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## KEY TAKEAWAYS

- ⇒ *It is obvious Monday will be another day of carnage. See what to expect later this week and why*
- ⇒ *We outline what will work and what will not work as you prepare for the inevitable bounce*
- ⇒ *History tells us an up year in 2016 is a slam dunk*
- ⇒ *Now is the time to compare the indices and to play dead money and under the radar stocks*
- ⇒ *Fancy yourself a day trader? Play the volatility and anti-*

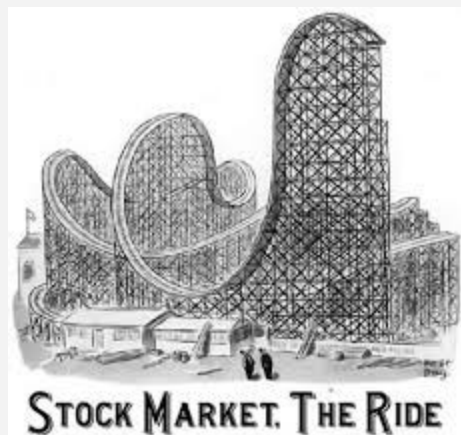
## THE MAJOR INDICES

Index	Close	2015
DJIA	16460	-1.9%
S&P 500	1971	1.6%
NASDAQ	4706	6.6%
Russell 2000	1157	0.07%

(figures are rounded)

## YOU FELT THE PAIN, PREPARE FOR THE GAIN

I will cut to the chase. Monday will be brutal, and maybe Tuesday. But, we outline what we think happens this week, possibilities in the near term, the likely long term, and what to buy when the inevitable bounce arrives.



With that in mind, we have the whole market picture, past, and present, and future, divided into 3 short parts:

*How Did It Come To This?*

*Two Possibilities* (in honor of Charlie Chan)

*Do You See the Parallels?*

Remember, whatever you do, if you take the emotions out of it, look at history as we outline it and see the parallels between now and years ago, it is easy to see that “what goes down will come up.”

Part I. How Did It Come To This?

Let’s look at the carnage before the quick, real unadulterated explanation of last week’s activity. The DJIA, NASDAQ Composite, and Russell 2000 index reached correction territory by dropping in excess of 10% from their spring 2015 highs. The S&P 500, while down as much as the DJIA (5.8%) for the week, was up more but its 7.7% decline from the high is in serious jeopardy. After all, 3 of 5 S&P stocks are down at least 10% now.

## ***Why Stocks Crashed***



As we pointed out in last week's issue of the Guide, the market was on thin ice. "Everybody" knew that China screwed the pooch by playing currency games, thus both inferring slow growth domestically and potentially hurting other economies. Here in the States, valuations were getting a little frothy, but it was the fact that market gains were due to narrow breadth, with few stocks carrying index performance, that seemed to weigh on investors.

To be sure, all of this stuff I listed is not new news. Hell, I practically repeated what I wrote last week verbatim. Call it a lack of news, or catalysts, or guys on vacation, but we just witnessed the herd at its worst. The selling started and it just did not stop. Just like a narrow group of stocks led the market, a narrow, large group of institutions started wholesale selling which triggered, more and more, etc. It wasn't panic, it was fairly orderly and would have kept going on Friday if the market didn't close at 4:00 PM. After all, all 3 major indexes (the Russell was the lone holdout) closed at the low of the day, and all indications are for more pain on Monday.

I have to be honest about something. I don't know what to do with Twitter. Half of me wants to post all the time, the other half reins it in. Last week, I could not help myself and posted these gems on Thursday, which got lots of play:

*"I wonder if stocks are down due to Ashley Madison members selling ahead of their upcoming divorce proceedings. "*

*"Should we really be surprised stocks suck this time of year? 10-12 weeks of hell brings oppty later."*

*"Amazing that big down days often occur when investors react as a herd to issues already out there as opposed to new catalyst. "*

The bottom line is this was bound to happen, when and what the trigger would be was always in question. We ended up being wrong about how to play it as the 'mo stocks' got really hit. However, we were and still are happy it occurred and you should be too.

