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The Goldman Guide

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Key Takeaways

- ⇒ We are going to get bullish soon
- ⇒ Reverse indicators are looking to be in our favor
- ⇒ Earnings will be great in Q44
- ⇒ Valuations getting attractive
- ⇒ Restaurant stock for the summer

Don't Give Up

We have a tradition at Goldman Small Cap Research that around the Memorial Day holiday we impart some stories which, in years past have been enjoyed by our readers. Along with these stories we provide some detailed market analysis. This year, we have elected to just focus on the market as our research has unearthed some extremely useful information that you need to know before you do anything.

We have been pretty negative on the market for over 2 months. While we aren't yet bullish, there are reasons why you better get ready to step into new positions because we are getting close to a return to a bullish stance, again. The triggers for us are sentiment and valuation.

<u>The Reverse is True</u>

A key indicator in market direction is related to sentiment. Typically, the more bearish the average investor and even the average investment professional, the better off we are. As logic would dictate, this lousy May has turned bulls into bears in short order. The weekly American Association of Individual Investors (AAII) Investor Sentiment Survey is decidedly bearish. At the beginning of the month, only 28% of those surveyed were bearish. It grew to over 45% and as of last week, is back to 39%. For reference, long-term averages include 39% bullish and 30% bearish. The figures are exactly reversed, which is a bullish sign.

The Investor's Intelligence Bull/Bear Ratio, which surveys Investment Professionals is considered the standard-bearer of sentiment surveys, with nearly 50 years of history. The idea here is that after buying stocks people are bullish, and after selling, they are bearish. (cont'd)

Don't Give Up (cont'd)

The Bull/Bear Ratio is a leading indicator of market sentiment, which in turn is a negative barometer.

A ratio of around 2.0 is considered extremely bullish (therefore you should read it as bearish) and a ratio of around .6 is considered bearish (which should be viewed as bullish.)

Two months ago, the Bull/Bear ratio was 2.45, which was a year-high. It has since dropped to 1.44. Still a bit higher than we would like but it is trending in the right direction.

<u>Earnings</u>

Now that Memorial Day is behind us, most of the Q1 reports have been released and all earnings forecasts revisions are likely in until new reports come out beginning 45 days from now. Fully 62% of companies in the S&P 500 Index reported results above estimates and earnings growth was 6.1%. Interestingly, Apple (NASDAQ—AAPL) accounted for around half of the total growth.

Looking ahead, analysts trimmed some EPS forecast for the balance of 2012. The decrease in earnings estimates for these S&P 500 companies, combined with the drop in the index have taken the 12-month forward P/E ratio on the index to 12.0x. This compares with an average of 14.5x, meaning that at current levels, the forward 12-month P/E multiple on the S&P 500 Index is 13% below its average. We may have some more trimming in the summer, but if one looks at expectations for 4Q, they are off the hook as it is getting attractive.

In most cases, the market tries to forecast and trade based on a valuation six months out. Given that the average expected earnings growth rate for 4Q is 15%, we should see some strength beginning this summer. We will soon highlight sectors and stocks that prove to have the greatest upside in anticipation of this growth.

High EPS growth is also expected for 2013. Essentially, what the market is likely telling us right now is that it has concerns over Europe, growth in Asia and unemployment in the U.S. If we can overcome these issues, which we believe the market will indicate in the coming weeks, it will be a hot summer. We aren't ready to jump in the pool, but we are in the bathhouse.

Meanwhile, the market is likely to react to anything Europe-related heading into Friday's unemployment results. Even a modest improvement from April could trigger a rally, so keep the faith.

Key Statistics

Index	Close	YTD
DJIA	12,455	3.1%
S&P 500	1318	5.7%
NASDAQ	2838	8.9%
Russell 2K	766	4.0%

(figures are rounded)

Select Research: Hungry? This Will Curb Your Summer Hunger

In recent months, we mentioned that the casual dining space could heat up. It has. We have a stock idea that dovetails nicely with Americans' summer travel habits this year.

With the price of gas at low relative levels, U.S. vacationers are happy to pack up the van and car and drive to...wherever. In the past 2 years, the road trips were generally regional in nature. It is no secret that if you are on the road for an extended period of time in this country, there are certain restaurant chains you see along the various highways, begging you to come inside and eat. They include Cracker Barrel (NASDAQ—CBRL) and Bob Evans (NASDAQ—BOBE), which in our view, are great investments, despite their high stock prices.

However, there is one chain that from both the valuation and stock price perspective is cheap. I confess I really do not like it but a ton of people do.

Ladies and gentlemen, welcome to Denny's (NASDAQ—DENN—$4.16), may I take your order. Denny's has about 1500 franchised and 200 company-owned restaurants. Many of you know the story so I won't go into detail. Here is what you don't know.

Denny's will generate about $500M in revenue this year and earn $0.29. The Company just 10 days ago announced a 6M share buyback which will reduce the shares outstanding by 6%. Chart looks great, and even at $5 the stock would only trade 17x CY12E EPS.

Many of you are likely familiar with the scandals in past years regarding racially insensitive incidents, which may have hurt the stock to a degree, but at current levels, it is trading at favorable multiple compared with its peers. The current 14x multiple is in the middle of the 13-16x range of the peer group.

Enjoy...

Until next week...

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