The Goldman Guide

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INSIDE THIS ISSUE:

What The Market Is Telling Us

Now that we are 2 weeks into the New Year, it seems apparent that with few singular stock exceptions such as the crazy (Intercept Pharmaceuticals – NASDAQ – ICPT), which is up over $300 in just a few days, that the stock market is directionless. Certain sectors are working but they are not being driven by fundamentals. Instead they are driven by coming of age trends (marijuana) and one-off, unusual circumstances such as Intercept.

The one saving grace may lie in the fact that while the stock market has been drifting, it has done so on decent but not necessarily heavy, daily volume levels. In the absence of real direction, speculators are all over the medical marijuana stocks. The traditional players in the health care arena have begun to step up their game in the hopes of landing the next Intercept. For day traders, some short term trading opportunities exist in isolated momentum plays.

Looking out across the smaller investment spectrum, the smallest of stocks such as penny stocks that trade on the pink sheets or the over-the-counter bulletin board have actually seen some decent increases in volume and prices as well which bode well for the near term future for retail investors and small stocks in general. However, too many of those moves higher have been driven by the marijuana stocks which have soared since trading began on January 2 so the returns have not been broad based in nature.

As a result, mainstream stocks that trade on NASDAQ or the NYSE have been largely listless and now that the very early part of earnings season is upon us, I fear that the current stock market fragility could crack if expectations are not met.

(cont'd)

KEY TAKEAWAYS

- ⇒ *Stock market is directionless aside from trendy stock and segments*
- ⇒ *A poor earnings season, bad weather, weak employment numbers could crack fragile market*
- ⇒ *Stay away from the troubled retail stocks for the near term*
- ⇒ *Tech stocks have attractive valuations and appear to be unaffected by macro issues*
- ⇒ *This micro cap tech stock has made higher but has legs to due to its attractive valuation*

KEY STATISTICS

Index	Close	2014
DJIA	16437	-0.8%
S&P 500	1842	-0.3%
NASDAQ	4175	-0.1%
Russell 2000	1165	-0.1%

(figures are rounded)

Say No To Retail, Yes to Tech

These first cracks are already starting to develop in the retail sector and could carry over into the entire consumer discretionary industry, which was a big winner last year. Big retail chains such as Macy's (NYSE – M), although trading at its 52-week high, announced a layoff of 2,500 employees. In late November we predicted that Pacific Sunwear (NASDAQ – PSUN - $2.70) was on the verge of a breakdown and that its holiday season's prospects were not looking too sunny. Low and behold, the stock dropped by 20% on Friday following an announcement that fourth quarter results would be markedly below consensus estimate. Target (NYSE—TGT) and Neiman Marcus are reeling from the widely publicized cyber-attacks which have rocked the industry and made anxious consumers wary. Separately, the ever-controversial J.C. Penney (NYSE – JCP) has also taken it on the chin which could exacerbate a downturn in this sector.

On a related note, the bitter cold at year-end and especially the "polar vortex" that hit the nation over the past week has probably hurt productivity, retail sales, etc. just like it has hurt employment gains. The freak and prolonged weather event will likely prompt incremental downgrades in estimates or forecasts when consumer companies (especially restaurants and apparel) begin to release their results in masse in the coming weeks.

Increases in share prices certainly will not be found in financials just yet either, with another taper looming on the horizon and murmurs of inflationary events which we view as unlikely. Although the industrials space is picking up steam in the fourth quarter the growth could be tempered by revised, modest forecasts in the first quarter of 2014 due to the aforementioned weather event.

Amid all of this potential carnage, investors need some help to boot their own confidence and it may have to come from the technology space, which in our view remains attractive from a valuation and growth perspective. It is unlikely that this segment was hurt at all in December and even in the early part of this year, which is a nice advantage over other sectors. Still, not all segments of tech may drive higher just yet. Some of the semiconductor companies have (odd) fiscal years that end in January so we may not get a real boost from this space until February. All in all, these stocks still look attractive and those trading at reasonable valuations should be accumulated. So, while earnings season could be rocky for the market, it may be wise to focus on tech and leave the others aside for a spell.

No More Hills for Dot Hill

In our view, one attractive micro cap tech stock that is leveraging recently announced good news is Dot Hill Systems Corp. (NASDAQ – HILL - $4.25). A public company since 2000, Dot Hill Systems Corp. is a recognized leader in software and hardware solutions for storing, sharing, protecting and managing data. With over twenty years in the storage industry, Dot Hill has deployed more than 500,000 storage systems worldwide that enable clients to improve performance, increase availability, simplify operations, and reduce costs. Dot Hill's intellectual property, demonstrated by its extensive patent portfolio, provides a complete platform for addressing customers' storage needs. The company's offerings include software, platforms, and systems, which combine to create its advanced SAN storage.

Dot Hill's solutions are used in critical applications such as virtualization and cloud computing along with accelerating demand for data storage related to email, databases, and high-performance computing. The company's end-user customers include IT managers in media and entertainment, oil and gas, retail, finance, education, defense, healthcare and government. Customers utilize the Dot Hill unified storage solutions for video streaming, high definition video production, transaction processing, and intelligence gathering and a host of business applications.

The stock has enjoyed a nice run since an announcement late last week that results for the fourth quarter of 2013 would be incrementally higher than current Wall Street analyst estimates. Management now expects non-GAAP revenue to be north of $59.0 million and non-GAAP fully diluted EPS to be between $0.05—$0.07, above the prior non-GAAP revenue guidance of $53M—$58M and a non-GAAP EPS range of $0.03—$0.06. Management now expects non-GAAP fully diluted EPS in the range of $0.16—$0.18 compared to prior guidance of $0.14 to $0.17.

At current levels, the stock trades 17x FY14E EPS estimates of $0.25 and around 1x the current Street revenue forecast of $235 million. In our view, a P/E multiple of 20x and a revenue multiple of 1.5x can surely be justified going forward considering the big growth projected in EPS and a 15% increase in annual sales. This valuation assumes that the stock would trade around the $5 level, a roughly 18% rise from the most recent closing price. Although the public float represents a huge 95% of the current shares outstanding, we do not believe this factor should be a deterrent to buying an attractively valued stock in the midst of a strong growth.

Have a great week!

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