## ***Two Possibilities***

It is important to take stock and view market direction and your own moves in two stages: near term and long term.

A Little Pain Ahead: We ain't dun yet, folks. With stocks closing at their lows of the day in the aggregate on Friday, selling has not yet abated. Plus, selling was orderly, with volume increasing by 25% on Friday from the day before, which itself was about 10-15% higher than recent days.

That means no panicked or capitulation selling has occurred—yet. We should also remember that just because a correction has been achieved does not mean that we go back to business as usual. Lower Asian markets and U.S. futures indicate that selling will at least continue through Monday AM, if not the whole day.



Possibility #1: As we noted in our tweet and in last week's edition of The 30-30 Report, we expect 10-12 weeks of pain, with some short term swings upward before a return to a longer term trend occurs. You should plan on being a buyer on these bounces, which could start Tuesday/Wednesday of this week, and we outline ideas later in this issue.

You may recall that in 2011, we corrected by about 12% on the S&P 500 over a period of a few months, before engaging the most recent cycle. I think it is possible, that we come close to testing the lows (1822) in the coming months, which would assume a 12-month forward P/E of around 16x and a trailing P/E of 17.7, which is below the 18.5x average for the past 25+ years. Then, we begin a serious bounce...

Possibility #2: All of this concern about global slowdowns, higher interest rates, etc. harken back to the bubble in 2007 that prompted a roughly 50% drop over 18 months followed by the S&P rising 150% over five years from the lows in 2009. In our view, this is very unlikely. We happen to be in an economic cycle that generates low revenue and solid if not unspectacular EPS growth through productivity and economies of scale—that does not mean we will be in an absolutely rotten economy for the next few years and thus, market. Still, it is a possibility, nonetheless. (A bigger concern is the global threat of immigration on the developed nations. That is the real wild card.)

## ***Do You See The Parallels?***



I realize that right now it is hard to think about what the market will do in 2016. However, after reviewing history and forecasting changes in the market for next year, we are convinced that whatever pain we endure this year, will be made up in 2016. In order to follow this thesis, taking a look at current and past events are incredibly instructive and affirm our thought process. The parallels we draw to the past are incredible.

As we near the primary and election cycle, the leading Democratic candidate for President, Clinton the anointed one, is facing a scandal that could derail the campaign and candidacy. Meanwhile, the nation is divided on an important issue regarding Mexico that could cause Americans to lose jobs, cost us money, etc. No one is particularly enthralled with the traditional Republican challengers for President. This has prompted a billionaire maverick that has a penchant and proclivity to speak to the “everyman” and is fueling the fire against Mexico, to throw his hat in the ring and is taking over the media and polls, while Bush lulls us to sleep.

Meanwhile in Asia, a giant economy endured a self-imposed economic mess as asset prices plunged, affecting markets around the world.

And of course, we have had people “in the media” make a mockery of the bizarre political scene and the TV anchors.

It may sound like August 2015 but it is really 1991/1992. Let me count the ways.

<b>Issue</b>	<b>1991/1992</b>	<b>2015</b>
Political Scandal	Bill Clinton	Hillary Clinton
Anti-Mexican Policy	NAFTA	Illegal Immigration
Political, Billionaire Maverick	Ross Perot	Donald Trump
Asian Economic Crisis	Japan Asset Bubble (Drop)	China's Currency Games
Media Coverage Pranks	Howard Stern/Stuttering John	PFT Commenter, Deez Nutz
Republican Challenger	George Bush	Jeb Bush

## ***Do You See The Parallels? (cont'd)***

The Clintons being involved in a scandal is like a Hip Hop Awards after party without a gunfight, so that is no surprise. Our protectionist attitude is interesting, and totally logical and understandable. Hell, even Baltimore Ravens Head Coach John Harbaugh advocated building a “border”. Where would Israel be without one? The whole thing is crazy and the groundswell of anti-government, anti-cop, and anti-minority that isn’t the PC flavor du jour is likely to spawn a remake or significant replaying of Twisted Sister’s “We’re Not Gonna Take It.” <https://www.youtube.com/watch?v=4xmckWVPRaI>

In some respects I see correlations to the punk rock movement in the U.K. during the 1970’s but that is another story...

