MONDAY MORNING KICKOFF

YOUR MARKET PRIMER FOR THE WEEK AHEAD

WEEK OF MAY 16, 2016

It was another bleh week for the stock market as the growing list of concerns ramped up, including another round of forecast cuts from big box retailers and department stores like **Macy's (M), Kohl's (KSS), Gap (GPS)** and **Nordstrom (JWN)**. There was also growing chatter over what could happen should the Brexit indeed come to pass and much talk over investors pulling assets from the market. These add to existing concerns over global economic growth, as well as what's looking more and more like aggressive earnings expectations in the back half of the year relative to the first half.

As we well know, the market does not like uncertainty, and this latest bout has been taking some of the wind out of the market's February to early April gains. Over the last few weeks, the S&P 500 has fallen roughly 2.5 percent, reducing its year-to-date return to less than 0.3 percent.

Thematic Signals

[Middle class is hollowing out in many cities]
Rise & Fall of the Middle Class

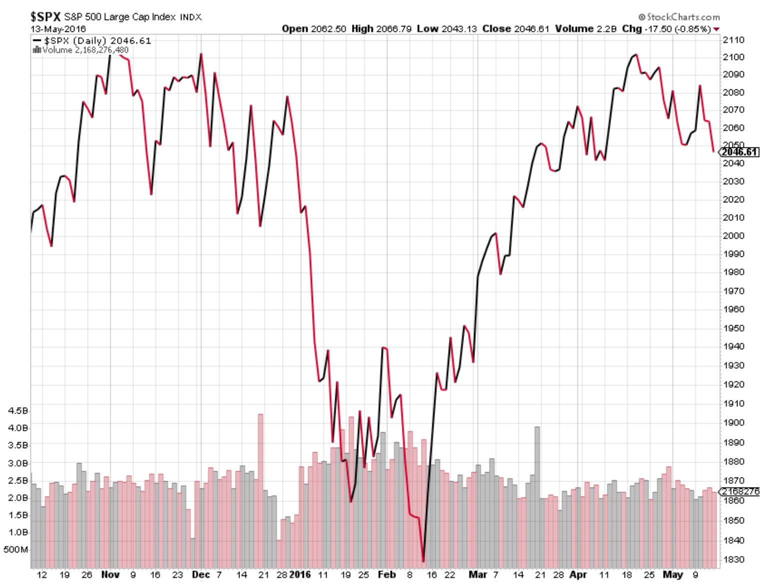
[Aging population means new jobs]
Aging Population

[Amazon's Stealth Takeover Of The Internet Of Things Dashes Forward] *Connected Society*

[Why Tesla's Mass-Market Car Should Scare Mercedes and BMW] *Disruptive Tech./Affordable Luxury*

[Retail Sales Gain Is Fueled by Web]
Connected Society

[Are These The Final, Doomed Days Of The American Mall?] *Connected Society*



TEMATICA RESEARCH

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.

The market's decline has led to investors pulling capital from the market.

According to data published last week from the Investment Company Institute (ICI), for the eight consecutive week mutual fund investors sold stocks and piled into bonds (see chart right). According to analysts at the investment bank, Jefferies, global equity funds "recorded their fifth consecutive weekly outflow, at a net $7.3 billion."

Combined Estimated Long-Term Fund Mutual Flows and ETF Net Issuance
Millions of dollars

	5/4/2016	4/27/2016	4/20/2016	4/13/2016	4/6/2016
Equity	-13,397	-3,179	-4,143	-3,464	-622
Domestic	-12,858	-1,276	-3,283	-2,525	-261
World	-539	-1,903	-860	-938	-361
Hybrid	-304	194	200	-119	490
Bond	3,791	9,244	5,731	3,398	6,752
Taxable	2,141	7,241	4,588	2,541	5,389
Municipal	1,650	2,002	1,143	856	1,364
Commodity	1,357	-128	-142	-617	237
Total	**-8,553**	**6,130**	**1,645**	**-802**	**6,857**

The cited reason for those moves according to ICI?

