Goldman SMALL CAP RESEARCH

The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

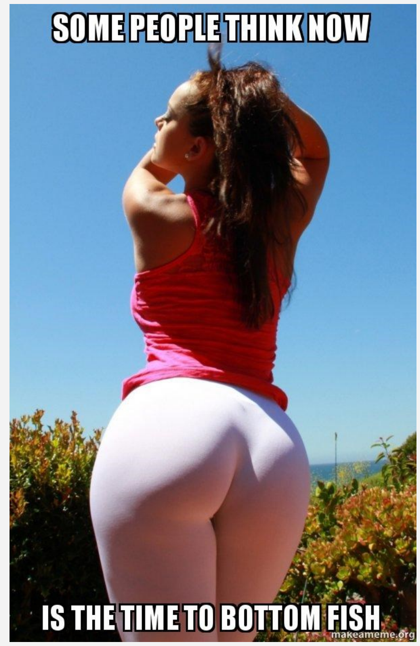
- ⇒ *Market strategists polled in Barron's are unanimous in their market opinions: Stocks are going higher*
- ⇒ *Valuations becoming attractive across the board and especially small caps*
- ⇒ *Stocks may still go through a rough patch but there is daylight ahead*
- ⇒ *Recent fund outflows will come back in the fall*
- ⇒ *Time to bottom fish, buy select blue chips and select story*

THE MAJOR INDICES

Index	Close	2015
DJIA	16102	-9.7%
S&P 500	1921	-6.7%
NASDAQ	4684	-1.1%
Russell 2000	1136	-5.7%

(figures are rounded)

Gentlemen, Start Your Engines



The market saw some weak-kneed investors last week. As we tweeted on Thursday, it looks like fearful traders did not want to be long while on vacation lest China blow up in two trading sessions before we even had one this week.

Instead, the pundits talked about the jobs number being the driver down. Bullshit. Everyone knows that the jobs number is crap with so many underemployed. Besides, the seasonality of the figure is always volatile which makes it superfluous, especially heading into a holiday weekend.

This is the classic version of "can't see the forest for the trees." We spent the past two weeks talking about a rough market for a while followed by a strong Q4 and strong 2016. After perusing a slew of articles, columns, reports, data, etc. I feel more confident than ever about the future for stocks.

This feels like the time to prepare for moves or make the first baby steps in the form of bottom fishing or select position establishment. The key is to ignore the international noise and focus on earnings, valuation, and opportunity—our mantra of late. It is hard to do in the face of losses in the market and doom and gloom stories. But, if it is any consolation, the panic appears to have subsided as demonstrated in more orderly and normalized volume levels. And there are a number of stock losers whose weak hands are now out of the stocks, akin to year-end selling, and aiding upward moves.

The Stock Market Today

U.S. Stock Market Index Performance
as of 9/4/15

Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% off High	% from Low	Bounce*	% Below 200-DMA
DJIA	16,102	18,351	15,370	5/19/15	8/24/15	12.3%	4.8%	16.2%	-9.3%
S&P 500	1,921	2,135	1,821	5/20/15	10/15/14	10.0%	5.5%	12.6%	-7.3%
NASDAQ	4,684	5,232	4,118	7/20/15	10/15/14	10.5%	13.7%	18.0%	-4.7%
Russell 2000	1,136	1,296	1,040	6/23/15	10/15/14	12.3%	9.2%	14.8%	-7.0%
Average						11.3%	8.3%	15.4%	-8.3%

* denotes the percentage index is up from recent low

Source: www.StockCharts.com, Goldman Small Cap Research

It would be disingenuous to ignore the potential pitfalls of the stock market today. While most eyes are (incorrectly) on the Fed and China, a bigger, more systemic risk is the proliferation of negative pre-earnings announcements. Investors are so focused on the external that they have ignored the internal, or domestic issues that could take us down to the recent lows and possibly lower. Remember, earnings for S&P 500 Index and NASDAQ stocks weren't exactly stellar in Q1 and Q2, so this is a real risk.

