TEMATICA INVESTING

THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES

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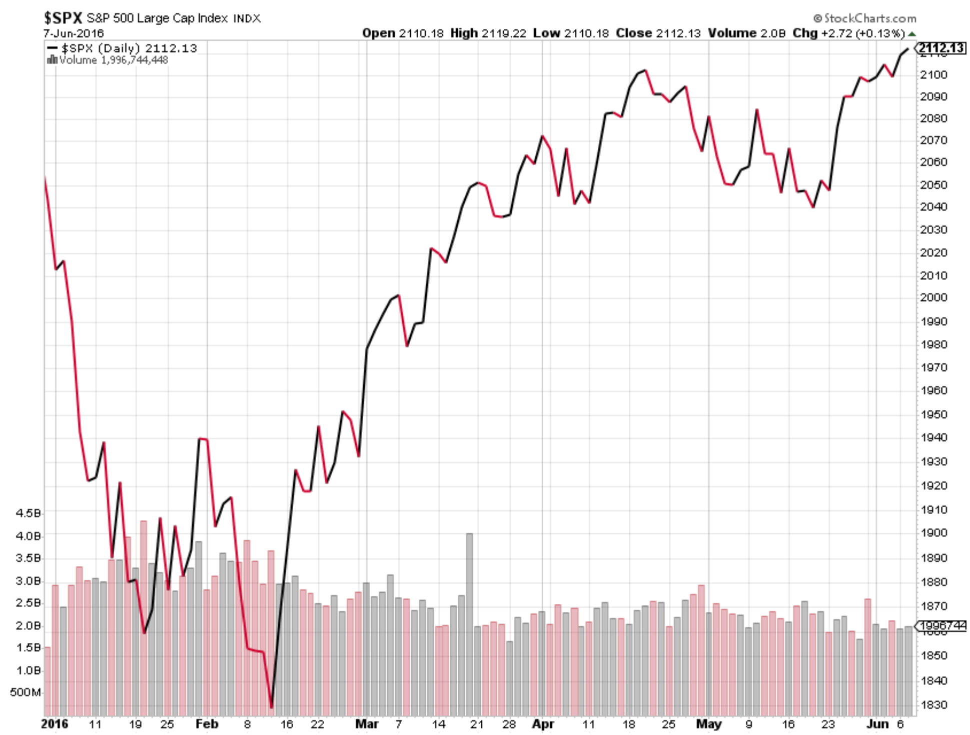
Tematica Investing, a weekly publication by Chris Versace, is designed for the experienced or professional investor, providing in-depth information on real-time developing thematic strategies, economic outlook, investment trading ideas, and analysis of the most pressing developments for the market, as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

INSIDE THIS ISSUE

Economics & Expectations

The market has moved up over the last few days, thanks to **Fed Chairwoman Janet Yellen's dovish comments**, which confirmed our view that the Fed will not boost rates in the coming few months. Helping out in the market push upwards: supply concerns over oil in Nigeria and inventory rundowns here at home that have pushed oil prices higher. The combination of these events has pushed an already stretched valuation for the S&P 500 higher, despite the growing number of economic data points that are shaping up and pointing to a slowing economy. We covered much of those economic data points in this week's [Monday Morning Kick Off].



Oil's rise looks to stagnate near-term

We see the recent run up in oil prices as inviting domestic producers that were shutting production and rigs several months ago back into the market. It was those closures that have led to slower inventory builds, which are now being drawn on despite the slowing economy. We've already started to see the weekly Baker Hughes rig count start to rebound, and we expect this trend to continue. Paired with no production cuts from Opec and Iran stepping up its oil export activity, we see oil prices being range bound as we head into the summer. In our view, this move in oil has been primarily supply driven, but as supply rebounds the next phase will be demand driven. Given the economic backdrop, we do not see a robust demand picture.

First the OECD...

Last week the **Organization for Economic Cooperation and Development (OECD)** lowered its growth forecast for the combined economy of the 34 OECD countries to 1.8 percent this year and 2.1 percent in 2017. That's down from the projected 2.2 percent for 2016 and 2.3 percent in 2017 the OECD issued in November. As part of that revision, the OECD now expects the US economy to grow 1.8% this year and 2.2% in 2017, instead of 2 percent and 2.2 percent as it forecast in February and 2.5 percent and 2.4 percent in November.