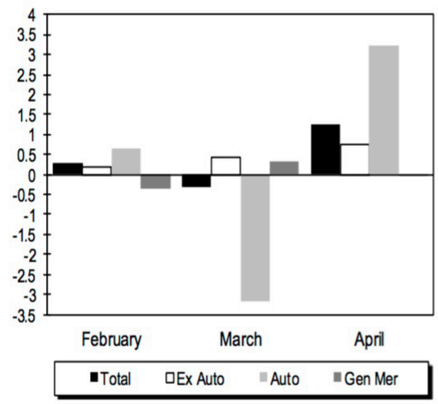
Investors still doubt the economy's stamina after a shaky first quarter. Over the weekend, there was more wood thrown on that fire:

- Growth in China's factory output cooled to 6 percent in April, the National Bureau of Statistics (NBS) said on Saturday. Expectations called for a 6.5 percent increase following an increase of 6.8 percent in March.
- Japanese Prime Minister Shinzo Abe has decided to delay a sales tax hike, which to us sounds very much like Abe does not want to add any additional weight to the sagging Japanese economy.

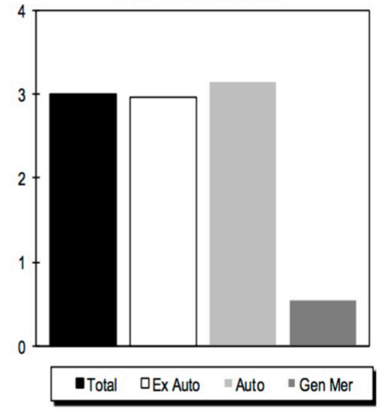
Even here at home, expectations for the current quarter are as high as they were in early February for the March quarter, while others are looking for only a modest pick up from 1Q 2016's disappointing 0.5 percent GDP reading. The Atlanta Fed's GDPNow currently forecasts GDP for the current quarter at 2.8 percent, which was boosted after Friday's April Retail Sales Report. The reported increase of 1.3 percent in April Retail Sales over the previous month (0.8 percent excluding auto sales) shows that while consumers are cautious, they are indeed spending. A reading of up 0.8 percent excluding autos is hardly gangbusters, and we see other confirming signs of this in our ***Cash Strapped Consumer*** investing theme.

Percent Change in Retail and Food Services Sales
(Estimates adjusted for seasonal variation and holiday and trading-day differences, but not for price changes)

From Previous Month

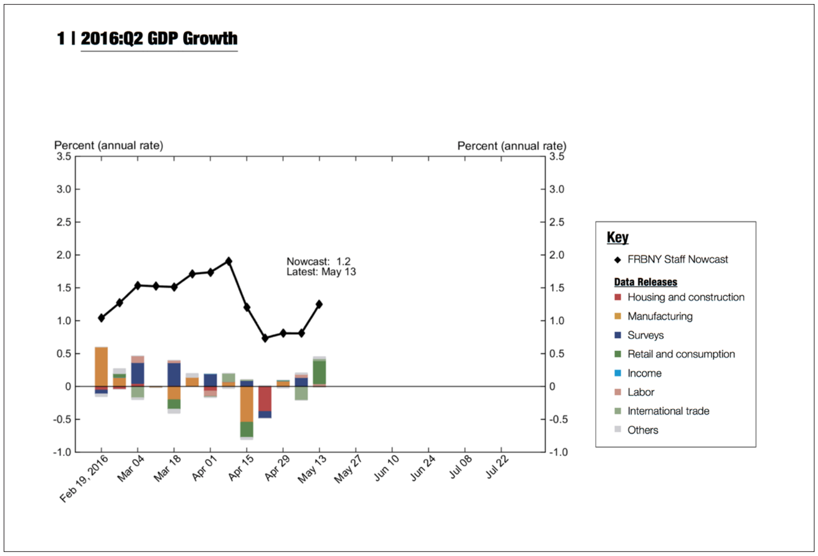


From Previous Year



Inside those figures, we also see confirmation for both our ***Content is King*** and ***Connected Society*** investment themes that Tematica CIO Chris Versace writes about in his new book ***Cocktail Investing: Distilling Everyday Noise into Clear Investment Signals for Better Returns.*** We will be discussing this in greater detail with ***Tematica Investing*** subscribers later this week.

