

MONDAY MORNING KICKOFF

YOUR MARKET PRIMER FOR THE WEEK AHEAD

Earnings, Fed Heads, Davos and the Trump Inauguration . . . all in 4 Days . . . Oh My!

As amazing as it might be, we are already half way through the first month of 2017. Much like yourselves, we too are thinking, "My how time flies!" Well, folks, it's about to get even faster as we wade deep into December quarter earnings. As we do this, we're seeing more investors start to question either the upward move in the market over the last several weeks or how much more room there is to run?

All fair questions in our minds given the sharp move in the major market indices despite the near-term tone of the economy, unknowns on the potential economic impact of President-elect Trump's policies (and Tweets!), and political issues in the Eurozone.

A Greek Tragedy Even Sophocles Couldn't Come Up With

If you haven't heard about it yet, in addition to hearing about the potential of a France exit from the EU (Yes, "Frexit" was the new term du jour this past week) on top of "Italeave" (Italy) and last summer's Brexit, it's looking like we are due for another round of Greek drama. As the Wall Street Journal reported last week that in Greece, "The government, knowing voters' exhaustion, is adamant that it won't legislate a multiyear package of pension cuts and income-tax increases, which the International Monetary Fund says is the only way for Greece to hit its agreed-upon budget targets."

If you're thinking we haven't heard the last of this Greek tragedy, we are right there with you. What's more than a tad different this time around is we potentially have far more countries in play, something that could cause big headlines in the coming weeks if not some larger changes in Europe.

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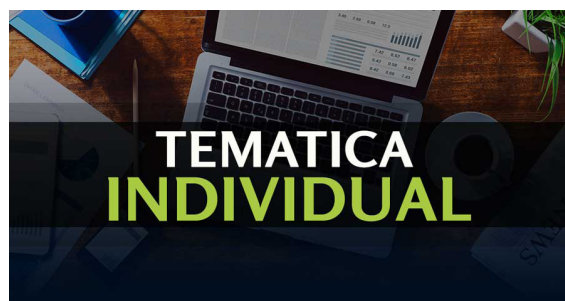
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ABOUT THE MONDAY MORNING KICKOFF

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.

The Impact of the European Drama on U.S. Shores

Needless to say, all of the twists and turns in Europe will have some impact on the dollar, and thus U.S. imports and exports. The only question is to what degree?

It's an important question given the percentage of components and other key inputs are sourced from outside the US. We were reminded of this last week by **Constellation Brands (STZ)** when its CEO shared that 60 percent of its cost of goods sold are sourced in Mexico. Similarly, **MSC Industrial (MSM)**, distributor of metalworking and maintenance, repair and operations (MRO) products and services, reminded investors that 12 to 15 percent of its cost of good sold come from outside the US, and roughly 40 percent of its US purchases are actually foreign sourced.

Last week, we also heard from Fed Chairwoman Janet Yellen that "the U.S. economy is doing well and faces no serious obstacles in the short term, with the labor market looking pretty strong." To us, that follows the questionable logic of "because things aren't bad, they must be good.". As most of have come to know, that's two things that are not exactly one in the same.

As far as the labor market looking pretty strong, yes the Unemployment Rate has come down significantly over the last few years. We can't, however, say the opposite has happened for the labor force participation ratio and payroll to population ratio, both of which have lagged for several years. In that regard, we agree with Chicago Federal Reserve President Charles Evans's view the economy "needs longer term strategies to expand a labor force constrained by issues like population aging and lagging productivity."

We see Yellen's comments simply reinforcing the cheerleader-like role the Fed tends to play when it comes to the economy; we'll continue to let the data be our guide when it comes to the Fed and assessing the on-going market rally since President-elect Trump's victory.

The data we'll be watching not only includes the latest rash of economic data, which as you know is far from scarce, but also company commentary and anecdotes, which should help round out the economic picture. As we gear into December quarter earnings there will be no shortage of that commentary.

We had a few earnings reports last week, including those from **Bank of America (BAC)**, **JPMorgan (JPM)** and other financials, but there were a few that caught our eye.

One of those was **WD40 (WDFC)**, which reported disappointing results, due in part to the strength of the dollar —there's that impact of the dollar again! While most of us think of WD40 for its industrial lubricant products, it derives 40 percent of its revenues from markets outside of the US. The dollar aside, the company's domestic business fell 4 percent year-over-year, which in our view helps to confirm the disconnect between the move in the stock market — especially industrial stocks — since November and the tone of the domestic economy. WD40's dollar comments add to those from **Honeywell (HON)**, **Adobe Systems (ADBE)** and others over the last few weeks pointing to weak performance despite a market rally.