... and now the World Bank.

This week the World Bank jumped on the "cut your forecast" bandwagon and has cut its projected global growth for this year from 2.9 percent it published in January, down to 2.4 percent. The bank also cut its forecast for growth in 2017 to 2.8 percent from 3.1 percent. When explaining its downward revisions, the World Bank said, "the global economy is increasingly vulnerable to a sharp slowdown as troubles in emerging markets mount and advanced economies struggle to grow."

What All this Means for Us as Investors

We always love it when these organizations catch up to the our way of thinking, but in this case it's a reminder that the vector of the global economy is down and its velocity slow.

Against that backdrop, we've got a stock market that is increasingly stretched from a valuation perspective on already robust earnings expectations for the second half of the year. As more data confirms the renewed slowdown, we expect to see earnings expectations for the back half to be revised lower.

The demonstrative thematic headwinds are still in place, and you'll see one of them below, but our position is we will have opportunity pick up these well positioned stocks at better prices in the coming weeks and months. Better to be patient than be rash.

ThematicSignals

We continue to gather and share all the latest "ripped from the headlines" data points and other nuggets that point to continued tailwinds associated with our investing themes. Below are just a few from the this past week, or click here to see a full listing on our site.

- More purchases happening online than offline for the first time . . . *Connected Society*
- China opens its markets to foreign bank card companies *Cashless Consumption*
- Waistlines continue to expand as America's obesity epidemic hits a new high so much for $WTW $NTRI $MED *Fattening of Population*
- Euro's, Pounds, Dollars . . . no matter the currency, the crunch is on *Aging of the Population*
- Food Network teaming with Instacart shows increasing reach of e-commerce *Connected Society*
- Assisted Living moving into the cities *Aging of the Population*

Waiting to Get Wet With AWK and WTR Shares

When we added hospital and health care services provider **AHS Management (AHS)** shares to ***Tematica Contender List*** several weeks back, we discussed our ***Aging of the Population*** investing theme and touched on how our Scarce Resources thematic was having an influence as well. While the ***Aging of the Population*** deals with the demand and pain points to be had from the geographic shift of the domestic and the larger global population, the ***Scarce Resources*** theme looks for opportunities that arise from a supply-demand imbalance.

Many people think of gold and oil, which hasn't really been a scarce resource of late, but there are a number of other commodities and natural resources that fall into this theme. When looking at potential Scarce Resource companies, we look to identify companies that are positioned to benefit from a scarce resource and side step ones that could see their margins and earnings come under pressure as key input prices escalate (see right for more details).

One scarce resources discussed at length in Tematica Chief Investment Officer Chris Versace's book ***Cocktail Investing***, is water and the pain points created by rising demand for it as the population grows and preferences shift with rising levels of affluence. Boiling it down (pun intended), there is only so much fresh water available today on the planet — as we point out on page 155, while nearly 70 percent of the world is covered by water, only 2.5 percent of it is fresh, and just 1 percent of that is easily accessible. Mix in a rising global population— particularly the rising middle class in the emerging markets that is part of our ***Rise & Fall of the Middle Class*** investing theme — and it's not hard to see a long-term supply-demand imbalance for the liquid of life.

Closer to home, California has been struggling with drought conditions the last few years, and more recently we've heard of drought conditions in the Southeast making it more than a challenge for farmers. You've probably noticed some price escalation in peaches and other produce over the last few weeks, and a new report from Cobank suggests the lingering drought conditions could leave California farmers and agribusinesses facing $1.5 billion in losses.

Looking beyond California, the US Drought Monitor published by The National Drought Mitigation Center found that nearly 32% of the contiguous US was facing some form of drought coming into this week. As bad as that may sound, the National Oceanic Atmospheric Administration's (NOAA) Climate Prediction Center recently shared its forecast calling for most of the country to expect a hotter than usual summer. Keep in

Gold. Oil. Tantalum. Platinum. Water. Eggs. Each of these due to varying circumstances are limited resources that are experiencing rising demand amid a global population and the awakening of third world economies.

