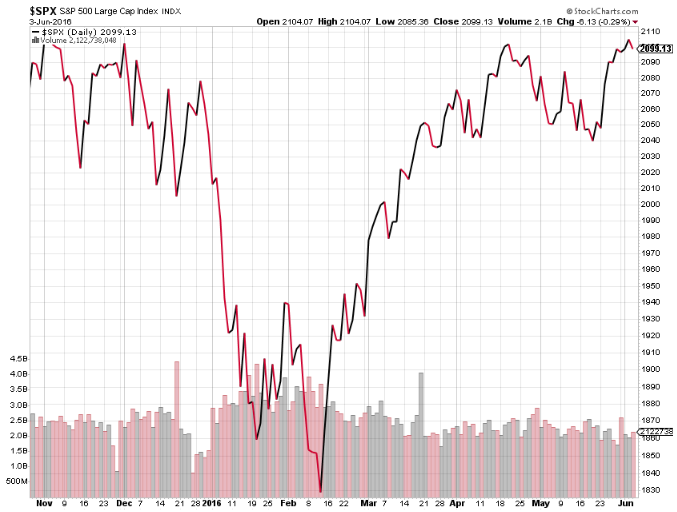
MONDAY MORNING KICKOFF

YOUR MARKET PRIMER FOR THE WEEK AHEAD

WEEK OF JUNE 6, 2016

Last week we closed the books on May, which saw the S&P 500 climb 1.53 percent, and entered the month of June at 2,096.96. Because of the Memorial Day holiday, we didn't publish a ***Monday Morning Kickoff*** last week, and given the plethora of data last week, we've got quite a bit to cover. Let's get started…



As expected, those first few days of what some call the "June swoon" were chock full of the usual bout of start of the month data. In aggregate, it pointed to the deceleration of the global economy, which is very much in tune with what we're seeing in our ***Economic Acceleration/Deceleration*** investment theme. The latest smear of data once again raised questions on whether the Fed would raise rates this summer, or have to wait until sometime in the back half of the year.

Amid that backdrop, and with the next Federal Reserve meeting slated for June 14-15, we can expect Wall Street and the investment community will zero in on Fed Chairwoman Janet Yellen's remarks when she pulls double duty today speaking at

Thematic Signals

Why so many Americans in the middle class have no savings *Cash-Strapped Consumers*

Going after Amazon, Wal-Mart to test grocery delivery with Uber and Lyft *Connected Society*

First disappointing May auto sales, now Jamie Dimon sounds the alarm on auto loans *Cash-Strapped Consumers*

More Americans Plan to Retire After 70 *Aging of the Population*

Champagne bubbles: reflect more than just the quality of the bubbly *Guilty Pleasures*

Recently confirmed Myspace hack could be the largest yet, dwarfing LinkedIn and Tumblr breaches *Safety & Security*

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.

World Affairs Council of Philadelphia and participates in a roundtable discussion at the West Philadelphia Skills Initiative.

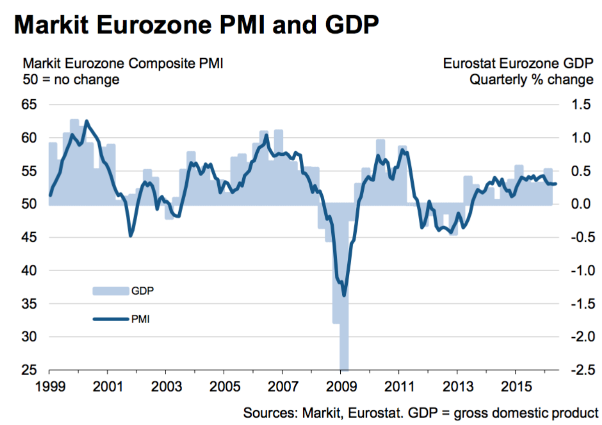
Manufacturing Data

With the four horsemen of the global economy (that's what we call the US, Eurozone, China and Japan) setting the tone of the global economy, it comes as little surprise that JPMorgan's Global Manufacturing PMI fell to a reading of 50.0 in May from 50.1 in April. The report showed output, orders and exports all fell month over month. Here are the specifics from Markit Economics findings:

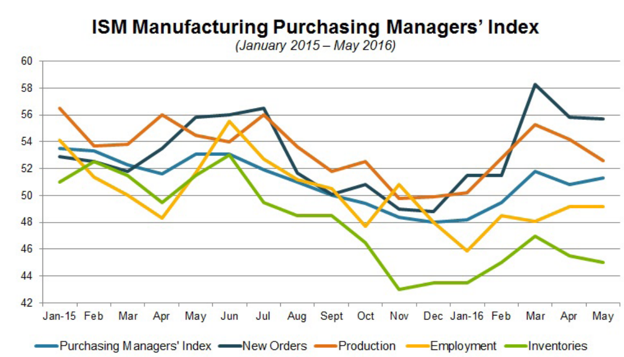
- **China**: May's PMI published by Caixin/Markit slipped to 49.2 from April's 49.4, marking the 15th month below the expansion/contraction line of 50.

