

TEMATICA INVESTING

THEMATIC COMMENTARY, EQUITY RESEARCH & INVESTING STRATEGIES



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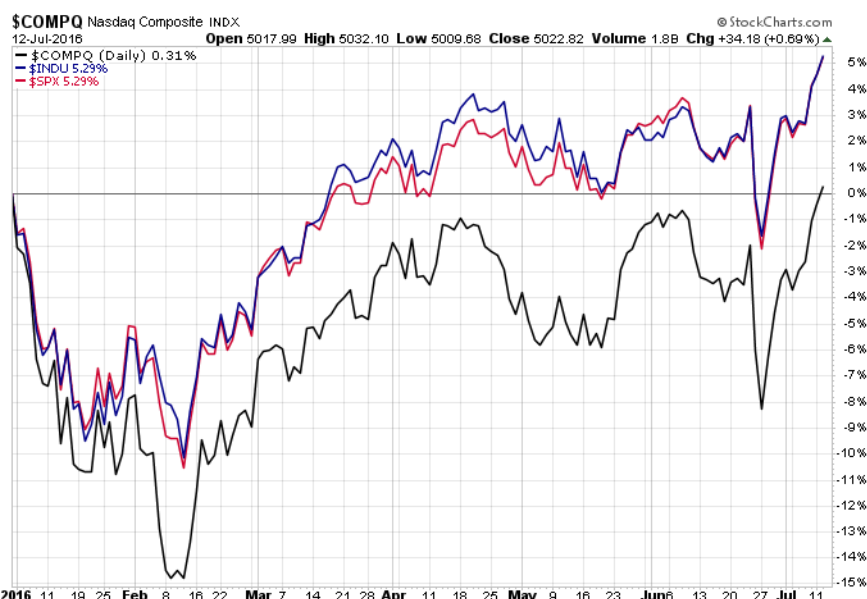
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Economics & Expectations:

Current Market Conditions Have Us in Wait and See Mode

The domestic stock market continued to move higher earlier this week, notching new all-time highs for both the Dow Jones Industrial Average (INDU) and our preferred market index, the S&P 500 (SPX). On the back of these new highs, both indices moved modestly higher on a year-to-date basis. Riding the rising market tide too was the Nasdaq Composite Index (COMPQ), which moved into positive territory on a year-to-date basis as well.



The Tematica Select List certainly wasn't left out, as it had a number of positions, such as **Alphabet (GOOGL)**, **Nike (NKE)** and the **Consumer Discretionary SPDR ETF (XLY)**, that outpaced the climb in the indices this past week, while **Amazon (AMZN)**, **Disney (DIS)**, **PetMeds Express (PETS)** all kept pace with the market.

Given the market melt up, the more defensive positions on the Select List, like **AT&T (T)**, **Regal Entertainment Group (RGC)**, and **Physicians Realty Trust (DOC)** as well as **ProShares Short S&P 500 ETF (SH)**,

Tematica Investing, a weekly publication by Chief Investment Officer 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.



