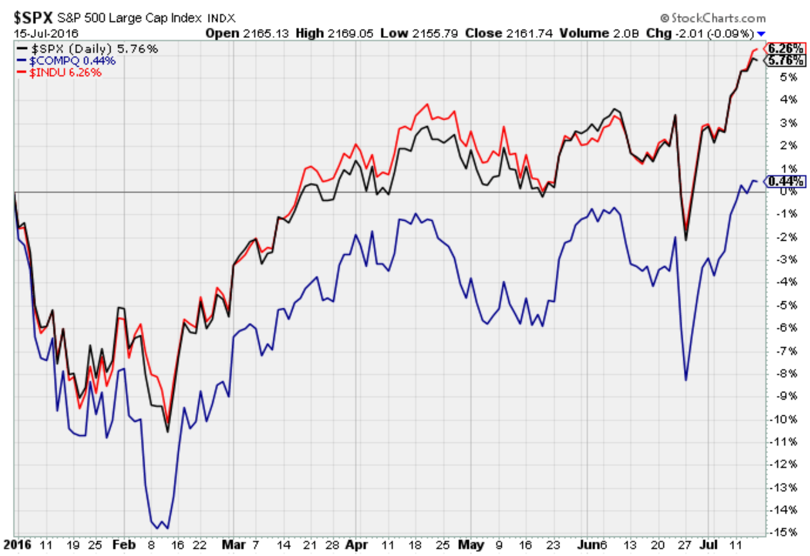
MONDAY MORNING KICKOFF

YOUR MARKET PRIMER FOR THE WEEK AHEAD

WEEK OF JULY 18, 2016

Last week saw a number of new records for both the S&P 500 as well as a new all-time high for the Dow Jones Industrial Average. The melt up in the market also saw the Nasdaq Composite Index eek its way into the green on a year to date basis.



That's the good news, but as the saying goes, it's not all peaches and cream.

First, investor sentiment has whipsawed over the last few weeks, shifting from Fear soon after the Brexit vote results were in to once again back to Extreme Greed. Closing out last week, the **CNN Fear & Greed Index** stood at an Extreme Greed reading of 89, up from 76 a week ago.

Moreover, while many like the new record high in the S&P 500, once we put down the party hats we find the index is trading at 18.2x expected 2016 earnings of $118.66, which are now only expected to grow just 0.6 percent year over year.

Thematic Signals

Will a Camera on Every Cop Make Everyone Safer? Taser Thinks So *Safety & Security*

Delivering e-commerce packages the final mile to remote locations

Connected Society / Rise & Fall of the Middle Class

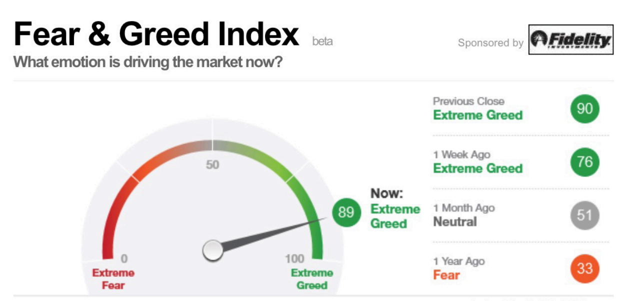
The cashless consumption battle is a crowded one – good news for us. *Cashless Consumption*

Experience-driven shopping and entertainment redefining the American Shopping Mall

Content is King / Connected Soceity

Masterpass expansion by $MA reflects the growth of Cashless Consumption thematic

Cashless Consumption



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 thematics.

A few observations:

- First, that level of earnings growth for the S&P 500 is down from 0.8 percent last week and from 2 percent several weeks ago.
- Second, it doesn't account for the near rampant share buyback activity that for all intents and purposes is acting like a Wonder-bra on corporate net income levels.
- Third, expectations still call for nearly a 13 percent jump in earnings from the S&P 500 companies in the back half of 2016 compared to the first half. As regular MMKO readers know, we have been, and continue to be concerned with overly robust earnings forecasts for the back half of the year.
- Finally, on a technical basis, all 10 S&P 500 industry sectors entered over bought territory. Granted our thematic methodology means we tend to ignore sector based views, but when all 10 are in overbought territory it's something to pay attention to when examining risk vs. reward to be had in the market.

All in all, that's quite a combination to have as we wade hip deep into the June quarter earnings season, especially when the latest economic data has been pretty much so-so.

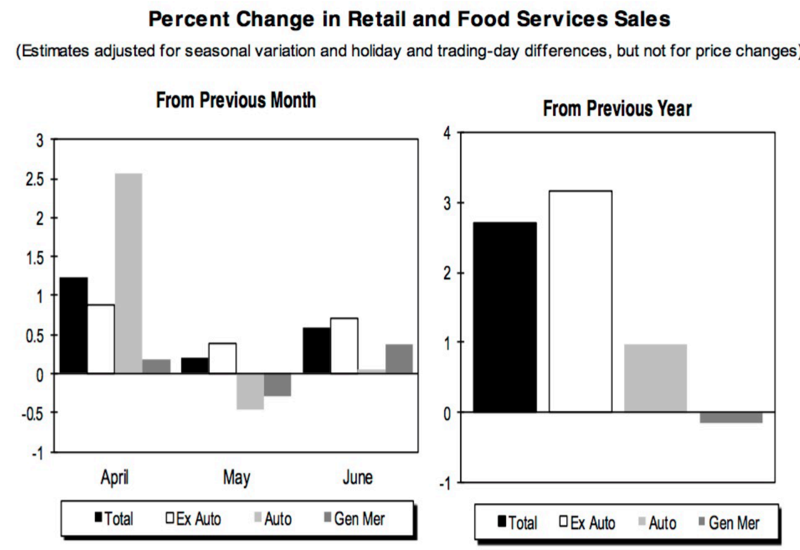
What About Inflation?