While there may only be so much water and oil on this planet, the ability to increase crop size for cotton, beef and other commodities takes time. There are disruptions, such as the avian flu that destroyed the hen laying flock, which will had a dramatic impact on food, pharmaceutical and restaurant companies in 2015.

Over the coming years, a potential risk in the developed economies is the combination of slower growth but also comparatively higher prices compared to today that will impact disposable incomes. This investing thematic looks to identify companies that are either positioned to benefit from a scarce resource or those that could see their margins and earnings come under pressure as key input prices escalate.

mind, this follows NOAA's recent report that found April 2016 was "April 2016 was the warmest April on record for the globe, making it the 12th consecutive month that earth has recorded its warmest respective month on record."

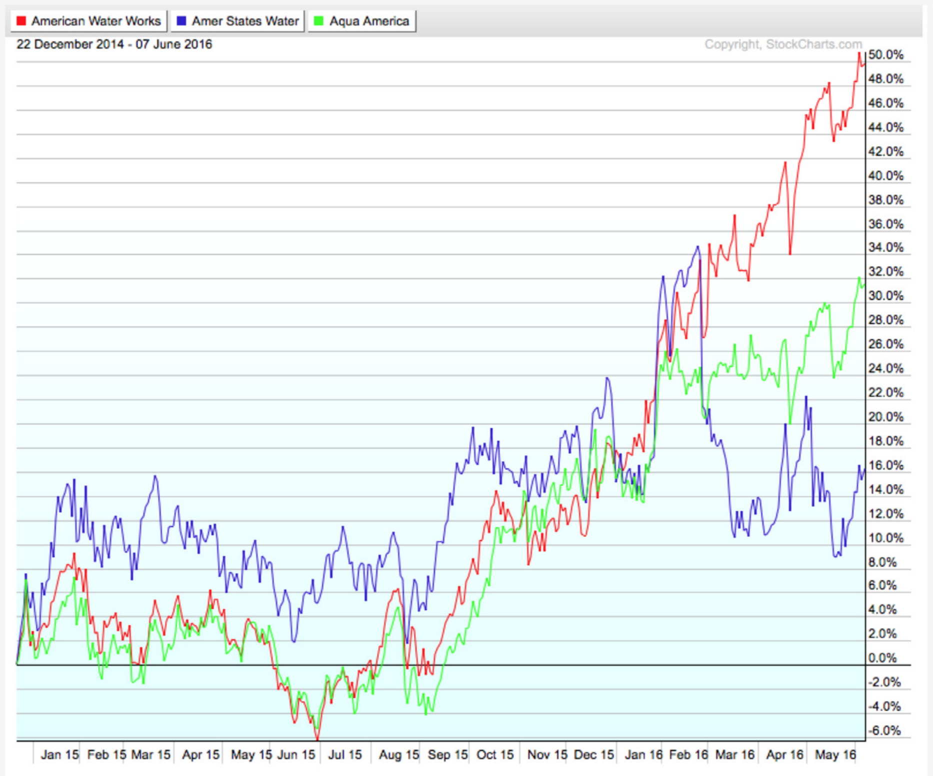
So, where do we turn as investors given these thematic tailwinds?

Taking stock of all the data we detailed on the previous pages all, we've put several water utilities under the microscope. While water utilities may sound a little sleepy, there's no denying that it's been a sleeper growth industry. Water utility bills have been increasing pretty steadily, up almost 5% per year between 1996 and 2012 according to American Water Works Association (AWWA). More recently,as the current drought situation has worsened, the price of water increased 6% in 30 major US cities during 2014 and another 6% in 2015. As Circle of Blue reports, there has been a 41% increase in the price of water in those 30 major US cities since 2010.

With prospects for the drought to continue, there is a high probability that water utilities will look to put through additional price increases to cover their costs as well as offset capital spending costs as they replace their aging infrastructure.

In looking at water utilities, there are a number of publicly traded ones, such as **Connecticut Water Service (CTWS), York Water Co. (YORW), Artesian Resources Corp. (ARTNA) and Middlesex Water Company (MSEX)**. We have cast those aside due to market cap or trading volume constraints. Others like **California Water Service Group (CWT)** and **SJW Corp. (SWJ)** get tossed aside given their spotty EPS track record, which candidly raises question over 2016 and even 2017 expectations.