To us a more sober view of the economy in the current quarter is had in the NY Fed's FRBNY Nowcast (see chart right). Exiting the week, that reading stood at 1.2 percent, and while up week over week, we'd note it's well below the near 2 percent reading it registered a month ago.



As we enter this week, we are halfway through the current quarter. This means that in the coming weeks we'll be filling in the blanks and coloring in between the lines with much more data, economic and otherwise. Much like how a page on a coloring book gets filled in, we expect to have a much fuller view on the quarter over the next two to three weeks. Until then, odds are high investors will remain cautious.

We'd also chalk some of that concern to the brouhaha coming out of the SkyBridge Alternatives (SALT) Conference this past week. This year has been challenging for hedge funds as they've experienced negative fund flows and redemptions of more than $14 billion in the first quarter. Over the past two quarters, investors pulled almost $17 billion from hedge funds, marking the largest outflows since 2009.

In looking over the industry's performance, it is easy to understand why the tide has turned against hedge funds. The industry has significantly under-performed the overall market, according to Hedge Fund Research. The HFRI Composite index has fallen 4 percent since the second quarter last year, under-performing the S&P 500 by 6 percent, and it started 2016 off with the worst January since 2008. Taking a longer view, the HFRI Composite Index is up just 1.7 percent over the past five years, compared with more than 53 percent for the S&P 500.

As these funds look to raise capital to meet cash redemption needs, it's another reason to see the overall market being constrained as we move deeper into "Sell in May."

From our perspective, there have been, and continue to be, a number of reasons to be cautious in the market. We've been rather selective in deploying capital into new positions, given concern over the mismatch between the global economy and stock valuations. That mismatch still stands with Friday's closing of the S&P 500 at 17.2x expected 2016 earnings of $119.11 per share. Not only is that market multiple above 5-and 10-year averages, but 2016 EPS is up all of 1 percent year over year (and yes, that doesn't account for all those stock buyback programs that are out there and actively boosting reported EPS).

Given the earnings results we've seen for the March quarter — on a blended basis earning fell 7.1 percent for the S&P 500 group of companies — and prospects for only modest improvement in the current quarter, we continue to see EPS expectations for the back half of 2016, to quote former Fed Chair Alan Greenspan, as "irrationally exuberant." This means our patience and selectivity will continue in the coming weeks.

Turning to the Week Ahead

From the flow of economic data this week, we'll start to get our first look at how the domestic manufacturing economy is fairing in May, starting off with the Empire Manufacturing Report and the Philly Fed Report. Other key indicators to watch include a hefty dose of housing data — including April Housing Starts and the May NAHB Housing Market Index — as well as the April CPI reading. With the Fed's next FOMC meeting just a month away, we expect the market will be paying more than passing attention to the April meeting minutes that are released this coming Wednesday (May 18).

As we mentioned above, the NY Fed's Nowcast for GDP in the current quarter clocking in at a moderate 1.2 percent. Add in the looming Brexit vote on June 23rd and the soon to be in full swing 2016 presidential election, and we maintain our view that the Fed will likely hold off boosting interest rates until the back half of 2016 at the soonest. The next key dates to watch for the global economy will be when Japan chairs the Group of Seven summit on May 26 and 27. The tone for that meeting will likely be set by the next round of Flash PMI reports from Markit Economics that are published on May 23rd.