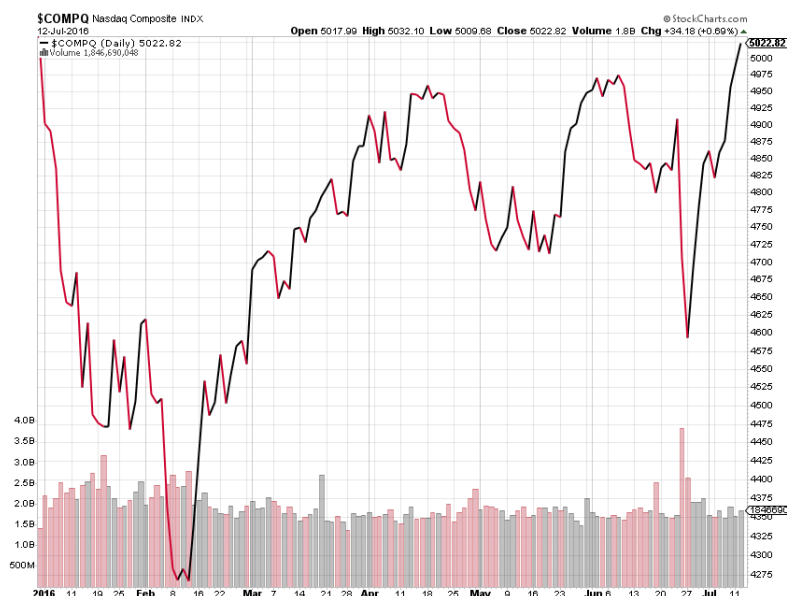
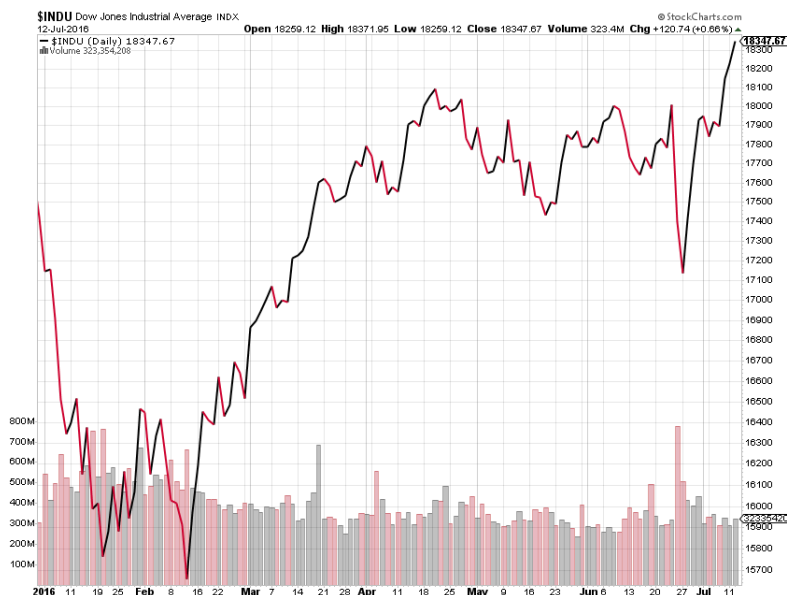
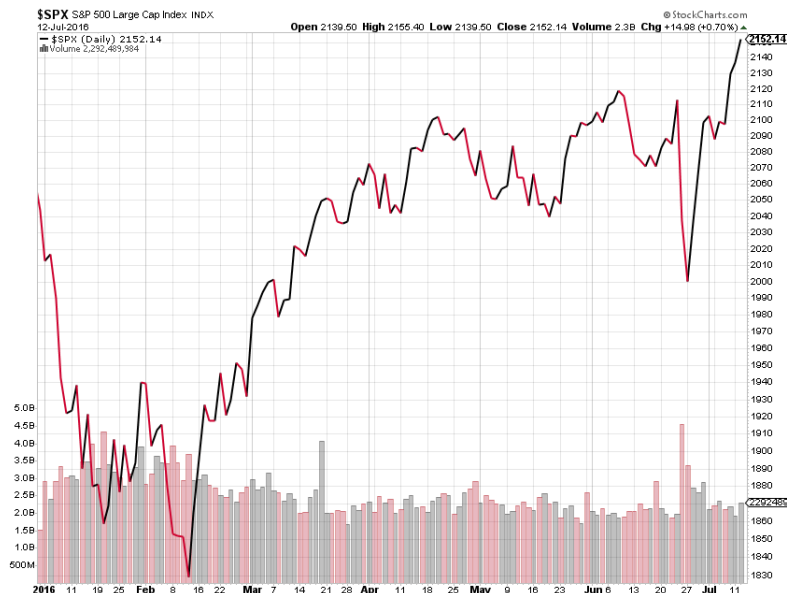
underperformed the market move. Given the number of uncertainties we discussed in this week’s [Monday Morning Kickoff](#), including the burgeoning June quarter earnings season, we will continue to keep these higher dividend yielding stocks on the Select List.