- **Japan**: May's headline PMI fell to 47.7 from 48.2, with both production and new orders posting sharp sequential declines.

- **Eurozone**: The final May manufacturing PMI came in at 51.5, down slightly from 51.7 in April, due to new export order growth hitting a 16-month low. What caught our eye the most was this comment in the Markit report: "New orders grew at the slowest rate for over a year as demand showed signs of waning both within the euro area and further afield. Not surprisingly, companies remain reluctant to build capacity and take on extra workers, lacking signs of any imminent upturn in demand."



- **US**: The May manufacturing PMI reading dipped to 50.7 from Aprils 50.8, but below that headline, new business growth fell to its weakest level in 2016. In our view, the following comment from Markit encapsulates the U.S. data rather well: "Manufacturers cited a range of factors acting to dampen client spending, including weak capital investment across the energy sector, uncertainty related to the presidential election and generally subdued economic conditions. Added to this, a marginal drop in export sales also weighed on overall new business growth in May." In simpler words, manufacturing continues to be a drag on the overall domestic economy and the data do not point to a rebound near term.



Also last week ISM published its view on how the domestic manufacturing economy fared in May. While the headline report showed a modest increase compared to April, higher prices month over month was the real driver behind that move. Excluding that price move, the overall index would have moved much closer to contraction territory. New orders, production, and backlogs of work all fell in May, and employment continued to contract. Clearly a harbinger of what was to come in the May Employment Report (more on that below). With new orders positing yet another decline after the one in April, barring another move higher in prices, odds are June will not see a pronounced pickup in the domestic manufacturing economy.

Services Data

Much like the manufacturing economy, the Services sector also slowed in aggregate month over month in May.

- **China**: The Caixin-Markit services purchasing managers' index for China slipped to 51.2 in May from 51.8 in April, making the lowest reading since December. Despite an uptick in employment, the pace of new orders slowed with service sector outlook falling to the lowest level in 2016.

- **Japan**: There was reason to be upbeat with the latest Business Activity Index reading that hit 50.4 in May, up from 49.3 in April. But any enthusiasm was short lived as three-quarters of the surveyed firms reported no changes in May compared to April. Similarly, while new business at Japanese services firms rose for the second consecutive month in May, not only was the rate of that expansion modest, it was reliant upon promotional campaigns helping to boost demand. To us, that speaks of market share grab tactics to keep output moving, but at the cost of profits - not a combination we like to see.

- **Eurozone**: The final Eurozone Services Business Activity Index marked a three-month high, hitting 53.3 in May. With the rate of growth in incoming new orders at Eurozone service providers easing to a 16-month low and business confidence sliding to its lowest since last November, the probability of a pickup in June is rather low. This tells us the Eurozone service economy is poised to contract in the current June quarter compared to the March quarter.

- **US**: Markit's reading on the domestic service economy fell to 51.3 in May from 52.8 in April. While that figure is still technically in expansion territory, the pace of expansion remained weaker than what's been posted on average since late-2009. No doubt this is calling into question the strength of the services economy, which until recently has been more than compensating for the recession-like conditions underway in the domestic manufacturing economy. We concur with Chris Williamson, Chief Economist at Markit, saying, "The service sector reported one of the weakest expansions seen since the recession in May, adding to signs that any rebound of the economy in the second quarter may be disappointingly muted." Williamson also noted, "With optimism about the business outlook dropping to a new post-crisis low, companies are expecting conditions to remain challenging in coming months, citing uncertainty about the presidential election as well as broader worries about weak demand at home and abroad."

Jobs and the May Employment Report

No matter how you slice it, Friday's May Employment Report was a huge miss relative to expectations. It's important to dig below the headlines, and that is certainly true with Friday's jobs report and the wide headline miss of just 38,000 jobs created in May vs. the 162,000 expected. Even so, we expected politicians in Washington, especially at the White House (it is an election year, after all), to point to the drop in the unemployment rate to 4.7 percent from 5.0 percent in April. Even as they did just that, there were simply too many other worms in the report for people on

Wall Street or Main Street to take that unemployment level seriously:

- The labor force shrank by 664,000 month over month, bringing the trailing 12-month total to more than 1.6 million. Given the number of under-savers for retirement that have been published, we doubt the bulk of this was due to baby boomers pulling the plug and retiring.