ECONOMIC CALENDAR, MAY 16 - 20, 2016

DATE	REPORT / SPEECH	DATA
16-May	**Empire Manufacturing**	May
16-May	**NAHB Housing Market Index**	May
16-May	**Net Long-Term TIC Flows**	Mar
17-May	**CPI**	Apr
17-May	**Core CPI**	Apr
17-May	**Housing Starts**	Apr
17-May	**Building Permits**	Apr
17-May	**Industrial Production**	Apr
17-May	**Capacity Utilization**	Apr
18-May	**MBA Mortgage Index**	14-May
18-May	**Crude Inventories**	14-May
18-May	**FOMC Minutes**	27-Apr
19-May	**Initial Claims**	14-May
19-May	**Continuing Claims**	7-May
19-May	**Philadelphia Fed**	May
19-May	**Leading Indicators**	Apr
19-May	**Natural Gas Inventories**	14-May
20-May	**Existing Home Sales**	Apr

From an earnings perspective, we have just 9 percent of the S&P 500 left to report first quarter earnings. Most of these tend to be January quarter end fiscal year companies, which means a heavy dose of retailers that closed their quarterly books at the end of April. The good news is the frequency will drop considerably this week, and you can see that reflected in our thematic dissection of what's on tap this week. The bad news is the news is likely to be bad, largely because the reports will be rather heavily handed on retail. As we said at the outset of today's MMKO, we saw a number of retailers issue worrisome news last week. Not a good set up for what is to come this week.

That said, it would be a mistake to think that all of retail is getting hit. As we mentioned above, when parsing the April Retail Sales data through our thematic perspective, there were several bright spots to be had, which will be putting to use in the coming weeks in **Tematica Investing**.

That's another example of how digging into the data and shining a spotlight on it can offer context and confirmation in what is looking to be a challenging time for the market. The key is to have the right perspective, and that usually means not following the herd.

As we look to chart the course of the good ship Tematica, we'll continue to let the data talk to us as we look to move the ship forward in the coming weeks. On tap this week, the following are the earnings reports by theme that we will be keeping an eye on:

Affordable Luxury
- L Brands (LB)
- Williams Sonoma (WSM)
- Perry Ellis International (PERY)

Aging Population
- Alere Inc. (ALR)

Asset Lite
- Virtues Corp. (VRTU)
- Axiom Corp. (ACXM)
- Booz Allen Hamilton (BAH)
- salesforce.com (CRM)

Cash-Strapped Consumer
- TJX Companies (TJX)
- Campbell Soup (CPB)
- Wal-Mart Stores (WMT)
- Ross Stores (ROST)
- Bon-Ton Stores (BONT)
- Advance Auto Parts (AAP)

Connected Society
- ParkerVision (PRKR)
- Comscore (SCOR)
- Cisco Systems (CSCO)
- Cato Corp. (CATO)

Economic Acceleration/Deceleration
- Eagle Materials (EXP)
- Lowes Co. (LOW)
- Home Depot (HD)

Fattening of the Population
- Famous Dave's (DAVE)
- Red Robin Gourmet (RRGB)
- Dick's Sporting Goods (DKS)
- Foot Locker (FL)
- Hibbet Sports (HIBB)

Foods with Integrity
- Flower Foods (FLO)
- Fresh Market (TFM)

Guilty Pleasure
- Rocky Mountain Chocolate (RMCF)
- SABMiller PLC (SBMRY)

Rise & Fall of the Middle Class
- Children's Place (PLCE)
- American Eagle Outfitters (AEO)
- Hormel Foods (HRL)
- Target (TGT)
- Urban Outfitters (URBN)
- Citi Trends (CTRN)

Safety & Security
- Elbit Systems (ELBT)

Scarce Resources
- Deere & Co. (DE)

Tooling & Retooling
- Itron, Inc. (ITRI)
- Applied Materials (AMAT)

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