Goldman SMALL CAP RESEARCH

The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *Crazy weather means avoid apparel stocks—again*
- ⇒ *Valuation and performance in the different sectors of small caps shows that health care, financials, and tech may be the place to be in the near term*
- ⇒ *Conflicting sentiments and sources are troubling but bulls outweigh bulls by just a tad, which is a good thing*
- ⇒ *Thumbs up and thumbs down for sectors and stocks*

THE MAJOR INDICES

Index	Close	2016
DJIA	17,577	0.9%
S&P 500	2048	0.2%
NASDAQ	4851	-3.1%
Russell 2000	1097	-3.4%

(figures are rounded)

Flip-Flops For Everyone

Whether you are watching the stock market or listening/watching/reading the rhetoric from the leading Presidential candidates, one thing is certain. They can give you a headache.

One minute the economy is great, stocks are great. The next minute, the economy and earnings suck, the party is over, etc. Or, whatever position he/she has taken policy-wise in the past, it is now time to change with the season, winds or site. The issues seem to be whether and weather. First, whether or not you are going to flip-flop with everyone else or stand pat. Second, maybe the brutal change in weather has gotten everyone's knickers in a knot…

Regardless of what, when, why, or how, "there's some bullshit here." Either everyone knows Q1 sucks or they think it will suck worse or perhaps not suck so bad. Can we make up our minds, please? And, are we going to have yet another bad start to a quarter for apparel companies because of wacky weather, leading to revised lower forecasts in a few weeks/months? Let's see, there was 1Q16, 4Q15, 1Q14, and others of late. Outside of **Under Armour (NYSE: UA)**, which struck gold with Jordan Spieth, Steph Curry, and Bryce Harper, I'd stay away from apparel companies for the foreseeable future.

The Stock Market Today

U.S. Stock Market Index Performance 4/8/2016								
Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% off High	% from Low	% Below 200-DMA
DJIA	17,577	18,351	15,370	5/19/15	8/24/15	4.2%	14.4%	**2.7%**
S&P 500	2,048	2,135	1,810	5/20/15	2/11/16	4.1%	13.1%	**1.7%**
NASDAQ	4,851	5,232	4,210	7/20/15	2/11/16	7.3%	15.2%	-0.1%
Russell 2000	1,097	1,296	943	6/23/15	2/11/16	15.4%	16.3%	-3.4%
Average						7.7%	14.8%	0.2%
Sources: www.BarChart.com, Goldman Small Cap Research								

We usually refer to the Russell 2000 Index as the bellwether for small caps. However, today we have some interesting insights regarding the S&P 600, the S&P's version of a small cap index. On a YTD basis, the S&P 600 is basically flat. Interestingly, there is some real performance divergence among sectors between the S&P 600 and the 500.

For example, the consumer discretionary sector is up 2.2% for small caps but down 0.5% for big caps. Health care stocks are down across the board but down twice as much for small caps than their large cap brethren, and the exact opposite is the case for financials. Not as surprisingly, small cap technology stocks are kicking the butt of the large caps. These figures reinforce our thesis that small cap financials, tech, and health care are the place to be given valuation/performance.

According to Ed Yardeni Research, led by the famed economist, the current Bull/Bear ratio is 1.63. (That means 1.63 bulls to bears and compares with the 1.45 for the AAII Survey.) That may seem high but it is pretty average. The lower the ratio, the better the outlook for stocks, or so the thinking goes. For perspective, in 2013 and 2014 the ratio routinely hit at or near the 4.0 mark.

Our take? With 27% of forecasters suggesting a correction (according to Yardeni), a not overly bullish environment, and other external (non-earnings reporting) bullish factors, we remain positive for the near term. Last week's slide? Bound to happen. Upward, ho!

Say What?

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

Bloomberg

http://www.bloomberg.com/graphics/2016-global-obesity/

An interesting reality check. I always thought the main problem was here.

The New York Post

http://nypost.com/2016/04/09/team-obama-is-setting-us-up-for-another-housing-market-collapse/

Not this again...

The Daily Mail

http://www.dailymail.co.uk/news/article-3531718/I-m-loving-McDonald-s-reveals-New-Jersey-restaurant-NO-indoor-seating-90-second-wait-time-customers-rush.html

The future of real fast food?

Marketwatch

http://www.marketwatch.com/story/these-4-charts-say-its-time-to-sell-the-rally-2016-04-08

A bit premature, if you ask me. Plus, the sentiment numbers are way off.

ZeroHedge

http://www.zerohedge.com/news/2016-04-08/regime-uncertainty-kills-us-growth

A short missive penned by one of the smartest economists you never heard of before.

Notable Numbers

AAII Sentiment Survey (figures rounded)

	Current	Last Week	*Long Term Avg*
Bullish	32%	27%	*39%*
Neutral	46%	47%	*31%*
Bearish	22%	26%	*30%*

As you may have seen in the Say What? section, one of BofA Merrill Lynch's theses that the market is due for a sell-off is that investors are too bullish. Those guys must perform their own weird poll/survey. After all, the Bullish category in the AAII poll is below the long term average while the Ticker Sense Bullish percentage is under 42%—a bit high perhaps but not materially so.

You certainly would not say mutual fund holders are bullish. According to the ICI, for the week ended 3/30/16, the net outflows of domestic funds totaled $3.7 billion, nearly twice that of the two previous weeks combined. Even the latest Lipper fund flows data, released in the middle of last week, showed further outflows of $328 million in non-ETF domestic equity funds, so the sales continue to persist.

It is very interesting to look at the valuations of some of the sub-segments of the key sectors that comprise the S&P 500 Index. For example, while the Consumer Discretionary sector may seem a fairly valued since it trades with a 12-month forward P/E of 18.1x, the homebuilding sector, which seems to be enjoying a bit of a resurgence in 2016, trades at a paltry 11.9x.

After its Q1 beating, the biotechnology segment of the health care sector looks downright cheap. It trades at a 12x 12-month forward multiple versus the 14.9x figure assigned to the entire sector which is much lower than its historical average, thus making it appear to be very attractive at current levels. Latching onto lower valuation groups that historically traded at a premium to the current valuation, inside sectors with a higher valuation can be a successful investing tactic. You may find some buys early next week as performance and direction should be dominated by economic reports released Wed-Fri.

Thumbs Up/Thumbs Down

Channeling our Siskel & Ebert...

We have been preaching that the health care space was oversold for the past few weeks, especially after it was the worst performing segment of 1Q16. As if on cue, health care stocks dominated in a down market, rising 1.5% while the rest of the market tumbled.

Leverage. It seems that the appetite for risk may not be strong for the small cap space or high yield debt. However, institutions seem happy to try and get some extra juice by trading the hell out of leveraged stock market and volatility ETFs. They should stick to stock-picking.

Coal, metals, and mining stocks ran like mad late last week. Don't follow the hype. These things tend to be short-lived, anyway.

We're reaching a point where some consumer discretionary stocks are primed to disappoint with pre-announcements, actual results, and forecasts, fueling the low GDP growth story further. While some big brands like **Gap (NYSE: GPS)** and **Ruby Tuesday (NYSE: RT)** are getting smacked, under the radar and up-and-coming brand names are great bets at this stage.

The financial sector took it on the chin, down 2.6% for the week as fears of a slowing economy took their toll. We believe that this story is already in the market (for the most part) and like select small/regional and mid-sized plays.

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