when **Bank of America (BAC), Comerica (CMA), Morgan Stanley (MS), Charles Schwab (SCHW)** and other companies issues their quarterly results ahead of the market open. As you digest our earlier MMKO comments and those on oil above, we think you'll agree the prudent move is to remain on the sidelines for now with fresh capital until such a time as the market storm clears and we can put money to work at better prices with far higher conviction.

**What's Going on with Our Investing Themes?**

Amid an environment like this, it tends to be shoot first and ask questions later, as evidenced by the sharp moves in some of 2015's "go-go" stocks. At the market close on January 14, all three major market indices — the Dow Jones Industrial Average, the S&P 500 and the Nasdaq Composite Index — entered "correction" territory. For those wondering, all S&P 500 sectors have posted losses at this point for 2016.

We know times like this when the market seemingly goes down day after day after day can be frustrating, if not confusing. And we would not be surprised if a few were having flashbacks, wondering if we are headed for a repeat of what happened from May 2008 to March 2009, a period of intense pain for the stock market.

It's in times like these that we keep one eye on the market (which is the indicator of price) and the other eye on our investing themes, looking for data points that help identify companies whose businesses will continue to perform regardless of what's recently happened in the market or will continue to happen in the next several months.

If you were here at Tematica HQ you would hear us bantering questions like some of these:

- Has the drop in the stock market changed the outlook for cyber attacks and related threats in 2016? ..... **Safety & Security**
- Despite the unseasonably warm temperatures in the eastern United States thanks to El Nino, has California's drought situation been eradicated? ..... **Scarce Resources**
- Has the shift toward streaming and other digital content consumption slowed because the stock market has lost close to \$1 trillion in value, lessening the demand for content? ..... **Connected Society**
- By some strange hocus-pocus, have people become de-aged so that less than 15% of the population is over 65 years old? ..... **Aging of the Population**
- As if by magic, did all those people with little to no retirement savings suddenly land on firm financial footing? ..... **Aging of the Population**
- Over the last few days has the costly and deadly impact of obesity and prevalent condition of so many people being overweight been reversed? ..... **Fattening of the Consumer**

- Have retailers, both brick & mortar as well as online, shifted to only taking cash and checks as payment for goods and services? ..... **Cashless Consumption**
- Are people all of a sudden smoking less in the last few days? If anything we would argue those who do indulge in this guilty pleasure are probably smoking more and having an extra drink or two along with it..... **Guilty Pleasure/Affordable Luxury**
- Has the domestic middle class started to expand dramatically in January? ..... **Rise and Fall of the Middle Class**

And so on... **Foods with Integrity...Asset-Lite Business Models...Economic Acceleration/Deceleration...Tooling & Retooling...**

The bottom line is these investing themes of ours continue to benefit from the shifting and evolving landscape that is the intersection of the global economy, changing demographics, disruptive technologies, regulatory mandates and other tailwind drivers.

As we said earlier, the stock market is simply the indicator of price.

If you saw a great product on sale at the store, you would be excited, maybe even ecstatic, if it was one you had been looking at for some time. The same is true with stocks!

We all tend to get caught up in the emotional response of the market moving lower, which usually is viewed as a bad thing, rather than an OPPORTUNITY to buy shares at an even better price. When viewed through that lens, who doesn't love it when stocks go on sale... so long as the fundamentals and business drivers remain intact.

Here's a great example — at the Consumer Electronics Show held earlier this month, **Fitbit (FIT)** announced its first smart watch, dubbed the Blaze, which will retail at \$199, compared to **Apple's (AAPL)** Apple Watch that sells for a few hundred dollars more. The price of Fitbit's Blaze is on parity with the UA Band announced by **Under Armour (UA)** as a new activity band priced at \$180 (above similar Fitbit products).

According to tech research firm Gartner, 91.5 million smartwatches, sports watches and activity-tracking wristbands were shipped in 2015 and the firm sees that growing to more than 116 million this year. Looking out a bit further, Technalysis Research sees the market growing to 175 million devices in 2020 from 22 million devices in 2014, while CCS Insights forecasts 245 million devices will ship in 2019, with fitness and activity trackers accounting for more than half of the units shipped in 2019. No matter which forecast one looks at, demand for these devices is going to be significantly higher than the 21 million units that were shipped in the September 2015 quarter.

Helping fuel this demand is the dramatic rise of healthcare costs over the last few decades. Those heightened costs accounted for \$3 trillion, or 17.5%, of GDP in 2014, and led employers to embrace strategies such as health and wellness programs. Those programs may include devices like those from Fitbit to offset costs. This trend puts FIT shares in the crosshairs of our **Fattening of the Population** and **Connected Society** investing themes.