As we pointed out in last week's edition of the Monday Morning Kickoff, we have seen some improvement during December in the industrial economy and some month over month softness in the services sector.

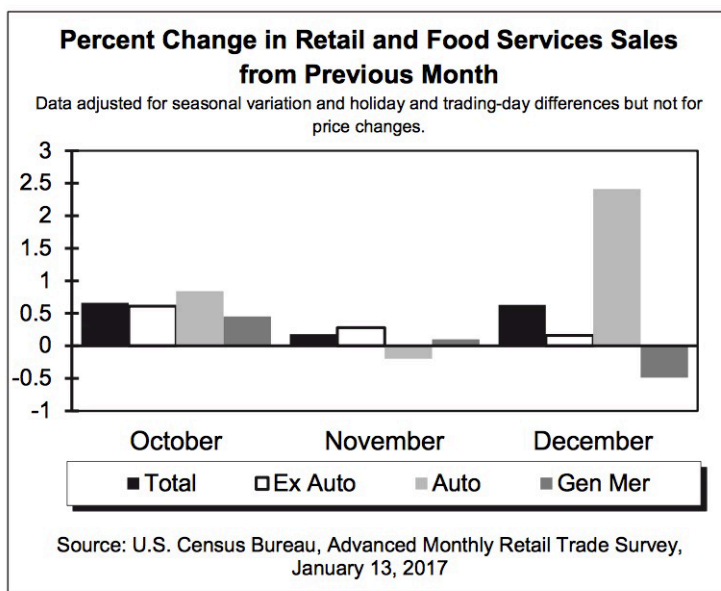
In keeping with that, MSC Industrial shared:

“the environment...is showing potential signs of stabilizing. We’ve also seen increased optimism from our customers over the past couple of months...It has been at least three years since we’ve seen anything resembling this...This stabilization has been pretty broad...machine and equipment folks, primary metals, metal fabrication. All of those are seeing an improvement over the last couple of months.”

As we tend to say, one data point does not make a trend, but we’ll be listening over the coming days and weeks for confirmation to determine if this is just a stabilization or perhaps something more.

The Silver Lining for Us in Disappointing Retail Store Sales

The big data point to be had last week was the December Retail Sales report, which had some thunder stolen the prior week given comments from **Macy’s (M)**, **JCP Penney (JCP)**, **Kohl’s (KSS)** and several other retailers over their poor performance during the recent holiday shopping season. As such, we didn’t expect any real upside to be had in the December Retail Sales Report and we were not disappointed. For the second year in a row, December Retail Sales ex-auto missed expectations, coming in at +0.2 percent month over month vs the consensus forecast of +0.6 percent. If we stripped out gasoline sales, which were +2 percent month-over-month due to the recent rise in oil prices, comparisons would have been even weaker.



Digging further into the report, however, we find the silver lining — confirmation for our **Connected Society** investing theme. Nonstore retail sales, which is US Census Bureau speak for e-tailers, rose more than 13 percent year over year in December vs. 3.4 percent increase year over year for retail sales ex-food and autos. For 2016 in full, Nonstore retail sales rose 11.5 percent year over year vs. 2.9 percent for retail ex-food and autos, and the main reason why our the **Connected Society** component of our Thematic Index returned 16 percent before dividends for the year.

To us, those comparisons certainly confirm the ongoing shift toward digital commerce, which is propelling the online and mobile shopping businesses that is one of the central aspects of our Connected Society theme. With companies like **Amazon (AMZN)** enabling apps beyond smartphones and tablets to platforms like its own Echo devices and even **Apple’s (AAPL)** Apple TV, it’s becoming increasingly easier to digitally shop. As a reminder, when we look at the pace of digital sales at **Nike (NKE)**, **Under Armour (UAA)**, **William-Sonoma (WSM)** and even **Macy’s (M)**, this shift is far more encompassing than “just” Amazon.

The disappointing December Retail Sales report led the Atlanta Fed to revise its 4Q 2016 GDP reading to 2.8 percent, down from 2.9 percent the week before. Our position remains the Atlanta Fed continues to be an outlier to upside as The Wall Street Journal's Economic Forecasting Survey still sits at 2.1 percent for 4Q GDP with the first half of 2017 expected to average 2.3 percent.

The net-net as they say for the week had the Dow Jones Industrial Average and the S&P 500 dip modestly, while the tech-heavy Nasdaq Composite Index climbed more nearly 1 percent. If we look at a chart of the Dow and S&P 500, you'll notice that over the last month they have been relatively unchanged. In our view, the key to their next move will start to unfold this week.