We learned that real average hourly earnings decreased by 0.2 percent in June, while the Consumer Price Index increased 0.2 percent, repeating May's increase, both are seasonally adjusted.

We suspect this reflects the increase in gas prices that led to restaurant same-store sales falling 0.7 percent in the second quarter of 2016, after declining 0.2 percent in the first quarter. While off of recent highs, gas prices are still up some 35 percent from their February lows. Based on this week's report from the Energy Information Administration that showed a surprise build-up in gas and diesel inventories, gas prices have likely peaked near-term. The rebound in oil prices led to an oil rig count reversal of late with the oil rig count rising in six of the last seven weeks. Should oil prices hover near current levels, odds are we will see more domestic oil rigs come back on line, which is good for job and wage growth, but is also another reason to think gas prices are not likely to jump dramatically higher in 2017.

Insights from the June Retail Sales Report

Because the consumer is such a key aspect of our domestic growth, we and the rest of the market fixated on the June Retail Sales Report. In aggregate, retail sales rose 0.6 percent month over month in June (up 0.7 percent excluding autos) and 2.4 percent year over year (up 3.2 percent excluding autos). While



better than expected, June's retail sales ex-auto were only modestly ahead of retails sales ex-auto for the first half of 2016, which came in at up 3.1 percent. On a headline basis, the report was good, but what we saw upon digging into it was far more interesting and confirming for our thematic investing strategy. Once again, the devil is in the details:

- **Hands down, non-store retail sales, up 14.2 percent, was the fastest growing component of retail sales last month.** To us, this was another confirming data point of the accelerating shift to digital shopping (both online and mobile) that is a key aspect of our ***Connected Society*** investing theme. Looking past the vibrant June non-store retail sales, the data shows that year to date 2016, non-store retail sales have climbed 10.6 percent, with year over year comparisons accelerating even faster over the last few months (April up 12.7 percent YoY, May up 12.7 percent YoY, June up 14.2 percent YoY).

  We anticipate further confirmation of this trend to be had in this year's back-to-school sales, which are expected to climb 3.3 percent to $540 billion. Just so we are on the same page, the back-to-school shopping period is defined as July through September. Digging into the data, online sales (roughly 18 percent of overall back-to-school sales) is expected to grow far faster at 11 percent year over year, meaning it once again will take consumer wallet share.

- **June Health & Personal Care retail sales rose up 8.4 percent year over year**, which comes as no surprise to us given our ***Aging of the Population*** investing theme.

- **Sporting Goods retail sales were up 6.8 percent in June**, and that strength echoes recent SportScan data that showed athletic footwear sales rose 11.8 percent year over year for the last four weeks, and up 10.5 percent year over year for the last 13 weeks. We see that as confirmation that rising middle class consumers, part of our ***Rise & Fall of the Middle Class*** investing theme, will continue to spend on branded athletic and footwear.

When discussing our ***Rise & Fall of the Middle Class*** investing thematic, we have to at least quickly mention all the activity at last week's 2016 Farnborough International Airshow. Both **Boeing (BA)** and **Airbus (EADSY)** shared new order wins, but both also upped their long-term industry forecasts as well.

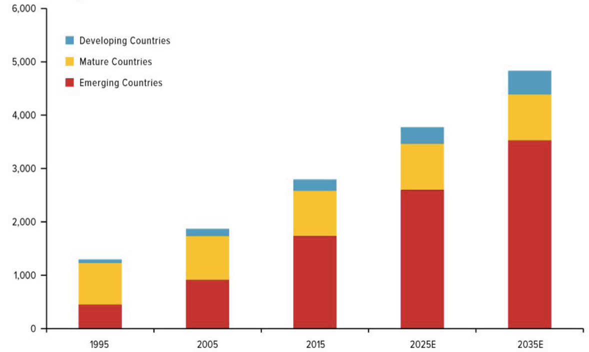
- Boeing shared it now projects the need for 39,620 new aircraft over the next 20 years, reflecting the steady increase in airline passenger traffic it sees over the next 20 years.
- Airbus increased it 20-year forecast for new aircraft to 30,070, up 500 from its previous projection. Much like Boeing, Airbus sees continued growth in passenger traffic, and the discrepancy between the new airplane forecasts from the two companies is explained by Airbus's more cautious passenger traffic expectations.

- Airbus sees passenger traffic growing an average of 4.5 percent per year compared to Boeing at 4.8 percent per year.