By the way, if stocks test the August lows, the Fed probably does not make a move for a few months, which would be a positive for stocks. So, in a sense, another decline in stocks is sort of a bad news, good news situation.

We, of course, look at both the stock market valuations today and those during the heart of Q4 and beyond, potential volatility in the near term notwithstanding. I hate to point out that stocks are getting cheaper and cheaper by the day...but, hey...The S&P 500 Index trades around 16.x forward 12-month earnings versus 19x a year ago, and trade at about 15x for 2016, which would be considered an average valuation at this stage. Of all the segments of the market, small caps are looking even better than growth stocks and blue chips, as they trade at a 16% discount to the NASDAQ 100.

Say What?

These links are bound to make you feel better and give your some pretty cool insights into some of the top issues affecting stocks and societal trends. Enjoy!

Barron's

http://bit.ly/1VHOlBO

All you need to see is the cover story headline. (Need subscription to read the story.) Suffice it to say the sentiment is exactly what we have been preaching the past 3 weeks.

Marketwatch

http://on.mktw.net/1FrPrrY

Another story that dovetails with our stock market theses. September sucks but the future is bright.

Bloomberg

http://bloom.bg/1PVzRKM

Check out this cool story about the bastard market manipulators.

Bizjounals

http://bit.ly/1KzsECd

Either this story is an enormous bunch of bullshit or ahead of the game.

Newsmax

http://nws.mx/1iqGyKj

The NFL season is upon us and George Will weighs in on the Redskins-name situation and politically correct names nationwide. It is pure genius and very funny.

Wall Street Consensus: Upward

I pride myself on being early and ahead of the rest of the Street when it comes to our projections for the market and individual stocks. With that said, I must admit that I am blown away by the comments and forecasts compilations by Wall Street's top strategists.

As noted in the *Say What?* section, Barron's has released its twice-annual market projections from a panel of the industry's top strategists. These excerpts are all you need to know:

"Although the tone of the strategists' commentary seems less upbeat than in past surveys, there is no dissent in the group on the market's direction: upward."

"Collectively, the strategists expect the Standard & Poor's 500 index to rise to 2150 by the end of the year, which would mean a gain of more than 10% from Friday's close of 1921.22."

"Stocks will pick up the pace in 2016 as investors stronger profit growth, they say."

Sound familiar?

For you data geeks out there, this piece from the Citi Research strategist, as quoted on Marketwatch is a real gem:

"Citi Research's Tobias Levkovich said his Panic/Euphoria model, which brings together such indicators as short-interest ratios, margin debt, compiled bullishness data, and put/call ratios, broke into "panic" territory for the first time since late 2012. While that may not seem good in the short term, Levkovich said that historically stocks have gone up 96% of the time over the next 12 months when the indicator has reached that level."

In our view, stocks will be first driven higher by technical factors, giving confidence to traders and setting the stage for fundamentals to drive the market later in Q4 and beyond.

