Goldman SMALL CAP RESEARCH

The Goldman Guide

VOLUME 4 | ISSUE 17 | SEPTEBMBER 2, 2013

INSIDE THIS ISSUE:

KEY TAKEAWAYS

- *Big M&A days will drive communications stocks and the market early this week*
- *Reality and declines set in, especially if we attack Syria*
- *September performance history is very mixed*
- *Buy telecom now and defense, small cap oil stocks later in the week*
- *Are S&P 500 options a play?*
- *The MSFT/NOK deal could be better for NOK than MSFT*

KEY STATISTICS

Index	Close	2013
DJIA	14810	13.0%
S&P 500	1633	14.5%
NASDAQ	3590	18.9%
Russell 2K	1011	19.1%

(figures are rounded)

What September Will Bring

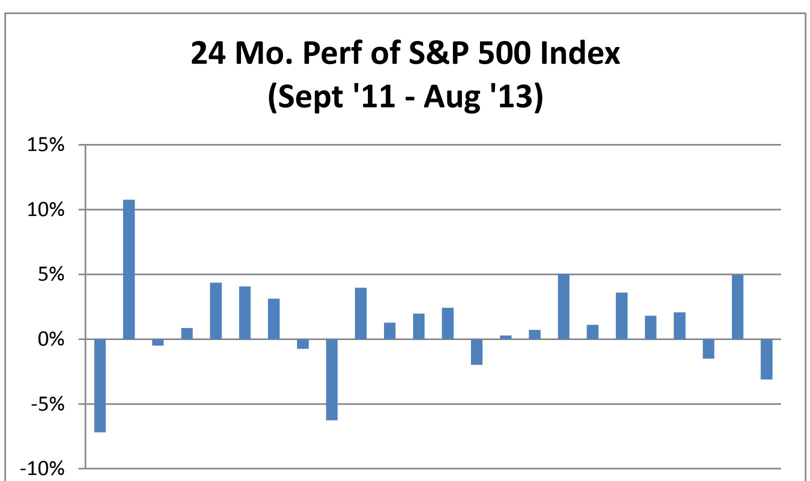
Will September be naughty or nice for investors?

Each September investors both welcome the return to major volumes and the anticipation of potential gains while simultaneously fending off the anxiety that comes with September which recently has been brought more aggravation than gains.

Over the past 50 years, the S&P 500 Index has averaged a decline of 0.69% in the month of September, and that number has stayed pretty flat on average since 2000 as well. However, that only tells us part of the story. Since 2000, the index has declined 6 times and advanced 7 times. While that seems pretty even, what sucks is that the magnitude of the down years is worse than the up years. On average, the 6 times the S&P 500 Index was down for the month, it declined by an average of 7.1% since 2000 and the gains only average 3.1%. So, when it is bad, it is really bad. Hence, the logical trepidation.

It is said that past performance is not indicative of future results. But, these figures can help give us some guidance, nonetheless.

For example, as indicated by the chart below, over the past 24 months, the S&P 500 Index has risen 17 times and only dropped 7 times. Plus, it has only had consecutive monthly declines once in the past 18 months. Still, while some feel the market is primed to rise this fall, we believe some more pain is ahead, and here is why and what you should do to head it off at the pass.



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How To Play September

It is clear that the stock market has to fight the current headwinds before moving higher. These headwinds come in the form of geopolitical risk, commodity risk, interest rate risk, financial stimulus risk, real estate risk, employment risk, and earnings risk. Is that enough risk for you?

Maybe it is only transparent to us but as we recently alluded, we believe this potential operation into Syria is nothing more than a sleight of hand by the Obama Administration to take focus away from the NSA and IRS scandals, and deflect attention away from domestic nightmares such as Obamacare costs and implementation and the low employment participation rate. Whether we are right or not is immaterial. The citizens of the U.S. are against it and until we know if we are going forward and to what degree, it will be an overhang on stocks for a while. And, it can cause oil to enjoy spikes from time to time, which will impact stocks negatively for the short term.

