

INSIDE THIS ISSUE:

The January Effect Explained

KEY TAKEAWAYS

- ⇒ *Big moves for small caps and microcaps last week are just beginning*
- ⇒ *Santa Claus rally already in swing*
- ⇒ *The AAI Sentiment survey and recent Lipper data indicate that small stocks have room to move higher*
- ⇒ *Trading day schedules in traders' favor*
- ⇒ *The January Effect appears to be ready to begin soon for—for the 29th time in the past 35 years*
- ⇒ *Oversold tech, consumer and*

KEY STATISTICS

Index	Close	2014
DJIA	17805	7.4%
S&P 500	2071	12.1%
NASDAQ	4765	14.1%
Russell 2000	1196	2.8%

(figures are rounded)

LET THE TRADING BEGIN

What a difference a week makes! Two weeks ago, the market looked weak and unsure of itself in the wake of sharply declining oil prices. Last week's comfort from the Fed and other external factors helped big caps pull a 180 while small caps and microcaps began their annual year-end ascent early, and in earnest. Although big volume did not begin to impact microcaps until Friday, the next couple of weeks should see some solid results due to the Santa Claus rally which leads into the well-known January Effect.

By the way, investors that missed last week's rally should not be kicking themselves. In fact, they should be glad. Despite the big moves higher last week, retail investor sentiment has not yet reached nosebleed levels. That means that the year-end tax selling is not yet finished. Therefore, this year's losers and sold-off stocks should begin to see some nibbling this week from bottom-fishing investors and traders since stocks are not likely overbought. Why?

Well, for starters. the AAI Sentiment Survey released last week showed that bullishness actually declined. Plus, all of sentiment percentages and ratios are generally in line with historical averages. This could signal that we did not yet enter an overbought scenario, although we are bound to have some down days.

Importantly, recent Lipper equity fund flow data indicates a lot of money waiting to be put to use which further confirms our thesis. For the past 2 recorded weeks (12/3/14—12/17/14) all equity *outflows* totaled \$16B as compared with *inflows* of over \$8B. This suggests that the major tax loss selling occurred in the previous 2 weeks and the cash from the sales could be soon moved to new equity fund investments.

The January Effect Explained

We talk a lot about seasonality because most investors' gains occur during big but short runs in the market, and oftentimes, these big runs occur from the last week of December through January of the upcoming year. This year it is a little different than most because of the surprisingly strong upward momentum in recent days. However, we believe it is representative of an early rally rather than the commencement of the *January Effect*. Instead, we believe that we have experienced a small Santa Claus rally that will morph into a sustained and broad movement.

There are multiple definitions associated with the *January Effect* and its related Santa Claus rally moniker. In a nutshell, the *January Effect* is an historical Wall Street moniker for the belief that small cap stocks outperform large caps from January through June, with the trigger based upon catalysts mentioned above. In fact, this event has occurred for 29 of the past 35 years, which is an 83% accuracy rate!

I have known some money managers and big-time traders that bought stocks in beginning in mid-late December during what is called the Santa Claus Rally, rode gains into the first half of the first quarter, sat on cash for a few months, and then started on the bike all over again.

The drivers of this phenomenon are easily understood. Now that we are in the last 2 weeks of December, virtually all of the institutional window dressing and selling have long since passed. Plus, all selling for tax purposes or the selling of small cap losers by individuals is ancient history. As a result, many small cap stocks are temporarily low prompting portfolio managers and individual investors alike to begin buying stocks with an objective of a 2-6 month holding period, based upon the risk/reward associated with current prospects and valuation of these stocks. Therefore, investors and traders should start making their list and checking it twice.

In the meantime, as you begin to build your list of potential buys, be sure to fill it with the big losers of 2014 that appear to be primed for a turnaround sometime next year and recent momentum plays of stocks that have just hit new 52-week highs. Pay particular close attention to technology and consumer stocks along with industrials.

We will start to give you some of our own *January Effect* stocking stuffers on Tuesday.

Happy Trading!



The Goldman Guide

Trading Reminder

With the Christmas holiday and New Year's Day occurring on Thursdays the next two weeks, we expect that volume could be very light on 12/26/14 and 1/2/15, which present a real buying opportunity for savvy traders. Also be aware that the markets will close at 1PM EST on Christmas Eve, 12/24/14.

Happy Trading!

From the entire Goldman Small Cap Research team, have a wonderful holiday season!



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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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