July 23, 2012

Volume 3, Number 10

The Goldman Guide

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Key Takeaways

- ⇒ Will the tax on dividends be less painful?
- ⇒ Low 10-year Treasury yields are a good thing. Here's how to play it.
- ⇒ Revenue figures in 2Q12 not too good.
- ⇒ Higher oil prices and drought may portend the hint of coming inflation.
- ⇒ Small cap dividend plays are here for the making and the taking.

Yield Sign Means Use Alternate Route

In case you thought we have a pretty narrow perspective on the market, here is a thought. Buy small cap dividend stocks.

The time is right for these overlooked gems. They have largely outperformed this year but we have two events that could ensure strong gains for the balance of the year. Early this year there was a major concern regarding the huge expected increase in taxes on dividends.

In fact until last week, the conventional wisdom was that unless Congress took action, the top tax rate for the highest earners on most dividends, currently 15%, will jump to a whopping 43.4% next year. That is a maximum income-tax rate of 39.6% -- since dividends will once again be taxed as regular income -- plus a 3.8% tax on investment income as part of the health-care overhaul passed in 2009. Ridiculous, right?

Since anything related to taxes is automatically a political issue, recent news bodes well for these payout-paying prospects. A number of Senate Democrats are breaking ranks with President Obama and have put forth a plan would raise dividend taxes from the current 15 percent rate to 20 percent. Look, any tax increase is a bad idea, but 20% is better than what we were facing. Even if this plan does not pass, clearly a lower tax on dividends will.

But that is not the only reason why an investment in dividend yielding stocks is timely. This past week the yield on the 10-year Treasury fell to an all-time low and closed at a yield of 1.49%.

Yield Sign...cont'd

The 10-year treasury yield is important for a few reasons. Some context might be useful. These yields ranged from 5 to 9 percent in the 1990s and 3-to-6 percent in the early 2000s. As recently as last year, they were often well above 3 percent. With yields this low, there is little incentive to buy these government notes.

Typically, a sharp reduction in yields indicates an expectation that the economy is slowing and the stock market may decline. While this is true, especially since this yield is down from a 2012 high of 2.39%, there are some positives as well. Income investors may return to solid-yielding equities as an alternative to bonds. With the now expected revised dividend tax to be tempered, we have the confluence of 2 events.

In the big picture, the federal government now has an opportunity to issue new treasuries (the 30-year yield is now 2.55%) at low interest rates, lowering our borrowing costs. It may even be able to replace other, existing debt with this new, debt, effectively refunding out-standing bonds to reduce our interest expense. Plus, new mortgage (home) buyers will enjoy the benefit of lower interest rates.

Check out this chart from the Treasury Department website. http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-LongTerm-Rate-Data-Visualization.aspx

Random thoughts...

Isn't funny that when there is European uncertainty on Fridays the market drops as no one wants to be caught holding the bag come Monday morning?

Do higher oil prices and drought mean inflation will rear its ugly head?

Does the continuing trend of reporting companies missing top-line expectations a cause for concern or just a blip?

Will Apple's (NASDAQ—AAPL) numbers be as solid as they have recently?

How big will Facebook's (NASDAQ—FB) loss be?

Key Statistics

Index	Close	YTD
DJIA	12,823	5.0%
S&P 500	1363	8.3%
NASDAQ	2925	12.2%
Russell 2K	792	6.9%

(figures are rounded)

Dividend Plays

You didn't think that we would mention dividend stocks without giving you some options, did you?

Alaska Communications Systems Group, Inc. (NASDAQ –ALSK—$2.28) provides wireline and wireless services to customers in Alaska. The Company is expected to generate $360M in revenue and $0.22 in EPS this year although next year is projected to be more challenging for the top-line. The yield is a staggering 8.8% at current levels but let's be real—-even if it was half that it would be a decent buy. ALSK has a market cap of $100M.

Electronics components provider **Pulse Electronics (NASDAQ—PULS—$2.02)** pays out 5% and is expected to have a huge jump in EPS in 2013.

Telular Corp (NASDAQ—WRLS— $9.26) provides products used in wireless networks. The business is very profitable, as noted by current forecasts. The Street is forecasting $82M in sales and EPS of $0.43 this year and $95M in revenue and $0.52 in EPS in 2013. The current dividend yield is 4.8% and the stock has done very well this year.

Simulations Plus, (NASDAQ—SLP—$4.19), which produces simulation software for pharmaceutical firms still looks like a winner. We have highlighted it before and it has done well since the original profile in 1H12. SLP yields 4.8% and is very profitable, despite its low revenue rate (sub-$10M.) One thing about SLP is that relative to the 3 stocks above, it is somewhat illiquid.

Until next week...

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