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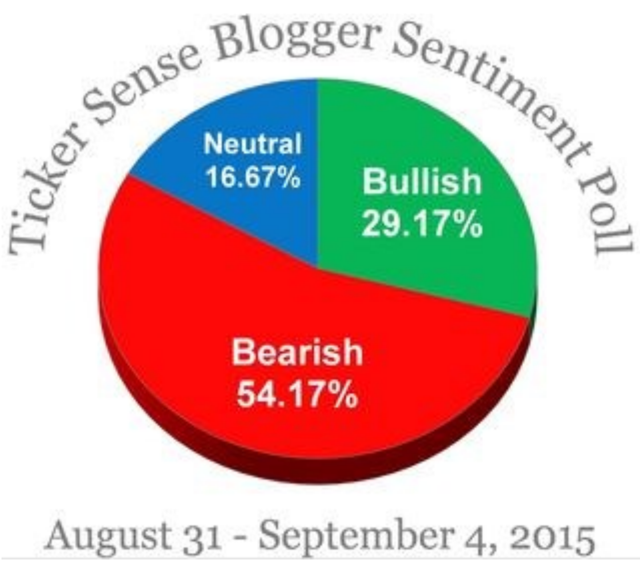
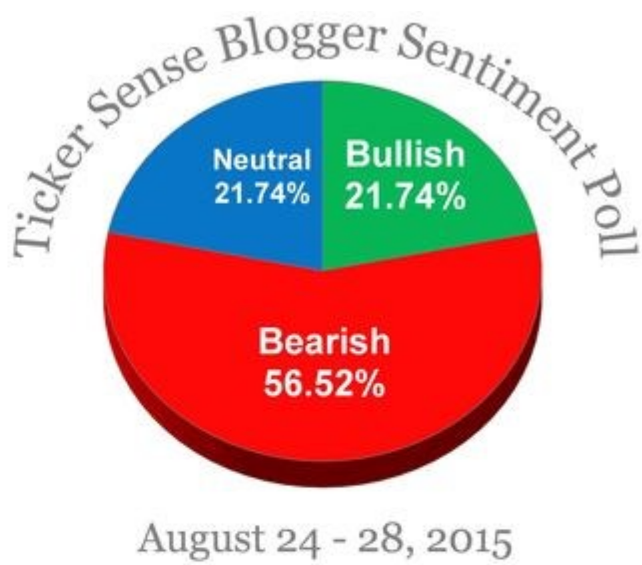
Just the Stats

AAII Sentiment Survey (figures rounded)

	Current	Last Week	*Long Term Avg*
Bullish	32%	33%	*39%*
Neutral	36%	29%	*31%*
Bearish	32%	38%	*30%*

As expected, the Bearish percentage declined. Look for the Bullish category to really move for a spell, when we have 2-3 up days in a row while more bulls and fewer neutrals for the pros should be the start of a trend to continue. Separately, fund flows from last week, according to Lipper, were most interesting. Following the $29B of total fund outflows reported recently, over $10B in money was taken out of money market funds! Also although equity funds had big inflows last week, they were dominated by the SPDR 500 ETF, and then offset by sales in other funds for a modest gain. This is a signal that money on the sidelines will return to the stock market in the coming months, one of our





Don't Forget The Basics

Until recently, we have been in a "me too market." That has resulted in stock performance being dominated by momentum plays. In today's environment, that may not be the best way to go. In fact, we have been reminding you to go back to basics and buying on weakness and selling into strength on a short term basis until there is a solid "buy" conviction in the stock market. Even then, stocks with the best risk/reward with respect to valuation and positioning will be the better plays.

With that in mind, there are three NASDAQ stocks and trading ideas which could prove to be stock market performance leaders—as trades only.

<u>Blue Chips:</u> You can't get any more blue chip than **Apple (NASDAQ—AAPL-$109.10)**. With its new iPhone 6S launch announcement on Wednesday, big strides in video and TV streaming—and with a gaming focus, no less. It looks terrible technically but pays a decent dividend (1.9%) and would certainly lead the market. The pending news and positioning could take it, and stocks like it, out of the doldrums.

<u>The Next Wave:</u> Could there be a better "story stock" than **Mobileye (NASDAQ—MBLY—$51.10)?** We featured it in the Market Monitor when it went public a year ago. MBLY is the global leader in the development of vision and data analysis for Advanced Driver Assistance Systems and autonomous driving. The technology reduces the risks of traffic accidents, saves lives and has the potential to revolutionize the driving experience by enabling autonomous driving. It's anything but cheap at 68x next year's EPS. But, with a lot of attention on the **Google (NASDAQ—GOOG)** and **Tesla (NASDAQ—TSLA)** autonomous driving tests, it could turn by 10-15% very quickly.

<u>The Bottom Fish:</u> **Liberator Medical (NASDAQ—LBMH—$2.55)** dropped 30% at one point and is now down 14% since our stock profile in May 2015. However, with a good bounce off its lows, and with a clearer path to better technical characteristics, LBMH could also be a 10-15%-type candidate, now that many weak hands are likely out. Its recent bounce should give investors confidence that it could continue.

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