

MONDAY MORNING KICKOFF

YOUR MARKET PRIMER FOR THE WEEK AHEAD


WEEK OF JULY 5, 2016

Last week we closed the books on the June quarter and the first half of 2016. Just one week after the unexpected Brexit vote outcome, the market more than recovered from the Friday-Monday sell-off, to close the June quarter up 1.9 percent. For the first half of 2016, the S&P 500 closed up 2.7 percent, while the Dow Jones Industrial Average closed up a tad higher at 2.9 percent. The growth heavy Nasdaq Composite Index trailed, finishing up the first half of the year down 3.3 percent.

We're putting the finishing touches on our proprietary thematic index, but based on the initial computations, it's pretty safe to say it handily beat all three of the major market indices during the first six months of 2016. We'll have much more to say on this next week, so stay tuned.

As we shared with subscribers to **Tematica Investing** last week, we saw the Brexit induced sell-off as overdone, as tends to be the case with these "shoot first and ask questions later" responses. At the same time, however, we saw the sharp rebound swinging the market pendulum back even further, despite:

- That there are still numerous Brexit questions to be answered on trade, employment, and in some cases the fate of the European Union;
- The more than peculiar 2016 presidential election, which will likely keep corporate checkbooks tucked away until the outcome is known;
- The US dollar gapped up post Brexit vote, renewing foreign exchange and currency related headwinds;
- A global economy that continues to be on a slowing glide path.



Thematic Signals

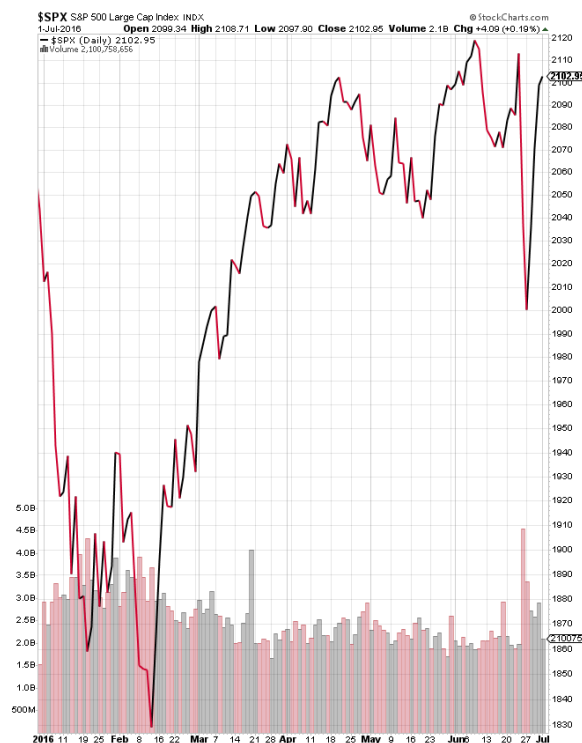
[Vermont's GMO labeling law now in effect — could impact the whole country](#) *Foods with Integrity*

[Thanks to UPS's new program, your boss doesn't need to see everything you buy online. . .](#) *Safety & Security / Connected Society*

[Fatal Tesla Crash Spurs Criticism of On-The-Road Beta Testing](#) *Disruptive Technologies*

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[MILLENNIALS: TECHNOLOGY = SOCIAL CONNECTION](#) *Connected Society*



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 shape the market in the near-term, and in-turn impact our tematics.

Amid the market move higher late last week, we were reminded of the slowing vector and velocity for the global economy. On Friday, both the June ISM Manufacturing Report and the final June PMI report from Markit Economics painted a relatively favorable picture of the domestic economy compared to that for China and Japan. Per data from Markit Economics, the economies in both China and Japan continued to contract in June. Chinese manufacturers reported the sharpest deterioration in operating conditions for four months in June, while in Japan production contracted for the fourth consecutive month.

While we are encouraged by the improving data for the domestic manufacturing economy, we find to be far more sobering both the May Personal Income & Spending Report, and overall lackluster June tone for global manufacturing (the J.P.Morgan Global Manufacturing PMI reading came in at 50.4, modestly ahead of May's 50.0 reading).

Looking past the May Personal Spending report, we are already seeing signs of more restrained consumer spending. Even though gas prices dipped modestly in June according to data from the Energy Information Administration, the 37 percent move higher since the mid-February bottom has started to take its toll on consumer spending, most notably in the restaurant industry. Unsurprisingly, that industry tends to be one of the early ones to feel any belt tightening by consumers. According to the NPD Group, visits to fast-casual restaurants fell 4 percent year over year in May. Declines like that tend to happen in a softer economy, but what makes this data point stand out is that it's the first year over year decline in May since NPD Group started tracking store traffic in 2004. Kinda makes you go "hmmmm".