This leaves us with three of the larger publicly traded water utilities — **American Water Works (AWK), American States Water (AWR)** and **Aqua America (WTR)**. Of those three, American States Water has the lowest compound annual earnings growth rate of the three at just over 4% for the 2013-2017 period —not terribly exciting even though its historical valuations do suggest modest upside from current levels, which could reflect the recent earnings guffaw related pullback in the AWR shares.



Better earnings growth, as well as dividend growth has been had at American Water Works and that is expected to continue. Based on current consensus expectations, American Water Works is called to deliver a compounded EPS annual growth rate of 8.6% over the 2013-2017 time frame. Taking even a conservative stance on potential dividend increases (more on this below), very easily leads to an estimated 10% compounded growth rate over the same time frame.

Not only is American Water Works the largest water utility player, but it aims to consolidate this rather fragmented industry, a strategy that has led to better-than industry average revenue and earnings growth. We also like the company's rising dividend policy, which tends to lead to a step up in the share price, and with a dividend payout ratio near 50 percent, there is ample room for additional increases. In addition, a 2003 study by the renown Cliff Asness and Robert Arnott found that future earnings growth is fastest when current payout rations are high, contradicting the conventional wisdom view that dividend payers are slower-growth stocks.

So why not pull the trigger on AWK shares now?

At current multiples, be it P/E, dividend yield or even P/E relative to that for the S&P 500, (which is itself stretched relative to expected 2016 earnings growth at 17.7x), the shares are more than fully valued. The peak P/E multiple over the 2010-2016 time frame is 21.6x. Even if we take a more generous multiple, like the average of 23.9x over the last few years, and apply it to expected 2017 earnings of $3.04 per share, we get a price target of $72-$73 per share. The current share price for AWK is near $75.

Even though we can see continued growth ahead for AWK's business, at a time when the market is encroaching once again on all time highs, it's hard to get interested in AWK shares at current levels. **Given the favorable fundamental outlook for water as a Scarce Resource, we will put AWK shares on Tematica Contender List and look to revisit them below $60.** Alternatively, if we see signs that EPS is looking more like $3.50 in 2017, or the annual dividend will resemble something between $1.80-$2.00, we would be inclined to get long on some AWK shares.

Finally, much like American Water Works, shares of Aqua America (WTR) are similarly over-valued at current levels. While Aqua America's earnings and dividend growth rates, as well as its overall business scale, are well below that of American Water Works, **if Aqua America shares pulled back to $28 or lower, the potential risk-to-reward to be had would be favorable enough to begin adding shares to the portfolio.** That assumes there is no downward change in the company's outlook. As such, **we are also adding WTR shares onto the Contender List as well.**

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.

AHS	AMN Healthcare Services	*Aging Population / Scarce Resources*
AWK	American Water Works	*Scarce Resources*
WTR	Aqua America	*Scare Resources*
CHGG	Chegg Inc.	*Tooling & Retooling*
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*
PANW	Palo Alto Networks	*Safety & Security*
SYNA	Synaptics Inc.	*Disruptive Technologies*
UNFI	United Natural Foods	*Foods with Integrity*
VZ	Verizon Communications	*Content is King / Connected Society*
XYL	Xylem, Inc	*Scare Resources*

Updates, Updates, Updates

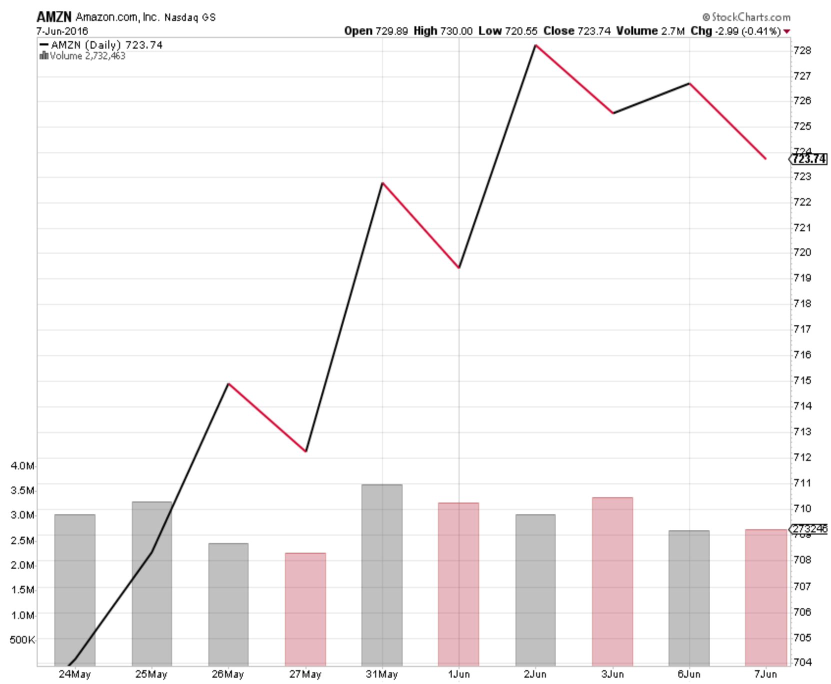
AT&T (T; Connected Society)

