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The Goldman Guide

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I Know When The Market Will Go Up

Ladies and Gentlemen:

Since I have dedicated my time to you, our loyal subscribers, I have spent the entire weekend working to identify when I can declare it is time to go all in, investing-wise. Ok, so I can't identify the exact date and time. But, I can deliver the next best thing—-the characteristics needed. My guess is that it happens in the next 2 weeks or so. Until then it could get bumpy. Let me explain.

We are all watching the drops in oil prices and of course our wallets are thankful for this event. After all it has dropped 25% in about 2 months. The problem is that big drops in oil and other commodities usually portend a decline in growth. If one looks at charts going back 30 years there is a clear correlation between a drop in oil prices and a subsequent decline in growth and stocks. Conversely, there is a correlation between a rise in oil prices and a jump in growth and therefore the stock market. One of the few times this did not happen was associated with very large increases in a short period that occurred during poor economic times. (See 2008-2011.)

The question we must ask is, why the sudden and steep drop? Is it demand slumping, a lack of speculation, lack of inflation, growth concerns, or all of the above?

From what we can tell there does not appear to be a material change in demand in the U.S. However, with growth easing in Asia, demand may be slipping a tad from the hyper-growth earlier this decade. With slow growth in general around the globe inflation is nonexistent.

(cont'd)

Key Takeaways

- ⇒ The correlation between oil prices and stocks could portend the market's direction
- ⇒ Serious geopolitical risk in the near term could make it rough for us
- ⇒ We still have European issues and a lot of economic data this week
- ⇒ Changes in the Russell Indices create opportunities and intel for the future

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I Know When The Market Will Go Up

My crystal ball is giving me the signs I need to tell when the market will be going up.

So, that plays a small role in all of this as well. However, I believe that it is a combination of the European cluster*** and related lack of dollars used in speculation. It is funny how the speculators are all over oil on the way up but quiet on the way down.

I am of the belief that low oil prices in the U.S. is great news for our economy, especially since we are likely to increase our driving this summer. Moreover, once Europe shows a real plan in place for Greece, Spain, and Italy, oil should not only stabilize but rise. Therefore, watch for trends on the economic front, and also be in the lookout for how earnings season starts to play out in early-mid July. It should tell the tale of when/how the market will make sustained moves higher. I recognize summer is usually slow, the market does little movement now, elections are coming up, etc. But, valuations are attractive—-not great, but attractive and that goes a long way.

With that said, there is still a wild card that could torpedo the whole premise. Frequent readers to these pages know I am far from politically correct and I don't mind rattling cages. For example, I spoke ill of the Arab Spring last year while the rest of the world basked in its glory. I even predicted a few months ago what might happen in Egypt. Well folks, it has happened.

Here is the story. The Muslim Brotherhood, a terrorist organization with a long history, and a domicile in Egypt, has just won in elections and will lead the country. This is after decades of the government trying desperately to shut them down to no avail. Egypt is a small producer of oil but 1 million barrels are transported through the Suez Canal daily. Plus, it is a top-15 producer of natural gas. We may see some volatility (i.e., rises) in oil and natural gas prices due to the saber-rattling over there. Add that to the war zone that is Syria, which is pitting the U.S. against Russia in a 1980's-style cold war and we could have the speculators back in the game, to take advantage of the geo-political risk in the Middle East and the economic risk in Europe. Then there is Iran.

Get my drift? So, if insanity gets held in check, we could be bullish soon. Until then, look for politics, European monetary policy, and a ton of U.S. economic data to dominate stock market performance this week. But some small caps could get a boost. Read on to see why...

Key Statistics

Index	Close	YTD
DJIA	12,641	3.5%
S&P 500	1335	6.1%
NASDAQ	2892	11.0%
Russell 2K	775	4.6%

(figures are rounded)

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Select Research: Trick of the Trade

It's time to play a game called, "Trade Like a Hedge Fund Manager."

Russell Investments, the proprietor of the well-known Russell 2000 Index and a whole host of others, is set to officially change (they call reconstitute or re-balance) the holdings in all of its indices on Monday. While they have given investors a peek into who is in and who is out in recent weeks, the final list was not out until after the close on Friday and does not take effect until Monday June 25th.

Why is this important enough to mention here? Well, many professional managers, mutual fund managers, and hedge funds use these indices as a benchmark. This means that they buy and sell stocks in these indices and try to overweight some, and have smaller positions in others, in order to outperform their underlying benchmark.

So what happens? If a stock is being deleted, it may have to be sold by some funds, if it hasn't been already. Conversely, additions may have to be bought. Since the final list wasn't out until last Friday, there may be some opportunities to make a quick buck in these new additions.

But there is another interesting thing about these changes. We pored over them with a fine toothcomb, especially the Russell 2000 and Russell Microcap additions/deletions. The deletion candidates include those under $1 and under $30M in market capitalization. So, stocks that have dropped below those thresholds may come under some selling pressure.

Moreover, if you take a close look at the Russell Microcap Index additions for example, you see that there are some real high-fliers of late on the list. Some of the names include stocks we have featured in the daily blogs like Reed's (NASDAQ—REED— $3.20) and Parametric Sound (NASDAQ—PAMT—$9.23).

This tells us that the stage may be set for stocks that have done well recently. These guys may continue to get play while those stocks that are not momentum plays may drift lower. This could be very good intel to use as a trader or an investor for the near term.

Until next week...

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