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## Which Way Will It Geaux?

There is a lot to like about Europe. Unfortunately, if you are invested in the market, the problems in Europe have been an albatross, an overhang, a downer, and a real pain in the “you-know-what.” Fears of the Euro collapse and the outright sovereign debt downgrades in key nations, along with downward forward GDP revisions and never-ending squabbling do not bode well.

What's wrong with them? Don't they know they are screwing up our Santa Claus rally in equities? This is a big reason why to avoid stocks with big European exposure. We are still very confident that it will occur, with or without our allies across the pond. We should note that it's not just equities that have had a bad turn of late.

I must confess that I am not a maniacal follower of the yellow metal. That may be counterintuitive considering my last name is Goldman, but, it is what is. I have only been passively following gold's price movements in recent weeks as I am a big believer that historically, small cap equities is the place in which to be invested this time of year. Statistics and history bear this fact out, and we are avid followers of history.

Nonetheless, we would have to be in a cocoon not to catch the major trading activity that occurred in gold on Monday and the days following that crazy day, and have elected to opine as to what that portends for the future of the yellow metal.

For the first time in quite a while, gold fell by roughly \$50 an ounce during the day's trading, breaking below an important support level since late September. It ended the week at \$1598 an ounce, after Friday's rally. Still, it is down nearly 10% for the month. In our view, there are three divergent reasons why the yellow metal is on the downside and will remain unfavorable for at least the near term.

First, the continued mess in Europe has had a deleterious effect on the Euro, which in turn has propped up the dollar. In typical economically uncertain situations, gold would be a safe haven. Instead, investors in the hard asset and its proxies have transitioned to the stronger commodity of late, the dollar.

Second, in recent weeks, some cracks seem to have opened on the demand side for gold. These cracks are particularly evident in the new economic powers India and China, who now account for over 50% of the hard asset procurement. As consumer and industrial demand for gold declines in these markets, one simply has to turn to the basic supply/demand concept to see why downticks in the pricing have occurred.

Third, the sell-off is representative of both the 2011 performance of gold and its proxies such as ETFs (IAU and GLD) along with the make-up of many of the yellow metal's buyers. We have discussed at length of late how small cap buyers have been selling losers or selling profitable positions on the downside. This is emblematic of the *January Effect* and the fact that small cap buyers and gold and gold stock (and ETF) buyers are performance driven, and short cycle driven players. So, just like small cap owners seek to stem losses or lock in profits, so too do gold players. It is no secret that their investment and trading philosophies are very much in lockstep, even if the timing of their actions can be divergent.

With the flight from gold to the dollar, demand from big hard asset buyers on the decline, and traders selling out of their positions, should you step in and establish a position?

We say, emphatically, no. It may look like a good entry point for contrarians, since so many things are going against it. Instead, it reminds us of the old investing adage: don't step into a falling knife. We would instead let it drop and wait for stabilization before stepping in. This may limit some upside but substantially reduces risk. By early next year, the selling based on trading activity will abate, which may help boost gold, but unless consumer demand picks up and economic uncertainty continues, it will likely drop further.

Plus, if there is any sense that the European or the U.S. economies are getting traction that would not help gold either.

With all of these factors in mind, we would recommend waiting for a 10% decline and even then might not establish a position, based on macro factors. Keep an eye on small mining stocks that are just beginning to extract gold.

These stocks could see less volatility due to gold price fluctuation and they happen to be on the correct side of the development chain. Thus, these stocks may emerge as the best way to play gold, even though they look terrible today.

## Bah, Zynga!

Yes, I am a fan of the sitcom *The Big Bang Theory*. But, Zynga Inc. (NASDAQ – \$9.50 - ZNGA) went public on Friday, raising an amazing \$1 billion after pricing 100 million shares at \$10 apiece, in the largest Internet-centric IPO since Google. Alas, the stock must have been fully priced at \$10.00 given the lack of the typical IPO pop. In fact, it is trading below the offering price.

And I hate to say it, but in a sad sort of way, just like the sentiment behind the TV term “Bazinga!” Zynga’s performance was a bit of a joke. But, I digress.

Zynga, primarily because of its ties to Facebook, has become a social gaming leader and is a major part of the social gaming lifestyle. Interestingly, in addition to the hype surrounding the Company, there is a great deal of substance here, financially speaking. Revenue for 2011 is expected to approach \$1 billion with (actual) operating margins of around 20%. Zynga’s fortunes are largely tied to Facebook, and the stock could be viewed by investors as a proxy for the social networking leader. However, it is its plan for the mobile gaming space, in an effort to partially de-couple those Facebook ties that is most interesting. If successful, the stock will be successful. If not, well...

...Zynga plans to continue to grow its business through mobile gaming platforms, much like Gluu Mobile (NASDAQ - \$3.18 - GLUU), a stock we recommended 3 weeks ago at a price of \$2.91, and which has seen a recent peak of \$3.81. While on the surface one might view this development as a negative for GLUU, it is quite the opposite.

The mobile gaming business is in its earliest of adoption stages but a firm like Zynga, with the ubiquitous FarmVille and Words with Games, provides greater exposure to the already explosive-growth gaming industry. It will be interesting to witness the migration of these and other games for mobile platforms, which should exhibit hyper-growth in terms of penetration.

Gluu Mobile is already enjoying such hyper-growth. For 3Q11, Gluu's smartphone revenue and freemium revenue grew by over 300%, year-over-year leveraging its huge library of titles. Gluu is up over 10% and has room to move much higher. Most analysts covering the stock have Buy ratings and price targets of \$5-6 per share. On its own merits, we believe that this expectation is very achievable. With more emphasis on the space, it is likely that Gluu and other mobile gaming stocks will move in tandem with Zynga, which is both good and bad.

There is an old saying: "A rising tide lifts all boats." In the case of Gluu, its sails were already positioned. Once the IPO hangover is completed, Zynga may ultimately be the new wind that could move Gluu and other gaming-related stocks higher. Conversely, if Zynga tanks, it is possible that Gluu and others may slide with it.

Regardless of Zynga's performance, however, we remain of the belief that Gluu will reach \$5.00 in the next 12 months, driven by huge revenue growth and broad market penetration.

## Don't Miss Next Week's Guide

Next week we will provide our top ten predictions for 2012, a performance scorecard for YTD stock recommendation returns, and a sneak peek into wholesale changes at Goldman Small Cap Research

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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