Shares of this mobile connectivity, consumer non-discretionary company rose more than 0.5 percent this week. The company participated in what essentially was a conversation on the eventual deployment of its 5G mobile network at Cowen and Company's 44th Annual Technology, Media & Telecom Conference. However, the bulk of the week's outperformance can be traced to the disappointing May employment reported the week's other economic data that point to another pronounced slowdown.

Why is shrinking employment and a slowing economy a good thing for AT&T?
It means investors will be looking for inelastic business models and dividend yield to ride out the pending storm. AT&T and its shares clearly fit the bill. Next week the company presents at the Robert W. Baird Global Consumer, Technology & Services Conference June 8.

We will continue to look for opportunities to add to the position. Our price target on T shares is $44.

Amazon.com (AMZN; Connected Society)



Shares of this e-commerce and cloud-solutions company, which sits at the heart of our Connected Society investing theme, rose just shy of 2 percent last week, making them one of the stronger portfolio performers. Surprisingly, it was a rather quiet week for Amazon as far as company generated news, but there was still no shortage of developments. Last week's April Personal Income & Spending report showed solid spending, even after adjusting for the continued climb in gas prices.

We continue to see Amazon taking consumer wallet share at the expense of department stores and other bricks-and-mortar retailers. This growing view led MKM Partners to boost its AMZN price target to $850 from $800, and we'd note this follows our own recent increase to $880 from $800.

As you know, Amazon has a number of initiatives to grow its global footprint and expand its offerings to drive revenue and earnings. One such initiative is apparel. Given recent comments from **Gap (GPS)**, as well as data points that suggest Amazon is working on private-label brands, we found last week's comments from **G-III Apparel (GIII)** rather interesting. On its earnings call, GIII noted it is active with Amazon in most brands and that most products with Amazon do not overlap with what is in stores. CEO Morris Goldfarb also shared, "We are looking at initiatives with Amazon that would provide them with private-label product, with unique brands, either their own or some of our brands that aren't distributed to department stores." We expect more details on Amazon's apparel business to emerge ahead of the back-to-school shopping season.

Our price target for Amazon.com (AMZN) remains $880.

PetMed Express (PETS; Aging of the Population)

Shares of this online pet pharmacy company trended modestly higher in what was a very quiet week with no company news. We remain encouraged by data that points to the continued shift toward online and mobile spending during the company's seasonally strongest quarter. Wet weather over the last several weeks should help drive its core flea and tick business. The shift tied to the company's more focused advertising and marketing spend that we described in last week's roundup bodes well for more margin expansion in the current (June) quarter. We will continue to look for opportunities to build the PETS position, which, given the 4%-plus dividend yield, should make the shares increasingly attractive as economic growth and S&P 500 earnings expectations are revisited.

Our price target on PETS shares remains $20.

Starbucks (SBUX; Guilty Pleasures)

While improving input costs in the form of dropping coffee prices, which should help drive better margins and bottom line results, is what initial lead us to make a move on SBUX shares, Starbucks at its heart is an innovative company, and we saw the latest signs of that over the last few days. First, the company has partnered with **Anheuser-Busch InBev (BUD)** to grow the Teavana and Tazo brands. The SBUX-BUD partnership will see Anheuser-Busch InBev produce the tea products at its US breweries and distribute them to about 300K convenience stores and grocery chains in the US.