We view Fitbit's entrance into the smart watch market as a bid by the company to expand on its current offerings



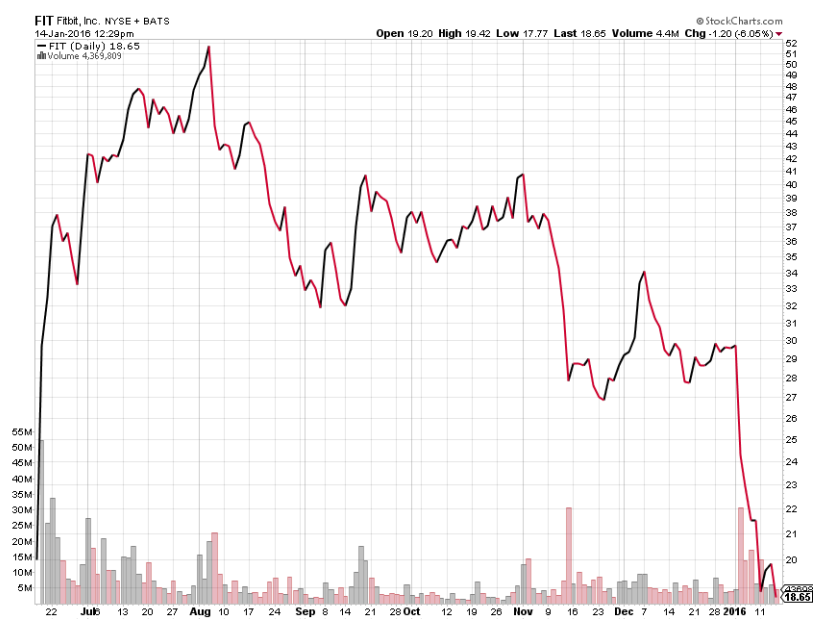
with a functional-fashion product that has a higher price point, \$200, vs. \$130 and \$150 for its Charge and Charge HR products. Its \$200 price is more than the \$180 for UA Band and less than the \$349 starting price for Apple Watch. It seems to us that Fitbit is becoming what we would call a product company rather than remaining one that depends on a single feature (pedometer) that probably will be coopted by other devices, much the way personal information management functions came to mobile phones and smartphones — killing demand for the original and subsequent Palm Pilots in the process.

We initially recommended FIT shares in December 2015, and then recommended adding to that position on January 6 of this year when shares initially dipped after the Consumer Electronics Show.

What’s happened with FIT shares since the start of 2016? They’ve fallen 33%, which reflects several factors such as the reception of the company’s smart watch, the entrance of our own Under Armour (UA) into the athletic band market (albeit with a higher priced offering), and the overall drop in the market. As you can see in the chart above, FIT shares have clearly entered over sold territory, which is a great opportunity to improve our cost basis, particularly given the strong showing the company’s products had this past holiday shopping season. The proof point for that was Fitbit’s app being ranked #1 on the Apple App Store after the Christmas holiday.

From our perspective, the sharp drop in the share price means FIT shares are “ON SALE”. Excluding the net cash per share of \$2.75 on the company’s balance sheet, FIT shares are trading at just over 17x expected 2016 earnings of \$1.13 per share (up from \$1 per share in 2015). And Fitbit earnings are slated to grow at nearly double the pace of the S&P 500, which currently trades at more than 15x 2016 earnings expectations.

While all of that sounds tempting, given our concerns with the overall direction of the stock market and prospects for more downside, we are going to hold off on adding even more of the FIT shares in the Tematica Select List, at least until the market settles down. Better to be patient and filled with conviction than buy just to put money to work haphazardly.



## Tematica Select List of Investments

AAL AMERICAN AIRLINES					Scarce Resources
RECOMMENDED	PURCHASE PRICE	CURRENT PRICE*	CHANGE (\$)	CHANGE (%)	
8-19-2015	\$43.53	\$40.10	<b>(3.43)</b>	<b>(7.88%)</b>	

DIS WALT DISNEY CO.					Content Is King
RECOMMENDED	PURCHASE PRICE	CURRENT PRICE*	CHANGE (\$)	CHANGE (%)	
8/12/2015	\$106.94	\$98.48	<b>(\$8.46)</b>	<b>(7.91%)</b>	

FIT FITBIT, INC.					Fattening of Consumer / Connected Devices
RECOMMENDED	PURCHASE PRICE	CURRENT PRICE*	CHANGE (\$)	CHANGE (%)	
12/14/2015	\$29.15	\$19.85	<b>(\$9.30)</b>	<b>(31.90%)</b>	
1/7/2016	\$22.90	\$19.85	<b>(\$3.05)</b>	<b>(13.32%)</b>	

RECOMMENDED	PURCHASE PRICE	CURRENT PRICE*	CHANGE (\$)	CHANGE (%)	
9/11/2015	\$23.75	\$22.35	<b>(\$1.40)</b>	<b>5.89%</b>	

NFLX Netflix					Connected Society
RECOMMENDED	PURCHASE PRICE	CURRENT PRICE*	CHANGE (\$)	CHANGE (%)	
9/11/2015	\$97.51	\$106.56	<b>\$9.05</b>	<b>9.28%</b>	

PYPL PayPal Holdings, Inc					Cashless Consumption
RECOMMENDED	PURCHASE PRICE	CURRENT PRICE*	CHANGE (\$)	CHANGE (%)	
9/2/2015	\$35.07	\$32.12	<b>\$2.95</b>	<b>8.41%</b>	

UA Under Armour, Inc					Rise & Fall of the Middle Class
RECOMMENDED	PURCHASE PRICE	CURRENT PRICE*	CHANGE (\$)	CHANGE (%)	
10/23/2015	\$92.02	\$71.87	<b>(\$20.15)</b>	<b>(21.90%)</b>	

\* As of Market Close January 13, 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 tradeoff to reach more appetizing levels.

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

## Companies Mentioned

- Apple (AAPL)
- Bank of America (BAC)
- Charles Schwab (SCHW)
- Comerica (CMA)
- Fitbit (FIT)
- Morgan Stanley (MS)
- Under Armour (UA)

## 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

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