As we shared last week, however, we would not commit fresh capital to T, RGC or DOC shares at current levels. We continue to see far more upside medium to longer term in shares of AMZN, GOOGL, **Starbucks (SBUX)**, NKE and DIS. Near term however, our recommendation is to hold off adding to those positions as we move deeper into 2Q 2016 earnings.

We’re just a few days into earnings reports and already it’s shaping up to be a mixed bag, with so far more companies missing expectations and reducing outlooks than those knocking it out of the park. Even those that have reported better than expected earnings for the June quarter have not offered a vibrant outlook, and in the coming pages we’ll put **Alcoa’s (AA)** results under the microscope.

As we’ve shared probably more than you wanted to hear, we are concerned about the outlook for second half earnings for the S&P 500 group of companies relative to expectations. We continue to see those forecasts as overly robust, particularly with the stock market at record highs. In our view, there is more downside risk to be had over the coming weeks as earnings expectations for the back half of 2016 get resized and reset. **With the probability of buying stocks at better prices ahead in the coming weeks, we’d inclined to sit on the sidelines near-term.**

As such, this week’s **Tematica Investing** is a tad shorter than usual, but from a brain power perspective it continues to be chock full of thematic goodness. Let’s get down to it . . .



Digging into Earnings from Alcoa and others

As we mentioned earlier, we are just starting to dip our collective toes into June quarter earnings and that naturally means that we've heard from **Alcoa (AA)**, which tends to be a harbinger of our **Economic Acceleration/Deceleration** investing theme and helps set the tone of the coming weeks. That tone is not simply because Alcoa is the first S&P 500 company to report its earnings. Rather because Alcoa's metal products are used in a wide variety of industries, from cars to trucks to aircraft and general manufacturing, it provides a pretty good anecdotal read on the health of the industrial economy, both here in the US and abroad.

We know the reported economic data over the last few months continues to point to a ho-hum global economy, with the US outpacing both China and Japan. With the post Brexit vote, the Eurozone expected to contend with another bout of slowing growth. Reinforcing that view, earlier this week the European Commission slashed its UK and eurozone growth forecasts post Brexit vote and forecasting the cumulative negative impact for British GDP would be about 1-2.5 percent, and the euro area between 0.2 to 0.5 percent by 2017. Keep in mind, like many other policy groups, the European Commission tends to overestimate to the upside and underestimate to the downside.

Additionally, as we've already shared, the Italian banking situation is only going to heat up as we move closer to the July 29 stress tests. Yesterday European Union finance ministers said both Spain and Portugal didn't take enough action to reduce their 2015 budget deficits, setting in motion a process that may lead to financial sanctions and potentially the freezing of EU funds for these two countries.

The bottom line is things are not looking all that rosy for our friends across the Atlantic.

So what did Alcoa earnings tell us?

- Total Sales fell 10 percent year over year in the June quarter to \$5.3 billion due in part to a 4.1 percent decline in shipments of aluminum products year over year.
- Adjusted Net Income fell 15 percent year over year
- Even though Alcoa managed to report a better than expected bottom line of \$0.15 per share for the June quarter vs. Wall Street expectations for \$0.10 per share, on a year over year comparison, June quarter earnings fell 21 percent from \$0.19 per share.

Not quite the robust picture that many of the talking heads were painting, particularly since most of the June 2016 quarter earnings beat was due to the elimination of restructuring charges, tax and other "special" items.

The bottom line is Alcoa beat already reduced earnings expectations on declining revenues. We'd color that as an okay quarter, but when we factor in the company's business commentary, we are still left wanting. Here's what we gleaned from below the headlines:

Global Aerospace

Alcoa continues to see 2016 as a "transition year" with the first half down roughly 1 percent, but given recent order flow it sees the market flat to up 1 percent for 2016.

In keeping with our **Rising & Fall of the Middle Class**, longer-term, Alcoa sees a pick up in new aircraft demand fueled primarily by increasing air traffic from the emerging economies due to rising disposable incomes. We have our thematic eyes on this and will look to capitalize on this as the industry hits the 2016 inflection point.