Last week, we noted that Europe may be the best play right now and if we go forward in Syria and the rest of Europe (save possibly for France) does not, the declines across the pond will be more muted than here. Buying one of the small cap defense stocks that we have referred to of late (including one of our recent 30-30 picks) or **CPI Aerostructures, Inc. (NYSE -CVU).**

Enough has been made of the tapering issue but not enough has been aid about how crucial 2H13 earnings are to sustain current valuations. It is a theme we have been hammering home and we believe the best thing is for the market to pause, valuations to right themselves and we move on from there.

It was reported late last week that ETFs had $16B worth of withdrawals last month, with the S&P SPDR ETF (NYSE—SPY) losing $13B, or 10% of its assets. This was the largest overall outflows of ETFs in more than 3 1/2 years. This is bad for the short term but good in the long term. The likely reasons for the sell-off are the tapering of bond purchases by the Federal Reserve and the Syria conundrum. When these outflows occur, they are usually in bunches, so we can expect more which will put pressure on the major indices.

The news is good because we should expect meaningful inflows again this fall once all of this blows over. Feeling frisky? But some out of the money November or December calls on SPY. It could be a nice pop.

As usual, the bulls and bears are engaged in a battle of equals and while the bulls may win from time to time, we think it is more likely that we will experience another drop this month, which is not a bad thing. This may be best illustrated by the most recent Association of Individual Investors Survey from late last week. One-third of respondents are bullish, 35% are neutral and 31% are bearish.

In addition to buying small cap defense stocks, European-based equities, and perhaps making an options play on SPY, buying small cap domestic oil producers may not be a bad idea in case things escalate in the Middle East. These stocks would benefit from higher oil prices and the fact that there would be more of a reliance on domestic production.

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Stocks to Watch

As we were wrapping up this edition of *The Goldman Guide,* news hit the tape that **Microsoft (NASDAQ—MSFT)** is buying **Nokia's (NYSE—NOK—$3.90)** handset business for $5B and will spend another $2.17B to license Nokia's patent portfolio.

Separately, Verizon (NYSE—VZ) has just finalized a deal to pay $130B to Vodafone (NYSE—VOD) for its 45% ownership in Verizon Wireless.

These two deals are likely to drive the market higher on Tuesday, pending Syria concerns. Moreover, expect these deals to impact the communications sector big-time. Let's take a closer look at the MSFT/NOK deal first. The MSFT/NOK deal is clearly Steve Ballmer's last hurrah, in an attempt to leave a legacy better than the one bandied about last week. Both firms have largely misjudged the opportunities in mobile and this puts MSFT all in with company they have been supporting through development arrangements for its Windows Mobile platform for some time. I am not putting a lot of stock in a big rise in NOK's shares. This deal essentially values 50% of the NOK business, and its most high profile, along with its related IP, at half of the current market cap. It doesn't feel like a real premium was paid, but I guess time will tell. On the plus side, it bolsters NOK in a huge way. Think about it. The $5B influx will result in a net cash per share of around $2.70. Plus, a $2.17B license will result in huge profitability as it is recorded on NOK's books. The sale may also mean that its core cellular service and related communications equipment business might prove to be more profitable. The change in NOK leadership will probably also be viewed as a positive. While some investors may be disappointed in the lack of a premium, when one lifts up the hood, it may be a pretty good deal for NOK and longer term investors should consider purchase.

I wonder how the MSFT/NOK deal affects **Blackberry (NASDAQ—BBRY)**? Does it mean that the only white knight is the Canadian savior, now that this is done? I don't think many watchers believed that MSFT would buy BBRY, but the price for the business may mean a lower price for BBRY. At least, that is our off the cuff thought. It is hard to predict what will happen here, but it is worth watching.

It will be interesting to see the ripple effect of these two mammoth service and product deals on the whole space. Usually large-scale M&A is a good thing. As a matter of fact, we highlighted that concept just a few weeks ago. The market needs these types of deals to feel better.

Once the happiness wears off, it will be back to business, so do not expect extended rallies.

Until next week...

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