If we put any stock in the National Restaurant Association's (NRA) May 2016 tracking survey, the restaurant sector is bracing for more of the same. Only 35 percent of restaurant operators said they expect to have higher sales in six months, down from 38 percent in April and 46 percent in March. The NRA also found 13 percent of restaurant operators expect their sales volume in six months to be lower than it was during the same period in the previous year. This tells us our Cash-strapped Consumer thematic is alive and well, which means today's consumer will continue to spend selectively. That's yet another reason to think we will not see a robust pickup in the overall domestic economy in the coming months.

As we recently shared with our Tematica Investing subscribers, we highly doubt companies foresaw the Brexit actually happening when they issued their June quarter and back-half of 2016 guidance in January and April. Combined with the slowing global economy, renewed US dollar strength, and prospects for restrained spending by consumers and businesses alike, the odds are high Corporate America will issue conservative guidance over the coming weeks.

If we are right in our thinking, it will mean a big re-think on second half expectations compared to the current view that S&P 500 earnings will grow nearly 13 percent in the second half of 2016 compared to the first half. And for those wondering, over the 2010-2015 period, S&P 500 earnings have grown on average just 4.6 percent in the second half of the year compared to the first half.

If you are thinking that we are a little stymied over how those overly robust earnings expectations have not been reduced over the last few months, you would be correct. It's quite the head scratcher — we're starting to feel very much like the cast members in the Big Short movie waiting for the market to catch up with the pending housing crisis in 2007. On the other hand, taking the "glass is half full approach," it means we are likely to get far better stock prices at which to put capital to work in the coming weeks, particularly after the sharp rebound last week.

The Week Ahead

The coming week is a short one due to the July 4th holiday here in the United States. With June quarter earnings not expected to kick into high gear until June 11th, when **Alcoa (AA)** reports its results, odds are the week will be more on the quiet side with lower than usual trading volumes as investors bask in the sun. We'll still get some earnings reports, and the two we will be watching closely will be **The Greenbrier Companies (GBX)** as a gauge for transportation equipment and the domestic economy, and **Walgreens Boots Alliance (WBA)** given our **Aging of the Population** investing theme.

On the economic calendar, the two key reports to watch will be the ISM Service reading for June and the June Employment Report. The June ISM Manufacturing Report showed a pickup in employment, and we expect a clearer picture after the June ISM Services report, but the devil will still be in the details given historical seasonal hiring in June. As far as the June Employment Report, the mix of jobs between full and part time will continue to tell the story of wage growth and what's ahead for consumer spending as will the trend in labor force participation.

In our view, it will take more than the June Employment Report to jump start talk of a July rate hike by the Fed.

ECONOMIC CALENDAR, JULY 5 - 9, 2016		
DATE	REPORT / SPEECH	DATA
5-Jul	FOMC Minutes	15-Jun
5-Jul	Factory Orders	May
6-Jul	MBA Mortgage Index	2-Jul
6-Jul	Trade Balance	May
6-Jul	ISM Services	Jun
6-Jul	Crude Inventories	2-Jul
6-Jul	FOMC Minutes	15-Jun
7-Jul	Challenger Job Cuts	Jun
7-Jul	ADP Employment Change	Jun
7-Jul	Initial Claims	2-Jul
7-Jul	Continuing Claims	25-Jun
7-Jul	Natural Gas Inventories	2-Jul
7-Jul	Crude Inventories	2-Jul
8-Jul	Nonfarm Payrolls	Jun
8-Jul	Nonfarm Private Payrolls	Jun
8-Jul	Unemployment Rate	Jun
8-Jul	Hourly Earnings	Jun
8-Jul	Average Workweek	Jun
8-Jul	Consumer Credit	May

AGING OF THE POPULATION

- **Walgreens Boots Alliance Inc (WBA)**

CASHSTRAPPED CONSUMER

- **Container Store Group Inc (TCS)**
- **PriceSmart Inc (PSMT)**

ECONOMIC ACCELERATION / DECELERATION

- **Greenbrier Companies Inc (GBX)**

FOUNTAIN OF YOUTH

- **Helen of Troy Ltd (HELE)**

FATTENING OF THE POPULATION

- **PepsiCo Inc (PEP)**

SAFETY & SECURITY

- **Barracuda Networks Inc (CUDA)**

TOOLING & RETOOLING OF AMERICA

- **Apollo Education Group Inc (APOL)**

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