From our perspective, the vector and velocity in these forecasts is far more important than the 20-year totals as odds are those forecasts will be rejiggered over the coming decades. The bottom line is both Boeing and Airbus see rising wealth in Asia driving greater air travel over the coming years, which is very much in the Fear of Missing Out (FOMO) or You Only Live Once (YOLO) mindset as well as our ***Rise & Fall of the Middle Class*** investing theme.

Global Middle Class to Move from 2.8 Billion to 4.8 Billion in 20 Years

Millions of People



Note: Households with yearly income between $20,000 and $150,000 in constant 2015 prices.

Source: Oxford Economics, Airbus, U.S. Global Investors

A better than expected Industrial Production Report . . . on the surface.

On Friday, we also received the June Industrial Production report, which saw US industrial output rise 0.6 percent for the month. On its face that was a better than expected reading vs the 0.4 percent forecast, but digging into the figures, we found however that most of the month's improvement was due to a surge in utility production, which we chalk up to the extreme heat running across the US. The month over month improvement we saw in manufacturing was largely due to the 9.6 percent increase motor vehicle assemblies, with output in other manufacturing categories little changed.

The bottom line is there are a number of thematic tailwinds that remain in place and we will continue to ferret out those companies best positioned to fly in those glide paths. Corporate earnings season is bound to offer us better opportunities to buy well positioned, quality companies at better prices.

Call our view askew, but we see nothing wrong with taking advantage of market pain for longer-term gain.

Turning our view to the week ahead...

The economic data this week will be housing heavy, with the July NAHB Housing Market Index as well as June Housing Starts and Building Permit data. Later in the week brings June Existing Home Sales data. Peering into the data, given the incredibly low inventories that have continued to push up average home prices, we expect to see recent strength in building permits translate into housing starts, but with consumers shunning restaurants of late, we are not expecting blow out housing results.

The rather light economic calendar means the two items of focus for the market will be earnings and the 2016 Republican National Convention (July 18-21). The latter is sure to attract much cable and TV news attention, but we will continue to focus on the ramp up in earnings reports — more than 350 next week, up from 52 over the last five days. Among those 350 companies, 104 are S&P 500 companies, which means we'll be paying attention to any revisions for second half earnings expectations versus the exuberant up 13 percent expectation relative to the first half of 2016.

EARNINGS ON TAP THIS WEEK

AFFORDABLE LUXURY

- Daimler AG (DDAIF)

AGING OF THE POPULATION

- Charles Schwab (SCHW)
- TD Ameritrade (AMTD)
- Interactive Brokers (IBKR)
- Intuitive Surgical (ISRG)
- Johnson & Johnson (JNJ)
- Abbott Labs (ABT)
- Morgan Stanley (MS)
- E-Trade (ETFC)
- Stryker Corp. (SYK)

ASSET-LITE

- GATX Corp. (GATX)
- Cash-Strapped Consumer
- eBay (EBAY)
- Southwest Airlines (LUV)
- Skechers USA (SKX)

CASHLESS CONSUMPTION

- Discover Financial Services (DSF)
- Blackhawk Networks (HAWK)
- American Express (AXP)
- Synchrony Financial (SYF)
- Paypal Holdings (PYPL)
- Visa (V)

CONNECTED SOCIETY

- IBM (IBM)
- Netflix (NFLX)
- VMware (VMW)
- Yahoo! (YHOO)
- Microsoft (MSFT)
- Ericsson (ERIC)
- Intel (INTC)
- Qualcomm (QCOM)
- Athenahealth (ATHN)
- Skyworks Solutions (SWKS)
- AT&T (T)

CONTENT IS KING

- Electronic Arts (EA)
- Grupo Televisa (TV)
- IMAX (IMAX)
- Pandora (P)

DISRUPTIVE TECHNOLOGIES

- Sensient Technologies (STST)

ECONOMIC ACCELERATION/DECELERATION

- JB Hunt (JBHT)
- Kansas City Southern (KSU)
- WW Grainger (GWW)
- Illinois Tool Works (ITW)
- United Rentals (URI)
- General Electric (GE)
- Honeywell International (HON)

FATTENING OF THE POPULATION

- Del Taco Restaurants (TACO)
- Del Friscos Restaurants (DFRG)
- Dunkin Brands (DNKN)
- Dominos Pizza (DPZ)

FOODS WITH INTEGRITY

- Chipotle Mexican Grill (CMG)

GUILTY PLEASURE

- Philip Morris (PM)
- Boston Beer (SAM)
- Starbucks (SBUX)

RISE & FALL OF THE MIDDLE CLASS

- United Continental (UAL)
- Tupperware Brands (TUP)
- American Airlines (AAL)
- Alaska Air Group (ALK)
- VF Corp. (VFC)
- Whirlpool (WHR)
- Unilever (UL)

SAFETY & SECURITY

- Lockheed Martin (LMT)
- F5 Networks (FFIV)
- Textron (TXT)
- Proofpoint Inc. (PFPT)

SCARCE RESOURCES

- Idex (IEX)

TOOLING & RETOOLING

- HealthStream (HSTM)
- Scholastic Corp. (SCHL)

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