While the “Donald” is not yet a third party candidate he is taking the country by storm and fomenting the righteous indignation so many Americans feel about the government and immigration, much like Perot did with NAFTA in 1992. Meanwhile, we all loved Stuttering John’s interviews and Howard Stern’s unabashed obsession with Bill Clinton back then but today we have others carrying the mantle of who can make the most fun out of the vapid TV airheads.

The unpopular sitting President Bush wasn’t setting the world on fire with confidence and neither is his son, present-day Jeb Bush.

Admittedly, the mess in Japan was brewing for a few years and did not “f” up the global markets like China’s recent games and subsequent global growth concerns. Still, the scenario is definitely worth mentioning.

After last week’s market debacle, it is hard to smile. But, instead of wringing our hands we should embrace it and deal with it for 10 weeks or so before we have some real daylight and more reasonable valuations, especially since 2016 will be markedly better than 2015. After all, energy alone will come back and that will help the S&P 500 Index earnings, valuation, and performance. Plus, EPS growth rates for next year, even if trimmed as they usually are in Q4 are likely to be above average. Meanwhile, much like there are other parallels to 1991/1992, history tells us to look forward to 2016---regardless of whatever numbnuts (Clinton and Biden included) runs this great nation.



## Do You See The Parallels? (cont'd)

Check it out. Since 1979, the election years have endured no down years (although recent returns have been weak) and the average annual return is substantially higher than in other years. And, the returns during the first year in office for Presidents haven't been too shabby when you eliminate the unusual circumstances in 2000 and 2008.

S&P 500 Returns					
Year	Election Year	Year	Next Year	Other Years	
1979	18.44%	1980	32.50%		
1983	22.56%	1984	6.27%		
1987	5.25%	1988	16.61%		
1991	30.47%	1992	7.62%		
1995	37.58%	1996	22.96%		
1999	21.04%	2000	-9.10%		
2003	28.68%	2004	10.88%		
2007	5.49%	2008	-37.00%		
2011	2.11%	2012	16.00%		
<b>Average</b>	<b>19.07%</b>		<b>7.42%</b>	<b>13.40%</b>	
Source: GSCR, Standard and Poor's					

If the parallels between 1991/1992 and 2015 are truly similar, and that appears to frighteningly be the case, then perhaps 2016 is a kick-ass year after all. It is hard to do now, but sometimes it isn't a bad idea to look ahead, especially when the future is bright. It helps you make the right contrarian decisions at the darkest hours, and darkness always leads to daylight.

## **Say What?**



Some real-world advice and market insight along with a story to make you laugh during these tough times. Enjoy!

### Barron's

<http://on.barrons.com/1JqiWes>

<http://on.barrons.com/1KFXcME>

<http://on.barrons.com/1LrAGdj>

Three quick blogs giving diverging opinions. (Note: Brian Belski of BMO worked together at Piper Jaffray for 2 years.)

### Marketwatch

<http://on.mktw.net/1JePM52>

Keen insight into underlying market sentiment...

### Investor's Business Daily

<http://bit.ly/1LrCS4C>

Simple, wise advice.

### USA Today

<http://usat.ly/1EPFDaR>

Could not have written this better myself. Market insight for the masses.

### Daily Mirror

<http://www.mirror.co.uk/news/weird-news/man-injected-viagra-penis-ended-6296941>

Because you needed a laugh. What a putz...

## Just the Stats!

**AAll Sentiment Survey** (courtesy of AAll.com, figures rounded)

	<u>Current</u>	<u>Last Week</u>	<u>Long Term Avg</u>
Bullish	27%	31%	39%
Neutral	40%	33%	31%
Bearish	33%	36%	30%



I bet that we see a lot of movement from both groups over the next few weeks as the bears, contrarians, and market timers weigh in.



