Goldman SMALL CAP RESEARCH

The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

⇒ *What's with the negative waves?*

⇒ *Valuations becoming more attractive*

⇒ *Small stocks getting pricey*

⇒ *Growth at a reasonable price are the place to be*

⇒ *Tech and health care will lead in Q4*

⇒ *Football and investing trends mirror each other*

⇒ *Be a diligent trader*

⇒ *Here is a stock worth a drink*

KEY STATISTICS

Index	Close	2013
DJIA	15259	16.4%
S&P 500	1696	18.6%
NASDAQ	3788	25.2%
Russell 2K	1078	26.5%

(figures are rounded)

Why Bad News is Good News

I can't be the only one that has noticed the scary amount of negativity in the financial media in the past few days. There may be as many as a dozen negative or pessimistic-leaning articles and columns in the weekend's Wall Street Journal and Barron's alone.

I was hoping to find some semblance of optimism so I literally waited until 2AM Monday morning to pen this edition of The Goldman Guide. Alas, the looming federal shutdown, the schism among political party leadership, vagaries of Obamacare, and a multitude of other stories are enough to drive one to drink.

As bitter a pill as this is to swallow, this is a good thing. Uncertainty is a negative for the market but can create opportunities in stocks, especially in those that may have had a it of a run recently. Look, today is the last day of the third quarter of the year, but for all intents and purposes, it already occurred on Friday. In the next 10-14 days, we will begin to see the start of 3Q13 earnings season and get the last bout of guidance for 2014.

With the backdrop of the quarter-end and the macro issues, we would recommend taking a brief Rip Van Winkle approach to stocks. Take 5, or at least take a nap for a couple of days to rise out the volatility. There may be more throughout the month as we wait for clarity on the macro issues and company financials. Already, the recent drop has shaved the 12-month forward P/E on the S&P 500 Index by 10% to 15.4x, which is a good thing. If we can drop by another 10%, that would likely serve as a buy signal even for the real bears out there. After all, a year ago, the same P/E was nearly 17x—yet EPS growth in 2013 was not expected to be as strong as the expectations for 2014.

I have to admit I am a bit nervous about the nosebleed multiple for the Russell 2000 Index which is approaching 20x. Right now the biggest sector exposure is financial services, followed by consumer discretionary. What does that mean for you?

Stocks that have worked this year will sell off in Q4 but good stocks that have not run yet as much in tech and health care should do extremely well. We will be all over these segments, beginning this week.

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Football and Investing Mirror Each Other

I read something over the weekend which prompted a light bulb moment. Prior to major changes in free agency rules and the institution of the salary cap in pro football, team executives who knew how to analyze talent, implement approaches to the game and manage their respective teams had an opportunity to establish mini-dynasties. These dynasties would last for up to ten years and teams like the Cowboys, Steelers, and 49ers were the model of consistency. You could practically predict the outcome of games ahead of time if you had enough of an understanding of the dynamics of the given systems.

Today, with few exceptions, there are no dynasties anymore. The Steelers and Giants, who dominated in Super Bowl appearances the past several years are a collective 0-8 to start the current football season. Execs have to be nimble, dynamically changing their approaches and personnel composition in order to succeed.

Years ago, investors could find good companies that generated consistent success, buy the stocks, and hold them for solid long-term gains. Today, although volatility has declined substantially in the past couple of years, stocks that worked a few months ago may be old news now and are underperforming. If you try to buy a good company that had a good history behind it, there is no guarantee the stock, especially compared to peers in head-to-head competition, will win out.

Does this mean you should be a day trader? No. Does it mean you can't hold onto stocks? No. But, now is the time to be a trader, even if you are buying a stock based on valuation, which is a strategy we suggested you should consider in Q4. Unfortunately, as fickle and impatient as society is today on a social basis, stock investors have engaged the same approaches and the same characteristics to stocks as well. Impatience is rewarded and patience is punished. However, if you stick to your guns regarding a strategy that embraces stock turnover that is orderly and not random, success will be more easily attained than a too-aggressive or too-timid approach.

Here is a stock that will make you say I'll drink to that! Castle Brands, Inc. (NYSE—ROX—$0.85) is a developer and international marketer of premium beverage alcohol brands including: Gosling's Rum®. The Company's Gosling Rum and Ginger Beer are the main ingredients in the Castle Brands' trademarked Dark N Stormy cocktail, which also includes Ginger Beer over ice with a slice of lime. The popularity of this drink drove the Company's rum sales by 20% in 2Q13 and Stormy Ginger Beer sales by 50%, for the period.

It is rare for an alcoholic beverage production and marketing firm to generate such top-line growth, but it appears as if growth may continue, especially as more drinks leveraging the brands occur going forward. Currently, sales are on track to reach around $40M this year with modest a modest operating loss.

The stock hit a new year high of $0.99 on Friday with a big increase in volume (five times average daily volume) and it may take a bit to get through the $1.00 mark, given traders' psychology. Still, we should note that famed billionaire investor Philip Frost owns over 20% of the stock and a number of noted small cap value institutions have nominal ownership as well, which bodes well for investors' comfort levels.

Until next week...

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Rob Goldman founded Goldman Small Cap Research in 2009. Rob has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell-side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*. As an investment manager, Rob's model portfolio was once ranked the 4th best small cap growth performer in the U.S. by *Money Manager Review*. In addition to his work at GSCR, Rob is the editor of The Stock Junction (www.TheStockJunction.com.)

Analyst Certification

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