Goldman SMALL CAP RESEARCH

The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *NASDAQ and momentum stocks have sold off and there are land mines all over the place in the market right now*
- ⇒ *Stocks have had a delayed reaction to events since January 1*
- ⇒ *We accurately predicted how things would shake out but off on timing.*
- ⇒ *We are confident that a correction will occur in May*
- ⇒ *Buy value, GARP, and seasonal stocks today and stocks we have recently highlighted that have outperformed*

KEY STATISTICS

Index	Close	2014
DJIA	16323	-1.6%
S&P 500	1865	0.9%
NASDAQ	4128	-1.2%
Russell 2000	1153	-0.9%

(figures are rounded)

The Most Important Week Of The Year

You will look back at this week and realize that this is the most important period of the year for stocks. A bizarre pattern has developed and depending upon what happens this week, we will know what lies ahead. This critical juncture could mean a big and steady drop with wholesale selling or a modest bounce that carries us for a few weeks.

The Backdrop: Bad Signs All Over the Place

Earlier this year, stocks ended on a strong note for consecutive Fridays which is an important technical positive. Last Friday, on the heels of new highs for the S&P 500 Index, NASDAQ collapsed 2.6% on heavy volume. In fact, the two biggest NASDAQ declines this year happened on Fridays in recent weeks and were driven by the 2 highest volume days of the year for the Composite. That is not a good sign going forward.

Friday's big drop on NASDAQ was largely due to mass selling of previous and long-standing momentum winners and was exacerbated by the realization that the unemployment picture isn't getting better and too many firms are guiding lower on Q1 financials. Although equity mutual funds saw their 15th straight positive inflows last week according to Lipper, the recent flurry of IPO activity has had an impact on the available dollars for investment. Essentially, institutions are being stretched thin. Finally, the momentum stock sales have resulted into a rotation into value and GARP (Growth at a Reasonable Price) stocks which, if they holds, could reflect a change in the pulse and direction of the market toward the corrective phase. After all, these types of rotations typically precede such moves downward.

To make matters worse, doomsday prognosticators are everywhere while bulls are clearly more muted in their sentiment regarding the market's future moves.

The Market's Delayed Reaction

Nothing thus far in 2014, save for the Cannabis stock rally makes any sense. Against this backdrop and the fact that stock trading has been erratic, we are now taking a very different approach toward stocks. Allow me to explain.

In almost every start to a new year, the previous year's big movers begin to sell-off and get replaced by stocks that perhaps had a bad year before but are well positioned strategically and fundamentally attractive. Our stock picks and approach reflected the expectation of this phenomenon. However, since it did not occur until about 2 weeks ago, our picks, which are generally short term in nature, have trailed the market. For some reason, the momentum stocks remained in play while the more undervalued stocks stayed under the radar. Plus, the market reached new highs despite our projections that Q1 results would be negatively affected by weather and should be used as a catalyst to sell stocks.

While we blew it on the King Entertainment (NYSE—KING) IPO, we have been very accurate as to how things would collapse. We were just wrong on the timing. I originally thought it could occur in March but when that did not occur we elected to just stick to specific plays that seemed good bets. Here is an excerpt from our March 9, 2014 edition of the Guide:

"We have been really cautious of late as we believe that we are in the 8th inning of this bull market game...We recommend engaging in a pre-set sector rotation strategy. This tactical ideology is based upon the continued accumulation of tech and biotech in the near term. When these sectors begin to show some weakness, we would shift to certain consumer plays such as those in the auto or housing sector. This strategy should result in near-term outperformance."

Unfortunately, these changes occurred on a dime. But, the rotation has pretty much happened as we outlined. Tech and biotech continued to move and then sold off. Once they sold off, autos such as **Autobytel (NASDAQ—ABTL)** and housing stocks have made a run of late.

So where does all of this leave us? Is the party over? Will tech and biotech see accumulation again soon? Will NASDAQ bounce back this week?

What To Do Now

I could see a dead cat bounce in the sold-off momentum plays this week and that would give the investing public some comfort. Still, I believe that we have more downside to go. NASDAQ and the Russell 2000 have declined by 5%+ from their highs achieved early this year and 10% takes us to a corrective phase which I believe will occur in May.

That means you need to stock up on GARP, value, and seasonal plays that we will highlight in the Market Monitor this week. Despite the wicked sell-offs of 5.8% since March 13th, our two most recent *Guide* picks, New York & Co. (NYSE—NWY) and Glu Mobile (NASDAQ—GLUU) are up and I expect continued accumulation in these stocks and sectors, as outlined in recent issues. Speaking of accumulation, investors should strongly consider a major industrial giant as well.

In the latest chapter of "Attack on Free Market Capitalism" this week, Michigan Senator Carl Levin accused **Caterpillar (NYSE – CAT)** of dodging $2.4 billion in U.S. taxes over the last fifteen years. The Company used its wholly-owned Swiss affiliate to shift $8 billion in profits from the U.S. to Switzerland and took advantage of a low 4% to 6% corporate tax rate it negotiated with the Swiss government. Cat representatives stated that it broke no tax laws, but Levin persisted on his crusade against this strategy stating, "I'm about as strong a supporter of manufacturing as you'll find in Washington…But this investigation demonstrates just how shifting profits to a tax haven is not just the province of high-tech companies."

So Levin's mantra for government regulation, union power, and most importantly getting more taxes from 'evil' corporations will no doubt put the U.S. on a path to prosperity. Look at Levin's model, Detroit. The bottom line is that 40% corporate tax rate is the highest in the world. One can argue about effective rates and tax shelters all day long, but as long as the rate is this high U.S., corporations will continue to move money off-shore. On a side note, Cat has gone from around 60,000 employees to 125,000 today over the same 15-year period, with over half now U.S.-based. Additionally, the stock has gone from around $20 to close to $100 creating wealth for investors over that time. It's amazing what can happen if government gets out of the way!

Have a great week!

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