Pretty much what we get here is the Starbucks brand with the distribution muscle of Anheuser-Busch, or a team of Clydesdale horses hopped up on caffeine!

Estimates put the domestic ready to drink tea market at $5.1 billion and growing at roughly 3 percent per year. We see this development with BUD as another step in expanding the Starbucks footprint, much like we've seen before with its ready to drink coffees and other products in grocery stores. Given our Fattening of the Population investment theme and the growing focus on sugar consumption, the move into teas and other ready to drink beverage is likely to bode well for incremental wallet share among thirsty consumers.

Our price target on SBUX shares remains $74.

Walt Disney Company (DIS; Content is King)

Disney shares stubbed their proverbial toe last week following a weaker-than-expected reception for its latest box office effort, "Alice Through the Looking Glass." The film came in behind the latest installment of the X-Men franchise, on a box office take that was one of the weaker ones year to date, even though it was a long weekend. Despite the showing, consensus expectations for Disney were unchanged this week, which tells us Alice was not expected to do much.

The two next catalysts for Disney will be the opening of Disney Shanghai later this month and the debut of the latest Pixar film, "Finding Dory." Disney Shanghai will be a focal point for the company's expansion into China and larger Asia, while expectations are building for "Finding Dory." To us, both should help drive Disney's parks and merchandise business, with both falling nicely into the company's ***Content is King*** playbook.

Our price target on DIS shares remains $125.

TEMATICA SELECT LIST PERFORMANCE

as of market close June 7, 2017

(AMZN) AMAZON.COM — *Connected Society*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
5/24/16	$704.20	$723.74	--	--	2.77%	$880.00	(BUY)

(XLY) CONSUMER DISCRETIONARY SPDR (ETF) — *Content is King*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
4/20/16	$79.57	$79.41	--	--	-0.20%	--	(HOLD)

(CMG) CHIPOTLE MEXICAN GRILL — *Foods with Integrity*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
5/11/16	$452.66	$433.39	--	$390.00	-4.26%	$550.00	(BUY)

(DIS) THE WALT DISNEY CO. — *Content is King*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
4/20/16	$102.16	$98.35	--	$87.00	-3.73%	$125.00	(BUY)
5/11/16	$101.78	$98.35	--	$87.00	-3.37%	$125.00	(BUY)

(DOC) PHYSICIANS REALTY TRUST — *Aging of the Population*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
6/27/14	$14.33	$19.49	$1.58	$16.00	47.00%	$--	(BUY)

(NKE) NIKE INC — *Rise & Fall of the Middle Class*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
5/18/2016	$56.10	$53.55	--	--	-4.55%	$--	(BUY)

(PETS) PETMEDS EXPRESS — *Connected Society*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
5/4/14	$17.80	$18.90	$0.19	--	6.18%	$20.00	(BUY)

(SH) PROSHARES SHORT S&P 500 (ETF)

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
1/14/16	$22.55	$19.78	--	--	-12.28%	$24.00	(BUY)
3/23/16	$20.56	$19.78	--	--	-3.79%	$24.00	(BUY)

(RGC) REGAL ENTERTAINMENT GROUP — *Content is King*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
11/23/15	$18.51	$20.36	$0.66	$19.00	13.56%	$24.00	(BUY)

(SBUX) STARBUCKS CORPORATION — *Guilty Pleasure*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
5/31/14	$54.89	$55.30	--	--	0.75%	$74.00	(BUY)

(T) AT&T, INC. — *Connected Society*

DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING
7/21/15	$34.67	$39.79	$1.40	$36.00	18.80%	$42.00	(BUY)

COMPANIES MENTIONED

AHS Management (AHS)

Amazon (AMZN)

American States Water (AWR)

American Water Works (AWK)

Aqua America (WTR)

Artesian Resources Corp. (ARTNA)

AT&T (T), PetMeds Express (PETS)

California Water Service Group (CWT)

Connecticut Water Service (CTWS)

G-III Apparel (GIII)

Gap (GPS)

Middlesex Water Company (MSEX)

SJW Corp. (SWJ)

Starbucks (SBUX)

The Walt Disney Company (DIS)

York Water Co. (YORW)

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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