Goldman SMALL CAP RESEARCH

The Goldman Guide

VOLUME 7 | ISSUE 10 | FEBRUARY 28, 2016

INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *Signs point to a rough March following a stock market reversal to the upside toward the second half of February*
- ⇒ *Domestic and foreign economic troubles are front and center again*
- ⇒ *GDP growth remains weak which could portend lower valuations ahead*
- ⇒ *Stocks moved too far too fast and are now in no man's land*
- ⇒ *Health care stocks that are beaten down, with low valuations, are EPS crushers and dividend payers offer upside such as this week's feature*

THE MAJOR INDICES

Index	Close	2016
DJIA	16640	-4.5%
S&P 500	1948	-4.7%
NASDAQ	4590	-8.3%
Russell 2000	1037	-8.7%

(figures are rounded)

In Like A Lamb...

The old saying about the month of March is that the month enters like a lamb and exits like a lion. We all know that refers to the weather, but I contend that we may see the same for the stock market as well.

Don't get me wrong. I am thrilled that stocks have bounced like they have. Unfortunately, we've got some things going against us. For starters, it appears that while valuation may have been a driver of the recent uptick, economic issues may rear their ugly heads again. You know the type...like the one that killed us early in the year…

Let's face it. If it weren't for "us consumers", we'd be up a creek without a paddle. According to a data recently released by the Bureau of Economic Analysis, the U.S. has not generated GDP growth of at least 3% for the past 10 years. To put that in perspective, that is the worst ten year stretch since these figures were tabulated starting after the Crash of '29. In fact, we haven't hit the 2.5% mark since 2010. Low growth, very low inflation could chip away at valuations.

Add the drop in Asian currencies and continued poor economic data there and the math does not make me feel warm and fuzzy inside, even though the S&P 500 has aveaged a 1.5% gain in each March since 2000.

The Stock Market Today

U.S. Stock Market Index Performance 2/26/2016									
Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% off High	% from Low	% Below 200-DMA
DJIA	16,640	18,351	15,370	5/19/15	8/24/15	9.3%	8.3%	-3.4%
S&P 500	1,948	2,135	1,810	5/20/15	2/11/16	8.8%	7.6%	-3.9%
NASDAQ	4,590	5,232	4,210	7/20/15	2/11/16	12.3%	9.0%	-6.3%
Russell 2000	1,037	1,296	943	6/23/15	2/11/16	20.0%	10.0%	-10.7%
Average						12.6%	8.7%	-6.1%
Source: www.BarChart.com, Goldman Small Cap Research								

If you look at the figures in the table above, you can see that we may have moved too far too fast since the lows achieved less than three weeks ago. After all, stocks have risen an average of over 8% in the past 10 trading sessions. Compared to where we were, that is pretty good. The problem is that we are in no man's land. With the exception of the Russell 2000 Index, the major indices are pretty much smack dab in the middle of their 52 week high/low ranges. Does that mean stocks are cheap, expensive, or fairly valued?

My answer is that some stocks are cheap, especially in health care and some technology. It is amazing to see how many stocks are actually just above their 52 week lows despite solid earnings growth behind it and expectations ahead. Last week we highlighted **LeMaitre Vascular, Inc. (NASDAQ – LMAT - $14.68),** a provider of devices and implants for the treatment of peripheral vascular disease, which was a perfect example of these characteristics. Following its mid-week earnings release which blew away Street estimates, the stock peaked with a 25% intra-day performance. This week, we have identified another heath care stock exhibiting EPS outperformance traits, although we expect returns to be more subdued. However, the stock does carry a solid dividend yield which serves to reduce risk to a degree.

Low Valuation, Dividend Paying Small Cap

Select Medical Holdings Corp (NYSE—SEM—$9.67) began operations in 1997 and has grown to be one of the largest operators of specialty hospitals and outpatient rehabilitation clinics in the United States based on number of facilities. Select Medical operates 109 long term acute care hospitals and 18 acute medical rehabilitation hospitals in 28 states, and 1,038 outpatient rehabilitation clinics in 31 states and the D.C. The Company had a very strong 4Q15 and FY15, announced late last week, and is in the process of closing the acquisition of Physiotherapy Associates Holdings, Inc. for $400M in cash which is expected to close in the first half of 2016.

When taking into account this pending deal, Wall Street consensus calls for EPS of $0.89 in 2016 and $1.04 next year. Considering that SEM has beaten EPS expectations by an average of 17% for the past four quarters, it is possible that these numbers could be a tad low. At current levels, SEM trades 10.8x 2016 EPS and also carries a 4.14% annual dividend yield. The stock is 44% off its year high and we believe it could rise by 25% to the $12 level, which assumes a 13.5x P/E.

Say What?

Great info, insights, and hard-hitting stories make up this week's *Say What?* feature...

Bloomberg

http://www.bloomberg.com/news/features/2016-02-27/warren-buffett-s-2015-shareholder-letter-annotated

Breakdown and translation of what The Great One just said…

The New York Post

http://nypost.com/2016/02/27/3-d-printing-poised-to-shake-up-us-manufacturing/

Reminiscent of the story a few years ago, only now coming to fruition.

The New York Times

http://www.nytimes.com/2016/02/28/upshot/feds-3-mandates-price-stability-jobs-and-wall-street.html?ref=business&_r=0

A hell of a question.

Marketwatch

http://www.marketwatch.com/story/this-is-where-all-of-the-true-trump-die-hards-live-2016-02-26?dist=tcountdown

Nice. All that needs to be said.

ZeroHedge

http://www.zerohedge.com/news/2016-02-28/three-charts-no-small-cap-asset-manager-wants-you-see

Interesting to see, but the forward P/E is what is truly relevant.

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