North America

The Automotive industry is at near peak levels, with roughly 17.4 million cars compared to the prior peak of 17.3 million in 2000. Alcoa sees the industry rising 1-4 percent this year, which when compared to its 2.6 percent increase year to date, suggests modest upside and the possibility of falling demand in the back half of 2016.

The heavy truck and trailer industry remains weak with production down 22 percent year to date, orders down 40 percent year to date and inventories more than 27 percent higher than the ten-year average.

Moving to building and construction, Alcoa sees some of that market up 4-5 percent this year, but it also sees the packaging industry flat to down 1 percent. In sum, the outlook does not paint a vibrant domestic demand outlook for light metal.

Europe

In the European automotive market, Alcoa sees growth of 2 to 4 percent in 2016, but year to date production is up just over 4 percent, which implies potential weakness in the back half of the year. Breaking it down:

- Western Europe is expected to be stronger (up 6.1 percent) than eastern Europe (down 8.5 percent).
- On the heavy truck and trailer front, strength in western Europe (positive registration and orders) is being offset by weakness in eastern Europe (down more than 16 percent).
- In the European packaging and building markets, Alcoa sees those markets up modestly and essentially flat, respectively.

The bottom line in Europe is it is also a picture of modest growth at best in the back half of 2016.

China

For 2016, Alcoa now sees auto demand in China up 3 to 5 percent, which suggest weakness ahead given that year to date sales are up 6.5 percent year over year. Buried in its comments, however, we found:

- China continues to exhibit presences that are keeping with our **Affordable Luxury** investment theme — a 35% year over year surge in SUVs and crossover utility vehicles.
- Much like the automotive markets, the outlook for the Chinese heavy truck and trailer market in the back half of 2016 is far from vibrant — year to date the market is up 10 percent, but Alcoa sees it up 2 to 4 percent for 2016.
- Building and construction demand is still expected to be slow in 2016, roughly up 3 to 5 percent for the year, compared to up 5 percent in 2015 and 8 percent in 2014.

Summing these markets up, it looks like more economic weakness ahead in China over the coming months.

The Bottomline and What We Learned from Alcoa

While Alcoa’s results confirm several of our investment themes, the over all tone suggests we are not poised to see a pronounced pickup in the global economy. Even though Alcoa is more upbeat on the global aerospace market, earnings last night from **AAR Corp (AIR)**, a supplier for products and services to the commercial aerospace market as well as government and defense ones, not only posted a wide miss relative to expectations, but slashed its revenue and earnings outlook for all of 2016.

In other words, fasten that seat belt because it is likely to get turbulent as we move deeper into earning season over the coming days. That volatility sees us keeping **ProShares Short S&P 500 ETF (SH)** shares on the **Tematica Select List** as we break out our calculators and spreadsheets to do some number crunching with regard to outstanding share counts. You see, even though profits are the mother’s milk for stock prices (per Larry Kudlow), according to S&P Dow Jones Indices, companies in the S&P 500 bought back \$161.39 billion of shares during the March quarter and through the end of June authorized \$357 billion in share buyback programs.

What this means is we are quite likely to see the “Wonderbra-like” effect on reported EPS continue: Shrinking share counts through share buyback programs can make falling operating profit and net income comparisons look more attractive if not outright higher year over year.

We’ll continue to focus on profit dollar growth and margin expansion as we parse upcoming reports for existing positions and potential ones as well. As you can see in the chart below, companies on the **Tematica Select List** will soon be reporting their earnings. In addition to those reports, we’ll be digging into those from key suppliers and customers to make sure we have a clearer picture. For now, we’re going to sit tight.