August 17 - 21, 2015



August 10 - 14, 2015



## File This Away

So we kinda let the cat out of the bag with our data on election year performance, P/Es, etc. Still, this chart puts a lot in perspective. Interestingly, we just started featuring it several weeks ago as a sort of :”correction watch.” In any event, the key take-aways are this: The Russell 2000 dropped by 4.6% for the week—by far the least of the major indices. Moreover, it ended



U.S. Stock Market Index Performance as of 8/23/15									
Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% from Hi	% from Low	% Hi/Rec Low*	% Below 200-DMA
DJIA	16,460	18,351	15,855	5/19/15	10/15/14	10.3%	3.8%	10.3%	-7.6%
S&P 500	1,971	2,135	1,822	5/20/15	10/15/14	7.7%	8.2%	7.7%	-5.1%
NASDAQ	4,706	5,232	4,118	7/20/15	10/15/14	10.1%	14.3%	10.1%	-4.2%
Russell 2000	1,157	1,296	1,040	6/23/15	10/15/14	10.7%	11.3%	11.1%	-5.5%
Average						9.7%	9.4%	9.8%	-6.4%
* denotes percentage index is down from recent high									
Source: www.StockCharts.com, Goldman Small Cap Research									

the day above the low of the day, unlike the other collapsing indices. While it was the first to reach correction territory, since it was on the edge anyway, our thesis that global growth and other economic issues affect larger stocks rather than big ones rang true, and will continue to do so, in our view. So, while bounces in the big cap indices will be stronger, steadier returns are to be had in “Smallville.”

By the way, we would be remiss if we did not point out that true bounces, albeit short term, may not yet occur until the S&P 500 reaches a corrective phase. Don’t worry. It’s damn close already. When the Dow drops over 1000 points in a week, it has an impact on valuation, which is becoming ever-attractive. For example, the 12-month forward P/Es on the Dow is 15.4x, the S&P is 17.4x, NASDAQ 100 is a still-rich 19.4x while the Russell 2000 is 18.3x.

## ***What to Do Now***

You probably already know that we are going to say that small cap stocks are better plays than big stocks right now. Yes and no.

Some of the best stocks to buy during a correction are stocks that were “meh”, prior to the correction. What do I mean? Well, after the Ashley Madison effect last week, it was clear that the momentum stocks were the first to go, since that narrow group (in hindsight) artificially held up the market. That is why some of them took it so hard on the chin. There were big gains and a lot of liquidity, so they were let loose.

For example, we took **Skechers (NYSE—SKX)** off our buy list a few weeks ago (at a price of \$150.45) because we thought it basically peaked. Damned if the stock didn’t drop by 12% at one point last week before coming back a bit.

The other segment of stocks that took it on the chin were real losers—stocks that need a good economy to stay afloat and meet revised, lower forecasts.

That leaves the “dead money” stocks, or stocks whose screw-ups or return to growth is not until next year. Many of these stocks were actually up on Friday. They are anchors during corrective phases and with patience, turn into winners in the first half of next year. One of our Guide-recommended stocks fit this mold: **Calloway Golf (NYSE—ELY)**, which could see a 10% rise from here.

**Good Times Restaurant (NASDAQ—GTIM)** and Voltari (NASDAQ—VLTC) are small stock under the radar, and therefore largely unaffected by these big swings. They too has 10% bounce potential, which brings us to the second group that tends to do well. Microcaps with an investor following that likes to bottom-fish. *A couple of recent 30-30 stocks also post these characteristics.*

Now is the time to get some (albeit small) exposure to gold. Again, it is more of a 2016 play, but despite likely volatility is an important component of most investors’ portfolios.

Looking for a trade? Our usual VIX play **VelocityShares Daily 2x VIX ST ETN (TVIX)** almost doubled last week and I think it is primed to tank by week’s end, meaning you should consider its opposite near term, and TVIX from time to time over the next few months, as volatility rears its ugly head on a consistent basis.

Stay Positive!



# The Goldman Guide

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