- The labor force participation rate fell to 62.6 percent in May vs. 62.8 percent in April and 62.8 percent in May last year —it's hard to support a real unemployment rate at 4.7 percent in May 2016 vs. 5.5 percent in May 2015 when the participation is down year over year.

- Despite a drop in May, job cuts reported by Challenger Gray, May saw big job losses month over month in mining, construction, manufacturing and information industries, which includes some impact from the **Verizon (VZ)** strike.

- March and April job creation was revised lower to the tune of 59,000, yet there was no revision in the unemployment rate, illustrating just how meaningless that statistic has become.

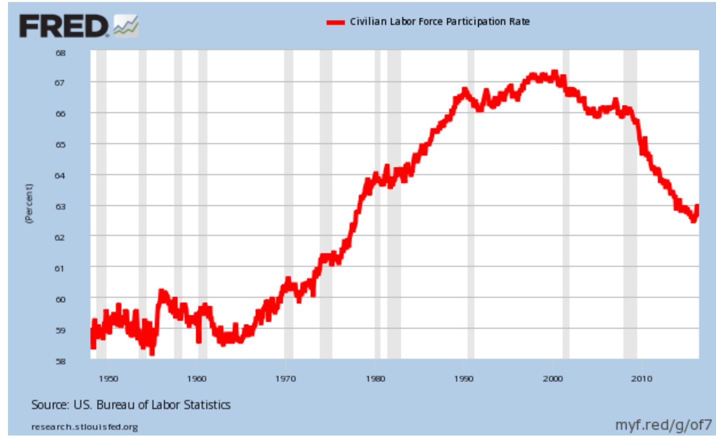
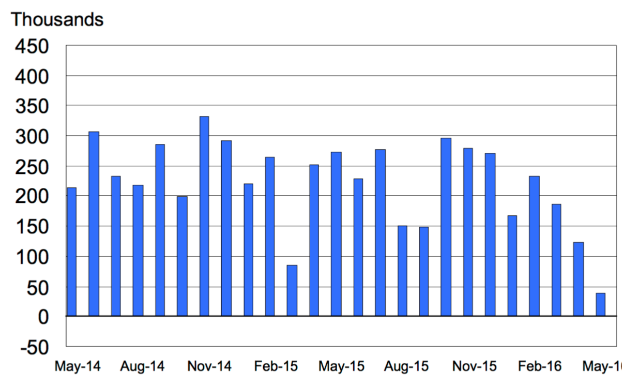


Chart 2. Nonfarm payroll employment over-the-month change, seasonally adjusted, May 2014 – May 2016



Looking back over the last few months, the vector and velocity of job growth has been down and slower (see chart right)

Where was there pronounced job growth? In the part-time positions, which rose 468,000 month over month. Not exactly the quality jobs that would lead to pronounced spending.

What's the bottom line on all of last week's data?

Following the tone of the manufacturing and service indices for May, and mixing in Friday's disappointing jobs creation figure for May, as well as the looming Brexit vote, we are relatively confident that the Fed is unlikely to boost rates at this month's meeting. Moreover, we see these data points and underlying order patterns leading to a re-think on current-quarter GDP expectations, which points to an even higher probability that earnings expectations will be rethought. From a thematic perspective, we see all of this as confirming for our ***Economic Acceleration/Deceleration, Rise & Fall of the Middle Class*** and ***Cash Strapped Consumer*** investing themes.

We've been on record as saying S&P 500 earnings expectations are too high for the second half of 2016 vs.

the first half (up nearly 13 percent per data from FactSet!), and this week's data only added more confirmation to that view. As expectations for the economy and S&P 500 earnings are once again revised, this will no doubt raise questions over how much higher the market can go. As of Friday's close, the S&P 500 was trading at 17.6x expected 2016 earnings that are forecast to grow all of 1.1 percent. Calling for second half forecast revisions likely means full year 2016 earnings are looking more likely flat to down than up modestly (even with the impact of corporate buyback programs). As this reality dawns on investors, we are likely to see investors shift to "ports of safety" including businesses with inelastic business models and higher dividend payments.

For those wondering, the Tematica Select List is already there.

