Goldman SMALL CAP RESEARCH

The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *Risk is greater that market drops than rises*
- ⇒ *What will drive stocks now?*
- ⇒ *Sector rotation into oil and autos could be strong in the near term*
- ⇒ *Health care could be big recipient of migration out of consumer stocks*
- ⇒ *Too much opportunism could be sign of the end of the bull run*
- ⇒ *IPOs and questionable M&A are samples of the latter innings of bull markets*

KEY STATISTICS

Index	Close	2014
DJIA	16103	-2.9%
S&P 500	1836	-0.6%
NASDAQ	4263	2.1%
Russell 2000	1165	-0.3%

(figures are rounded)

Questions to Answer Before Buying

The stock market tried to punch through a new high last week and it was oh so close to doing so before selling off. The ever-bullish and typically accurate prognosticator Laszlo Birinyi forecasts that the S&P 500 Index will reach 1900 by the end of the second quarter. That suggests a paltry 3.5% rise from here. Seems to me that the risk is greater that the market drops by more than 3.5%, so one has to be extra cautious at this stage. Now that the Q4 earnings season is basically over, what is the driver for stocks to move higher?

The real questions that arise are why are you investing today or buying a specific stock? If financial results and guidance have been released then isn't all the news in a given stock? So, what's the catalyst, aside from pending news or a very favorable valuation?

Believe it or not, even investment managers and other pros ask themselves these very questions today, in the absence of focusing in on financials. This brief window is when investment pros are uncertain and latch on to secular themes and momentum. Given that the volatility in stocks is greater than what we have seen since the summer of 2012, playing the momentum and day-trading game may not be as fruitful as it once was.

Instead, industry themes, favorable valuations relative to growth rates, seasonality may play a role in sector successes. We still maintain that Q1 growth will be subpar. Nonetheless, gas prices are sure to rise in the coming weeks and months and we could even see a strong car sales month in March since February has been so tough. So, oil and autos could be clever plays, especially if they show some weakness. Separately, health care stocks tend to do real well in the first half of the year. With consumer stocks in the tank, the sector migration here could be even stronger than usual.

Read this week's *Market Monitor* blogs for stock picks.

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Signs of a Bull Market's End

No one *really* accurately calls the end of a bull market. Sure, some prognosticators get lucky sometimes. Instead, investment professionals seek out signs that signal the end is near. These signs can be technical, fundamental or related to changes in economic or geopolitical policy. In my view, a better indicator is what I refer to as opportunism. At the tail end of bull markets it is not uncommon to find companies, investment bankers, and investors become more opportunistic. This is not to say that when this happens the market tanks shortly thereafter. Still, it usually means that the current period is akin to the 7^{th} or 8^{th} inning of a 9 inning baseball game.

Being opportunistic comes in several forms. One of the more telling examples is in the IPO world. Investment bankers are vilified as greedy individuals who foist overvalued companies on unsuspecting investors. Of course that is not the case in reality. However, when investment bankers see the possibility of the IPO window closing they pull out the stops and try and push through as many deals as possible and some can be of questionable quality. In conjunction with this premise is the CEO who seeks to take advantage of trends by striking while the iron is hot. King Digital Entertainment, the developer of the super-popular mobile game *Candy Crush Saga* filed to go public last week. Will it be a good stock to own? I do not know. I do know that 80% of its $1.9 billion in revenue is generated from one game and if the fad subsides, then what happens? By going public now, the company takes advantage of the opportunity to cash in (or out.)

Since opportunism and risk often go hand in hand, another example of this phenomenon that signals the end of bull markets is the plethora of stocks whose business models are focused exclusively on emerging markets. In this case I am not speaking of China or Mexico but countries in Africa whose names are likely unfamiliar to most Americans.

Since I covered and invested in emerging markets in the past I am not casting aspersions. Still, aren't there enough attractive stocks and situations in the U.S.? Isn't there too much geopolitical and currency risk in a company doing business exclusively abroad in Third World nations?

Being opportunistic is a trait we all want to see in emerging stocks. But, when risk seems to be thrown aside and opportunism is all around us, it is likely a sign that we should take some money off the table.

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