Company	Theme	Ticker	Reporting Date
Alphabet	<i>Asset-Lite</i>	GOOGL	28-Jul
Amazon	<i>Connected Society</i>	AMZN	21-Jul *
AT&T, Inc.	<i>Connected Society</i>	T	21-Jul
Nike, Inc.	<i>Rise & Fall of the Middle Class</i>	NKE	TBD
PetMeds Express	<i>Aging of the Population</i>	PETS	22-Jul *
Physicians Realty Trust	<i>Aging of the Population</i>	DOC	TBD
Regal Entertainment Group	<i>Content is King</i>	RGC	28-Jul *
Starbucks	<i>Guilty Pleasure</i>	SBUX	21-Jul
The Walt Disney Co.	<i>Content is King</i>	DIS	9-Aug

* Estimated reporting date
 Source: [Company reports and Zacks](#)

TEMATICA SELECT LIST PERFORMANCE

as of market close July 12, 2017

(AMZN) AMAZON.COM							Connected Society	
DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING	
5/24/16	\$709.53	\$748.21	--	--	5.45%	\$880.00	(BUY)	
(GOOGL) ALPHABET, INC.							Asset Lite	
DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING	
6/15/16	\$733.94	\$732.51	--	--	-0.20%	\$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	\$81.41	--	--	2.31%	--	(HOLD)	
(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	\$100.20	--	\$87.00	-1.92%	\$125.00	(BUY)	
5/11/16	\$101.78	\$100.20	--	\$87.00	-1.55%	\$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	\$21.11	\$1.80	\$18.00	59.87%	\$25.00	(HOLD)	
(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	\$58.06	--	--	3.49%	\$66	(BUY)	
(PETS) PETMEDS EXPRESS							Connected Society	
DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING	
5/4/14	\$17.80	\$19.33	\$0.19	--	9.66%	\$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	\$41.12	\$38.62	--	--	-14.37%	\$24.00	(BUY)	
3/23/16	\$45.10	\$38.62	--	--	-6.08%	\$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	\$22.20	\$0.66	\$19.00	23.50%	\$24.00	(HOLD)	
(SBUX) STARBUCKS CORPORATION							Guilty Pleasure	
DATE ADDED	ADD PRICE	CURRENT PRICE	DIVIDENDS	STOP PRICE	RETURN (%)	TARGET	RATING	
6/1/16	\$54.90	\$57.48	--	--	3.42%	\$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	\$42.41	\$1.43	\$39.00	26.45%	\$45.00	(HOLD)	

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	<i>Aging Population / Scarce Resources</i>
AWK	American Water Works	<i>Scarce Resources</i>
WTR	Aqua America	<i>Scarce Resources</i>
CHGG	Chegg Inc.	<i>Tooling & Retooling</i>
CMG	Chipotle Mexican Grill	<i>Foods with Integrity</i>
SCOR	Comscore	<i>Connected Society</i>
GLW	Corning Inc.	<i>Disruptive Technologies</i>
EPR	EPR Properties	<i>Content is King</i>
IMMR	Immersion Corp.	<i>Disruptive Technologies</i>
KIM	Kimco Realty	<i>Rise & Fall of the Middle Class</i>
LOCK	Lifelock	<i>Safety & Security</i>
MKC	McCormick & Co.	<i>Cashstrapped Consumer / Middle Class</i>
MRK	Merk & Co.	<i>Aging of the Population</i>
NLSN	Nielson NV	<i>Connected Society</i>
PANW	Palo Alto Networks	<i>Safety & Security</i>
SYNA	Synaptics Inc.	<i>Disruptive Technologies</i>
UNFI	United Natural Foods	<i>Foods with Integrity</i>
VZ	Verizon Communications	<i>Content is King / Connected Society</i>
XYL	Xylem, Inc	<i>Scarce Resources</i>

STOCKS / FUNDS MENTIONED

AAR Corp (AIR)

Alcoa (AA)

Alphabet (GOOGL)

Amazon (AMZN)

AT&T (T)

Nike (NKE)

Consumer Discretionary SPDR ETF (XLY)

Disney (DIS)

PetMeds Express (PETS)

Physicians Realty Trust (DOC)

ProShares Short S&P 500 ETF (SH)

Regal Entertainment Group (RGC)

Starbucks (SBUX)

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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Investment opinions are based on each stock's 6-12 month return potential. Our ratings are not based on formal price targets, however our analysts will discuss fair value and/or target price ranges in research reports. Decisions to buy or sell a stock should be based on the investor's investment objectives and risk tolerance and should not rely solely on the rating. Investors should read carefully the entire research report, which provides a more complete discussion of the analyst's views.

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