



# The Goldman Guide

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## The Market Could Use Some Yelp

Sorry for the bad pun but I could not resist.

The stock market is pretty directionless these days with a push-pull between economic data, valuation, oil prices, and geopolitical issues. It needs a boost of some sort, somewhere. That something may come in the form of Friday's highly anticipated IPO of Yelp, the local business review site. But, the market could also use Yelp in another way. More on that in a moment.

If memory serves, the early speculation regarding Yelp's valuation was north of \$1 billion. Based on the filings we perused over the weekend, that valuation is closer to the several hundred million mark, depending upon the final pricing.

As is usually the case with many IPOs, the question becomes, how will this perform? Another question might be: Since it is a relatively average IPO (in terms of dollars raised and valuation) is a strong performance good enough to give the market a shot in the arm?

I am kinda split on these issues. Historically, underwriters would shy away from bringing companies public on Fridays and I seem to recall they would generally not perform that well. The reasoning behind a Friday IPO is that the market may be weak, but if you do it on a Friday, the retail investor reads about it and then comes in as buyers the next Monday. Otherwise, while you might get a good pricing, if the market is weak, the support could be limited.

In Yelp's case, I think there is some correlation, but I also think that it should perform well, on its own merits. Yelp has a great brand, a following of 66 million passionate, monthly unique visitors. Users on the site really provide a value proposition to the local businesses and consumers seeking its product or service.

Some IPO watchers seem unsure about how well it will perform, given that social media and Internet-based IPOs have been a bit of a mixed bag in recent months. From the outside looking in, we think it will do at least as well as Angie's List (NASDAQ – ANGI) which is a different model, but in the same segment.

Angie's List solicits memberships from consumers who provide reviews on local businesses and services. The 1 million-plus members have access to exclusive discounts from these providers, who, by the way, cannot pay for placement on the list.

With Yelp, revenue is generated from local business and brand advertising whereas ANGI's primary revenue driver is memberships. We should note that for 2011, ANGI generated \$90M in revenue and a pretty hefty loss of \$49M. Yelp recorded roughly \$83M in revenue and a loss of \$16.9M.

It seems that Yelp's model is a better one in the long run given the high membership acquisition costs for ANGI, and the fact that Yelp is probably closer to profitability, helped along by a more diverse revenue stream. Bottom line: Look for a modest pop from Yelp, which might even be helped along by its millions of adoring users who may wish to own a piece of the reviewing site. Plus, despite its relatively small size, a pop would probably help end the market on an up note.

One final thought: Think about how different the market would be if there was a Yelp for brokers, advisers, money managers, mutual funds, investment banks, and guys like me. There are separate ratings services such as Morningstar, but I bet that some of the shenanigans in the market could be averted with a Yelp-type service. The bad apples would be gone and poor performers would be forced to upgrade and the good ones would be rewarded.

Food for thought...

## Don't Fall Into the Trap

Numbers can be exciting, inviting, and intimidating. The Dow Jones Industrial Average reached 13,000 last week for the first time in four years. Will it close above 13,000 for days or weeks in a row, and is it sustainable? The NASDAQ Composite is approaching the 3,000 mark for the first time in, well, since December 2000---and that was on the way down! Will we reach this mark for the first time in almost 12 years?

Who cares? Don't fall into this trap as a basis for investing decisions. These milestones are meaningless and the answers will not take your portfolio to the Promised Land.

These are questions the media likes to ask. These are also questions that the average investor likes to ask. If they do occur they are likely triggers for the average retail investor to put more money in the market.

And that is why most people in the media, the blogosphere, and most average investors are all morons. When I managed money, I thanked these people. After all, the only better negative barometer you could find were when mainstream financial publications such as *Money* or *Business Week* declared bull markets on their magazine covers. The pros use these milestones to *sell* not buy.

As a reader to these pages, you are automatically infinitely smarter than the average investor or trader. You already know that these types of numbers in the "market" are meaningless. It is human nature to like round numbers. Inherently, we want to buy and sell as close to a round number as possible. Many investors routinely enter stop-loss orders with round numbers. Don't get caught up with those strategies.

Some of you newer or younger investors may not remember the days when stocks were quoted in fractions, not cents. They were "teenys and "eighths." In those days investors were less concerned with round numbers and more with trends, flows and percentage gains. In fact, in Europe many institutional investors could scarcely give you an accurate quote. Instead, he/she will cite how much a stock has increased or decreased on a percentage basis. Decimalization has helped liquidity but it has also harmed the average Joe's ability to make correct decisions.

We have talked about pigs getting fat and hogs getting slaughtered. Don't be a hog. Set a reasonable goal/target for each stock purchase on a percentage basis. Don't be afraid to sell a portion of your position into strength. Yes, you will incur more costs but it is the prudent and wise thing to do and is more often than not, a more profitable trading method.

We have been cautious about the near term direction of the market and if you start to hear/read a great deal about 13,000 and 3,000 and other nonsense, you should be cautious too. Be smart and don't get caught up with monitoring the "market". Monitor your stocks instead.

