Goldman SMALL CAP RESEARCH

The Goldman Guide

VOLUME 4 | ISSUE 7 | JUNE 16, 2013

INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *There is a bad volume metric no one seems to have uncovered.*
- ⇒ *When this metric does a 180, it is a very bullish sign*
- ⇒ *Oil, breakout stocks and the 3-Day Rule will make you money this summer*
- ⇒ *Consumer and Semis are 2 places to be*
- ⇒ *This under $3 bank stock on the OTCBB is rocking and could be a takeover target*

KEY STATISTICS

Index	Close	2013
DJIA	15070	15.0%
S&P 500	1627	14.1%
NASDAQ	3424	13.4%
Russell 2K	981	15.5%

(figures are rounded)

Why The Market Hates Us

It is hard not to take it personally but for anyone following the trading of the past two weeks, it is as if the stock market is mocking us. One day things are great, the next day they are bad. One day the market shakes off its negative undertones to trade meaningfully higher only to trade lower by day's end. It can be maddening. If the stock market was a sentient being, I would say it is trying to teach us a lesson.

One thing is for certain. Investors of all shapes and sizes, along with the media, are on pins and needles regarding the recently increased volatility. So, let's put this in perspective.

Stocks are up on average about 15% year-to-date. Just a couple of months ago it felt as if the stock market was invincible and could only go higher. Now, due to concerns over the potential of reduced monetary easing, and economic problems in Asia we have lost faith in the stock market. What is crazy is that it only seems worse than it really is. For example, stocks are down around 1% for the first half of the month, which isn't a calamity. It is an amazing thing to see how psychologically, we freak out over a little volatility and price reductions yet are border-line arrogant about big returns.

As painful and difficult as it might be, it is okay and actually a good thing that volatility returns and we have price reductions in stocks. Modest readjustments are a typical and expected result of big moves, regardless of direction.

When faced with choices, people tend to make the wrong decisions. However, when a broad market rally occurs, the mistakes are masked. When volatility and stock reductions occur, the mistakes are magnified and anxiety sets in. This is where e feel as if the market hates us, won't behave correctly and we view it with disdain. The best way to overcome this situation is to remember we buy stocks, not the market. To succeed in the present market, follow the right paths. What paths? Read on...

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Follow This Overlooked Measure

For the most part, the smart money actively seeks out leading indicators in order to correctly invest in both the stock market, and in stocks. These leading indicators can be economic, market, or industry-based. In the absence of leading indicators, one must refer to lagging indicators. As we referred to earlier, investors are a bit anxious and not as confident about the market's near term fortunes in recent months, as compared to 1Q13. A prime example of this skittishness is stock volume. And this metric seems to be overlooked by everyone. On most of the market's biggest down days of Q2, volume in the S&P 500 Index rose above 4 billion shares traded, while on NASDAQ, volume exceeded 2 billion traded shares. However, even on big up days, volume was not nearly as high and in fact was very average.

This does not bode well. Until we have big up days with big volume, we will likely languish in the doldrums. Moreover, the advance/decline ratio of NASDAQ stocks has been especially poor on down days versus other indices.

So where does that leave us, considering we are in a flat to down and very skittish environment?

Oil, Breakouts, and The 3-Day Rule

Oil prices are on the move, especially in the past week, as geopolitical conflict such as another war in the Middle East, and the likelihood of U.S. involvement, underlines the severity of the situation. In fact, the moves higher have had a role already in higher producer prices. If oil prices exceed the $100 mark again, they could rise an additional 10%, which makes oil a place to be for the summer.

Chart I. WTI September 2011 (NYMEX) Price

(Source: NASDAQ.com)

Plus, consumer stocks had a great May—especially in the auto sector and prices are rising again as are auto loan rates. As sectors, these are places to be in the near term, as is the semi arena, as we alluded to last week.

When the Adv/Dec line is poor and volume not so hot, it is time to find momentum stocks that have broken out, especially in the sectors noted above. Trying to find value and hoping for rises may not occur. For all of you traders out there, remember the 3-day rule. Sell breakout stocks after 3 days, as the volume wanes and stocks decline.

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A Breakout M&A Target

It is not often that we profile M&A candidates, but when we do, the stocks usually get acquired for big premiums. (See Charming Shoppes, Great Wolf Lodge, New Frontier Media, among others.) Nor is it often we talk about bank stocks, let alone a troubled bank that is on the mend. In this case, the following bank stock has broken through year highs on big volume and could be a takeover target as it continues its operating improvement.

First Mariner Bancorp (OTCBB – FMAR - $2.62) is a top-ten bank in the Baltimore area with $1.3 billion in total assets.

Let me remove my filter as I describe the Company's history. The stock was an abortion dropping 90% over a few years as the mortgage crisis hit them extremely hard. Frankly, it seemed as if Company policy was if you had a heartbeat, you could qualify for a mortgage. There was a complete overhaul of the bank, key leadership including the beloved founder left, and for the past year, after a failed financing, the Company has been slowly coming back to life.

Listed for a number of years on NASDAQ the Company trades on the OTC Bulletin Board and has seen a big rise in its share price on strong volume since releasing its 1Q13 results a month ago. Although the Company recorded a net loss, much of it was related to the disposition of $14.4M in non-performing assets which resulted in major asset quality improvement for the 3rd straight quarter. Across the board, FMAR showed improvement in deposits, loan quality, expenses, etc. which indicates that the bank may have truly turned the corner. Thus, the stock has enjoyed a rejuvenation.

However, we also believe that the stock has considerable upside based on word late last week that a bank comparable in the Baltimore market is being acquired for a big premium. BCSB Bancorp (NASDAQ – BCSB) is being acquired by another regional bank and based on certain metrics we believe that FMAR could prove to be an even more favorable M&A target.

BCSB has roughly half of the assets of FMAR yet is being acquired for 40% more than First Mariner's current market cap. Obviously BCSB does not have the baggage that FMAR has. Still, if a bank wishes to have a major presence in the market, FMAR would be the next likely target. Moreover, FMAR could be bought for a 50% premium to its current price and its price/assets and other metrics would still be below that of the BCSB deal. Thus, we believe that as FMAR continues its resurgence, the stock reaches the $5.00 in the coming months.

Until next week...

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