The Week Ahead

Compared to last week, the slate of economic data to hit this week is far more tame. Other than the usual weekly data, we have March quarter Unit Labor Costs and April Consumer Credit, as well as the JOLTS report for April coming our way. Given the Fed's eye on inflation, the Unit Labor Costs report will likely be one of the final pieces in their rate hike puzzle, but in our view the dynamics of the May Employment Report are likely to outweigh it. Outside of the official government generated statistics, Gallup will publish its Economic Confidence Index for May, and we'd note the downward spiral it has been on for the last few months.

ECONOMIC CALENDAR, JUNE 6 - 10, 2016

DATE	REPORT / SPEECH	DATA
7-Jun	**Productivity-Rev.**	Q1
7-Jun	**Unit Labor Costs - Rev.**	Q1
7-Jun	**Consumer Credit**	Apr
8-Jun	**MBA Mortgage Index**	4-Jun
8-Jun	**JOLTS - Job Openings**	Apr
8-Jun	**Crude Inventories**	4-Jun
9-Jun	**Initial Claims**	4-Jun
9-Jun	**Continuing Claims**	28-
9-Jun	**Wholesale Inventories**	Apr
9-Jun	**Natural Gas Inventories**	4-Jun
10-Jun	**Mich Sentiment - Prelim**	Jun
10-Jun	**Treasury Budget**	May

Last week, **JPMorgan's (JPM)** Jamie Dimon had some harsh words when it came to subprime auto loans saying, "Auto is clearly a little stretched in my opinion… Someone is going to get hurt…" Keep in mind those comments follow disappointing May auto sales from **Ford (F), General Motors (GM), Volkswagen (WLKAY), Honda Motor (HMC), Toyota Motor (TM)** and **BMW Group (BAMXY)**. Looking at that list, it was pretty well spread across the major auto companies, and when paired with Dimon's comments, it means watching to see if domestic auto demand has peaked.

This has us paying close attention to the April consumer credit report, especially after the gap up in March Consumer Credit to $29.6 billion, from $14.3 billion in February and $6.3 billion this past December. Not a trend we like to see, but one that fits with our ***Cash-Strapped Consumer*** and ***Rise & Fall of the Middle Class*** investing themes.

As we've suspected, given the upward move in oil prices, which you are probably feeling at the local gas pump by now, we've started to see the US rig count begin to rebound. Come Friday we'll see how many more have been fired back up, and what that may mean for oil prices moving higher as we head into the summer. Given the economic discussion above, we continue to see the demand side of the equation as less than inspiring for a pronounced move higher following the latest conversation on production cuts at OPEC.

With roughly four weeks until we close the June quarter, we agree with those thinking, "What? We still have more companies reporting earnings?" But we do. Roughly 100 companies will report their quarterly earning with more than a few cutting across our investing themes. We'll be sure to dig through looking for salient data points and we'll also be doing the same for company presentations across a number of investment conferences this week and next.

Aging of the Population

- **Action Ltd. (ALIOF)**
- **Alere Inc. (ALR)**
- **LuLuLemon (LULU)**
- **Restoration Hardware (RH)**
- **Cashless Consumption**
- **Verifone Systems (PAY)**

Cash-Strapped Consumer

- **JM Smucker (SJM)**
- **Connected Society**
- **Sigma Designs (SIGM)**
- **Comscore (SCOR)**
- **Pointer Telocation (PNTR)**
- **Liberty Tripadvisor (LTRPA) Disruptive Technologies**
- **Organovo Holdings (ONVO)**
- **Economic Acceleration/Deceleration**
- **HD Supply (HDS)**
- **Greif Inc. (GEF)**
- **KMG Chemicals (KMG)**

Fattening of the Population

- **Krispy Kreme (KKD)**
- **Dave & Busters (PLAY)**

Foods with Integrity

- **Cavolo Growers (CVGW)**
- **United Natural Foods**

Guilty Pleasure

- **Brown Forman (BF.A)**
- **Rise & Fall of the Middle Class**
- **Thor Industries (THO)**
- **Hooker Furniture (HOFT)**
- **Tailored Brands (TLRD)**
- **Crown Crafts (CRWS)**
- **Francesca's Holdings (FRAN)**

Safety & Security

- **Ability Inc. (ABIL)**
- **Verint Systems (VRNT)**
- **Scarce Resources**
- **Itron Inc. (ITRI)**
- **Ferreligas Partners (FGP)**
- **Yara International (YARIY)**
- **Adecoagro SA (AGRO)**
- **Global Water Resources (GWRS)**

Tooling & Re-tooling

- **Korn/Ferry (KFY)**

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