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The Fear Factor

Recession at home. No real change in the employment picture. The debt contagion spreading across the European continent from one country to another. The downgrade of the U.S. credit rating.

It's enough to make the cowardly lion jump off a cliff. Make no mistake. There is a lot of chaos, confusion, uncertainty and fear. It is times like this that we look to point fingers. I blame the politicians. All of them. There is an old saying:

"Be careful with the government, for they befriend a person only for their own needs. They appear to be friends when it is beneficial to them, but they do not stand by a person at the time of his distress."

Kinda feels just like that doesn't it. In the absence of leadership, and believe me, there is an absence of leadership 30 miles to the south of me, a new leader emerges, or we founder until we rally behind that person. I wonder if these guys have a clue.

Instead of being a downer, let's hit these things rapid-fire and some ideas of how to cope and react.

The Dow was down 5.7% and the NASDAQ dropped by 8.1% for the week. According to *The Wall Street Journal*, on Friday, the Dow changed direction 130 times! Triggers were the sovereign debt problems potentially moving from country to country in Europe, leaving Germany and France holding the bag. In addition, more and more signs that we may have teetered back into a recession (I disagree because I don't think we ever really left it.)

While the employment numbers were better than expected, they still, well, suck. And with the looming layoffs by Fortune 500 firms, it is not getting better.

The cherry on the top of the sundae that is the economic news was the announcement that Standard and Poor's downgraded the credit rating of the U.S. from AAA to AA+.

This move, while not entirely unexpected, is likely to have a ripple effect on the market next week, adding to the current economic and market uncertainty.

I would like to take this opportunity to be the voice of reason, given the circumstances. Regardless of what you may read, we are pretty sure that no one knows how the market is going to react in the next few days. The downgrade has powerful negative psychological and practical effects.

In the psychological sense, the world's largest economy has been given its "come-uppance" and demonstrated the dysfunction of its political leadership. One of the major factors behind the downgrade was in fact this dysfunction and the lack of a credible deficit and budget plan. Are we still the leader of the free world? A question for another day. In the meantime, we are now on par with Taiwan, New Zealand, and Lichtenstein.

In the practical sense, it will have a deleterious effect on the economy, in the form of higher interest rates the government will pay, along with companies, for debt. It's not just a kick in the shins. It is another increase in costs that will impair our ability to operate. Unfortunately, since we are on a negative outlook, it could be 2 years before our AAA rating is restored, if it is restored.

While some of this news had been factored into the market to a degree, the incredible volatility may not be done. The bond market is surely going to be in for a rough ride. It is not as if other countries will not continue to buy our paper, but it will cost us more, and devalue the dollar, which will increase our costs of goods. Initially, the value of the Treasuries will decline as the rates increase, by roughly 50 basis points. It could cause certain funds that hold only AAA rated debt to sell the bonds.

We will certainly know more in the next few days. There is still confusion and fear. Companies that do not know in which direction the economy is heading, or what positive catalysts lay ahead will continue to sit on cash, and likely show decent earnings growth. I still maintain that job growth is the best engine out of this malaise. However, policy, which has been detrimental to our return to growth, is likely the source of the next round of plans again.

What We Expect

The market has been very volatile and I expect it will continue. While we are not FINRA or SEC-registered advisers, and are unaware of all of our subscribers' suitability and risk tolerance, if I was still managing money, I would not buy the dips until after we see some bounces and support. Doing so beforehand is akin to stepping into a falling knife.

Despite the drops, the market valuation has not been reduced by a significant amount. Plus, September and October are also historically tough months. We may not start to see real strength until November, when we have greater visibility into our economic situation, 2012 earnings, and the next stage of deficit reduction. If I had big losers, now might be the time to sell those, too.

Fear the Turtle

I know it is boring, but in times like these, slow and steady is a good way to go. Find stocks that have not yet been crushed, load up on blue chips with nice dividend yields. as those will likely weather the storm. News-driven firms and companies with inherent intra-industry advantages are also good candidates. Longer term, find some economically sensitive stocks and watch them. When the market turns, it is likely that they, along with financials, could lead the market higher.

A stock we talk about a great deal that is clearly a turtle is **SunSi Energies, Inc. (OTCQB: SSIE -$3.95.)** Remarkably, the stock rose by over 5% for the week. Small, underfollowed stocks tend not to be as heavily traded or affected by these market situations, but it is rare they show these returns. SSIE is growing like a weed, is profitable and has no long term debt. With a future move to the AMEX it has a number of catalysts to keep it moving higher. And judging by its performance last week, current shareholders have no interest in selling at these prices. Our year-end target is $6.00.

Click here for more research on SSIE.

One of the babies thrown out with the bath water last week was **Oculus Innovative Sciences, Inc. (NASDAQCM:OCLS - $1.43.)** The Company reported 1Q12 financials after the close on Thursday that were better than our and Street estimates, and the Company guided higher.

All Oculus is doing is growing revenue in multiple markets with its multiple products and distribution channels. OCLS offerings treat infections, improve healing, and reduce the need for antibiotics.

With a new product and technology initiative to be launched sometime this quarter, pending approvals, new partnerships, and higher royalty streams, OCLS is in great shape. The stock is very inexpensive and we have a target of $3.50. We believe catalysts over the next 90 days could take the stock nearly 60% higher to $2.25, which we believe is current fair value.

Click here for more research on OCLS.

Hopefully this week's S&P 500 chart will not look like an EKG. At least we have football.

Until next week….

Analyst: Robert Goldman

Rob Goldman 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*.

Analyst Certification

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