Turning to the Week Ahead

As we mentioned several paragraphs ago, while Wall Street earnings season kicked off last week, it's this week when we really start to see the velocity of earnings announcements pick up. This week we have more than 125 companies reporting, 33 of which are in the S&P 500 (including 5 Dow 30 components). These reports will start to give some substance behind the S&P 500 earnings forecast from FactSet that calls for a modest dip in the collective earnings from those 500 companies in 4Q 2016 vs. 3Q 2016.

In keeping with our thematic perspective, several heavy weights in our **Economic Acceleration/Deceleration** theme — **CSX Corp. (CSX)**, **General Electric (GE)**, and **JB Hunt Transportation (JBHT)** among others — should offer insight into what they see in the global economy and impact of the dollar. We'll also hear from **Connected Society** company **Skyworks Solutions (SWKS)**, which should offer perspective on the strength of the smartphone market, the potential adoption of 5G wireless technology and progress on the Connected Car and Connected Home markets. Also on tap this week is **Netflix (NFLX)**, a company that is blurring the lines between our **Connected Society**, **Content is King** and **Rise & Fall of the Middle-Class** themes as it brings more original content to more and more countries around the globe.

On the economic front, the week brings several pieces of December data — Industrial Production, Housing Starts, will be had that should help bring 4Q 2016 GDP into even sharper focus. We'll also get a few regional Fed reports for January as well as the Fed's Beige Book for January, which should help start to frame the tone of the economy for 2017. Making that earnings and economic data velocity a tad more frenetic this week is the fact that domestic stock markets are closed this Monday (a three day weekend for some of us). Nothing like cramming five days of data and earnings reports into four.

ECONOMIC CALENDAR JAN 16-20, 2017		
DATE	REPORT / SPEECH	DATA
17-Jan	Empire Manufacturing	Jan
18-Jan	MBA Mortgage	14-Jan
18-Jan	CPI	Dec
18-Jan	Core CPI	Dec
18-Jan	Industrial Production	Dec
18-Jan	Capacity Utilization	Dec
18-Jan	NAHB Housing Market	Jan
18-Jan	Fed's Beige Book	Jan
18-Jan	Net Long-Term TIC	Jan
19-Jan	Initial Claims	14-Jan
19-Jan	Continuing Claims	7-Jan
19-Jan	Housing Starts	Dec
19-Jan	Building Permits	Dec
19-Jan	Philadelphia Fed	Jan
19-Jan	Natural Gas Inventories	14-Jan
19-Jan	Crude Inventories	13-Jan

Also this week, we have the World Economic Forum in Davos Switzerland, where politicians, CEOs, celebrities meet to establish the conventional wisdom over fondue, cocktails, and high-minded debates. We get to watch it all unfold on TV as we decipher the likely cryptic and mixed messages to be had this week from several Fed heads. New York Fed President William Dudley speak on Tuesday; San Francisco Fed President John Williams speaks on Tuesday, Wednesday and Friday; Minneapolis Federal President Kashkari talks on Wednesday and Philadelphia Federal Reserve Bank President Harker on Friday. Amid the various comments, we'll try to zero in on what the Fed is thinking when it comes to its December pronouncement that it could raise interest rates three times in 2017.

As we said when that was uttered, we'll watch the data and see.

Rounding out the week, we have Inauguration Day, which means before too long we should start to see some meat on the policy bones that soon to be President Trump and crew will be putting forth.

EARNINGS ON TAP THIS WEEK

The following are just some of the earnings announcements we'll have our eye on for thematic confirmation data points:

AGING OF THE POPULATION

- Charles Schwab (SCHW)
- United Health (UNH)

CASHLESS CONSUMPTION

- American Express (AXP)
- Synchrony Financial (SYF)

CONNECTED SOCIETY

- Netflix (NFLX)
- Skyworks Solutions (SWKS)

ECONOMIC ACCELERATION/DECELERATION

- CSX Corp. (CSX)
- General Electric (GE)
- JB Hunt Transportation (JBHT)
- Kansas City Southern (KSY)
- Union Pacific Corp.

FATTENING OF THE POPULATION

- Brinker International (EAT)
- Del Taco Restaurants (TACO)

RISE & FALL OF THE MIDDLE CLASS

- Alaska Air (ALK)
- United Continental (UAL)

SAFETY & SECURITY

- Checkpoint Software (CHKP)
- Scarce Resources
- Aqua America (WTR)

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