The Goldman Guide

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Play the Dead Cat Bounce

REALITY SUCKS

*W*e hope you had a restful and meaningful Memorial Day weekend. Honoring our veterans and those that gave their lives for our freedom is an awesome reminder of the greatness of this country.

Unfortunately, under the current Administration, our leadership status around the globe has shrunk to such low levels that our closest allies are concerned about whether or not we have their back and best interests at heart while the rest of the world takes the lead.

Back in the 1980's and 1990's, geopolitical events abroad had an impact on the markets in the U.S. Today, these events—both good and bad barely register and that is dangerous. They serve as lagging indicators only when followed by major economic events such as the recent landmark $400 billion Russia/China energy deal. A positive for these nations is not a positive for the U.S. Moreover, our weak policies are bound to have an impact on the future strength and duration of bull markets.

For example, a dirty little secret about our domestic bull markets is that it is often aided by foreign investment dollars. When the U.S. is believed to be the number one market in which to directly invest, whether public or private, that capital sustains us. However, when other markets are afforded large investment dollars due to our perceived weak policies, bloated bureaucracy and related issues, those dollars flee to other markets as we have seen in recent weeks.

Last week, the S&P 500 Index hit the 1900 mark for the first time. While it is likely to move incrementally higher, unless systemic changes occur, we don't envision big stock performance will have the legs it once did.

KEY TAKEAWAYS

- ⇒ *Geopolitical risk and events re a lagging indicator for big stocks*
- ⇒ *Economic events that follow geopolitical events can hurt stock*
- ⇒ *U.S. bull markets cannot be sustained without foreign dollars and money is going elsewhere*
- ⇒ *Playing the dead cat bounce may be the best way to generate quick returns*
- ⇒ *This strategy has a system to it but can be risky*
- ⇒ *Buying the most hated stocks on bounces jump 10% or more*

KEY STATISTICS

Index	Close	2014
DJIA	16606	0.1%
S&P 500	1901	2.9%
NASDAQ	4186	.2%
Russell 2000	1126	-3.3%

(figures are rounded)

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Play the Dead Cat Bounce

Last week, we noted that the Russell 2000 Index correction was a positive and sure enough small stocks roared back with a vengeance. However, going forward, sustained gains may be hard to come by. So what is an investor looking for very short-term, quick gains to do? Play the dead cat bounce.

Investopedia.com defines a dead cat bounce as "a temporary recovery from a prolonged decline or bear market, followed by the continuation of the downtrend. A dead cat bounce is a small, short-lived recovery in the price of a declining security, such as a stock. Frequently, downtrends are interrupted by brief periods of recovery - or small rallies - where prices temporarily rise. This can be a result of traders or investors closing out short positions or buying on the assumption that the security has reached a bottom. A dead cat bounce is a price pattern that is usually identified in hindsight. Analysts may attempt to predict that the recovery will be only temporary by using certain technical and fundamental analysis tools."

I believe that the everyday investor can identify dead cat bounce opportunities ahead of time, rather than only in hindsight, as the definition and description above suggests, by recognizing the pattern of the big sell-off. Once that is identified, the dead at bounce period typically occurs on the third trading day following the sell-off. Therefore, by buying shares in the afternoon on the second day of the sell-off, you can sell into strength over the next few days.

For example, Millennial Media (NASDAQ – MM - $3.96) reported terrible first quarter financial results after the close, on May 7th. By the end of the first day of the sell-off, the stock closed down 37% to $3.36. On the second day, the stock dropped another 7% intraday and closed essentially unchanged. However, within 5 trading days, the stock was up 17% from the sell-off close. Therefore, investors seeking a dead cat bounce could have turned a tidy profit. Even short term players could have generated a 10% return in 3 days.

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Play the Dead Cat Bounce (cont'd)

The key to the strategy is that in most cases, the bulk of the selling occurs on the day of the news, with some stragglers following behind the next day. By buying on Day 2, and setting tight stop-loss parameters, downside risk can be minimized. These stocks tend to rise on Day 3 as traders and market makers have completed their sales and for those that ended Day 2 short the stock, the short covering and dearth of sellers typically results in the dead cat bounce for the day.

One play that I fraught with risk but also could trade the in the same manner as MM is Aeropostale (NYSE—ARO—$3.41). The stock has been a disaster and the Company released its quarterly financial results on Friday which is never a good sign since it was a holiday weekend. Nonetheless, it looks like a lost ship, was sold off in a huge way on massive volume and everyone is negative on management and the Company's prospects. Therefore, it could be the perfect dead cat bounce candidate, but not an investment option.

I caution that the dead cat bounce does not necessarily work out the same way each time and that there is risk involved in utilizing this strategy. Still, in this environment where big blow-ups are becoming more and more common, it is a tactic to strongly consider.

Have a great week!

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1498 Reisterstown Road, Suite 286 Baltimore Maryland 21208 Phone: 410.609.7100
info@goldmanresearch.com www.goldmanresearch.com

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