## Politics Meets Investments

The financial plan salvos have been fired by the Obama administration and the Romney campaign. While none of President Obama's plans are expected to be passed in an election year, the rhetoric from both sides is a glimpse into what may lie ahead next year for the economy and the stock market. It is way too early to handicap anything but having a sense of direction is not a bad thing.

President Obama has proposed reducing the corporate tax from 36% to 28% but reducing a large number of tax breaks and closing loopholes used by companies in a variety of industries, including oil and gas. As a result, not all industries are made equal.

Not to be outdone, Mitt Romney is calling for a reduction of the corporate tax rate to 25%, a reduction in the top-end individual income tax rate to 28%, repealing the alternative minimum tax and the inheritance tax, and proposed that no one earning less than \$200,000 annually should be subject to the 15% capital gains tax.

Conversely, President Obama has proposed an increase in the capital gains tax to 20% from 15% and a massive increase in the tax on dividends to 39.6% (before taking into account other taxes which raise it even higher.)

What would all of this mean for stock investors?

In response to the Obama proposal, we may see even small companies sitting on a lot of cash declare dividends this year, or accelerate the rate of dividends, followed by suspension next

year. Simulations Plus (NASDAQ – SLP - \$4.10) has done exactly that and the stock is up nearly 25% since the announcement. More importantly, we would expect that more money flows into non-dividend-paying equities could occur next year as investors previously seeking dividends determine that the tax makes it cost-prohibitive and the risk/reward, worth the risk.

The unfortunate after-effect could mean a return to some of the volatility we saw in 2011 as these investors are not likely to invest large sums in this category for long periods.

We might even see an appetite return for high-yielding, low quality corporate bonds. Issuers would not have to pay taxes on these distributions (interest income versus dividends) and the effective tax rate on interest income is likely to remain lower than on dividends, under the Obama plan.

Under the Romney plan, which while more favorable to the market is unlikely to pass even if he were to win office, the environment for attracting capital and investing would probably be better in the aggregate. It will be interesting to see how this all shakes out and how companies and institutional investors position themselves in the coming months.

## NASDAQ vs. OTC

There are literally thousands of small caps, micro caps, and penny stocks traded in the U.S. markets. It can be a challenge to find real gems. Interestingly, when retail investors perform research or due diligence on stocks, they base a lot of the decision-making process on the reward side of the risk/reward ration. When investment pros perform due diligence, they focus on risk rather than reward.

Why?

Risks are current and pervasive while rewards are in the future. One of the keys to investing success is not having huge winners. It is about managing risk. If risk is minimized real gains are more easily obtained. Otherwise it's like trading in a used car in which you are upside down on (loan greater than current value) and you attempt to buy a newer car yet have a lower down payment. You are already behind the proverbial 8-ball.

With that in mind, how does one manage risk in a particular stock?

One easy method of measuring and managing risk is how one approaches investments in stocks that trade on NASDAQ versus the OTC (BB, QB, PK). In most cases, NASDAQ companies are larger or more mature in their business than OTC firms. Most people associate larger size with lower volatility, lower risk and fewer rewards but that is not necessarily so.

Risk includes share price and average volume. Both factors are used to measure liquidity and volatility, as each change in price for a lower-priced stock is going to have a larger percentage move than a higher one. Plus, a stock trading with greater volume usually offers less risk than a thinly traded one due to liquidity issues.

Another key is financial and news reporting. If a company routinely provides material news and financial results, risk is minimized. Of course risk is always greater if a company is not well capitalized, but that is another discussion.

Generally speaking, we prefer NASDAQ companies over OTC, as there are more stringent requirements for listing, management teams provide, greater information transparency, stocks have a larger following, and tend to offer lower volatility. Frankly, NASDAQ stocks attract investment a bit more than OTC, which attracts traders more than investors. With higher volume NASDAQ stocks, the risk of losing a great deal quickly is limited whereas with OTC stocks, big rises and drops are more the norm.

As we noted above, simply by minimizing losses, or the prospect of losses, one manages risk. This does not mean that a NASDAQ stock will not decline 30% in a day. They can and do. But, on average, declines are tempered, as are gains. However, gains tend to have longer, sustained periods on NASDAQ.

With that said, this does not mean OTC stocks are just a crapshoot---far from it. OTC stocks are less mature and the trading styles and activity are geared for, well, traders! In the OTC world, investors and traders are more likely to make much higher gains than on NASDAQ if they invest in the right type of companies.



Companies with management teams that have proven success are critical as OTC stocks are largely a bet on management. If one trades in OTC stocks that have growing revenue bases with a clear path to near term success, clear financial backing, or are leaders in a niche segment of their respective industries or practice areas, success is much more likely. After all a good story with little else is just a good story.

Finally, we strongly remind investors and traders that with more intermittent volume in OTC stocks, buying based upon just announced or expected catalytic events are keys to success.

(For a perfect example of how to succeed based on catalytic events, check out an update just released today on Mimvi, Inc. (OTCQB: MIMV - \$0.12.) Go to <http://www.goldmanresearch.com/Popular/the-next-takeover.html>.

But, one must set a tangible, realistic price target and/or stop losses with these transactions as well. That is as much a part of risk management as anything else.

Until next week...

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Rob Goldman has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell-side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

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