The Goldman Guide

Goldman SMALL CAP RESEARCH

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *Things are completely upside down for veteran investors*
- ⇒ *ETFs, hybrid funds overseas investments and big gains in a narrow group of stocks dominate*
- ⇒ *Instead of real ideas or analysis, the herd is following the big name investors every step of the way*
- ⇒ *Play the market and its volatility for $1 with this very risky and*

THE MAJOR INDICES

Index	Close	2015
DJIA	18232	2.2%
S&P 500	2126	3.1%
NASDAQ	5089	7.5%
Russell 2000	1252	3.9%

(figures are rounded)

Why Info is Usually Wrong

On behalf of the entire Goldman Small Cap Research team, I hope everyone had a meaningful Memorial Day weekend.

As we near the midpoint of the year it is always a good idea to get introspective about the market and we have done that in these pages each Memorial Day weekend, with a teaching moment. For example, we produced a 50-year study of the S&P 500 Index performance a few years back.

With today's market at nosebleed levels it is a good time to break through the haze to recognize that data and information have to be interpreted, to get the true answer. The notion of how numbers lie struck me after reading an editorial on changes in journalism over the past 50 years that was published in a recent edition of *The Wall Street Journal*.

Much of the fault lies with the author but the reader is culpable as well since the reader's approach is to skim headlines rather than actually process the information provided. This factor also fosters the presentation of false information.

Today's approach to learning has resulted in the regular publication of stories that merely provide lists of interesting topics or the inaccurate interpretation of a single data point that frankly gives the reader misinformation. Granted, if the topic is mundane the conclusion's inaccuracies are benign to the reader. But when it relates to stocks, it can be devastating. The problem is that this "lying data" or information is so pervasive and ubiquitous we can't discern simple fact from fiction.

Take the completely innocuous issue of sports, for example. Without looking it up, what do you think the fastest growing sport is in America?

All is Not What It Seems

On the surface it would seem a cut and dry response is readily available. However, after performing a search on the web I still don't know the answer!

According to some articles I found on the web, *lacrosse* is the fastest growing sport in the U.S. with staggering growth in many states, and a roughly 20% jump for boys and girls organized lacrosse participation over the past 5 years. Still, a March 2015 USA Today story says the answer is *rugby*, because during the last five years the number of players has increased 14% year-over-year to 1.2 million participants, which is much higher than lacrosse. To make it even more interesting, NBC News proclaimed that something called *pickleball* is the fastest growing sport. So what is the answer?

The problem here is that the question cannot be answered because the definition of growth is not outlined. Is it growth percentage or absolute numbers? Without a true definition, information and data can be manipulated.

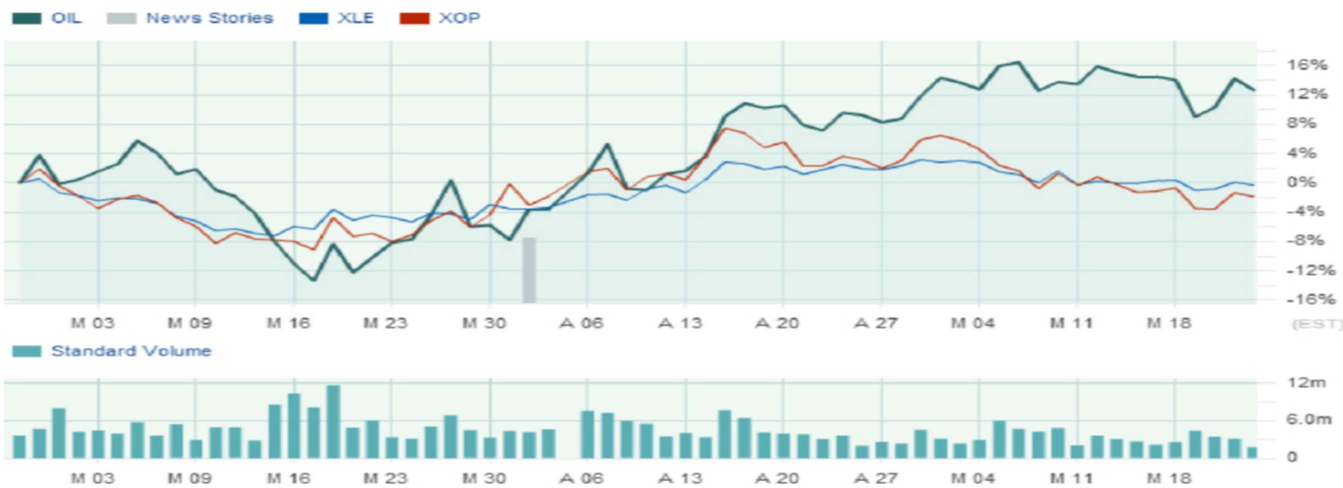
We run across the same problems every day in the market. For weeks now, the stock market has reached new highs and done so with very low volatility which has been lauded in certain circles as if it is natural that low volatility and rising stocks are always correlated. As a result, some investors have been lulled into complacency. However, the fact remains that when the VIX is at trough levels, like it is today, it is a negative barometer not a positive one, as we would be led to believe.

The VIX is an options-based metric of the prices investors are willing to pay for insurance against declines in the S&P 500. On Friday, the VIX broke below $12 for the first time in 2015. According to UBS, in recent years, stocks have dropped after reaching this level. In fact, the last time it happened the VIX declined by 5% in the next 30 days.

Another example of when numbers lie is the assumed correlation between oil prices and oil stocks/ETFs. When oil made a big move from its low in the upper $40's (per barrel) to the upper $50's from March—April, a 25% move, much was written about how *all* oil ETFs and stocks should move in a similar order of magnitude. Bur, not all oil exploration and production equities enjoyed big gains. In fact, most oil stocks and ETFs topped out at a paltry 10% return.

All is Not What It Seems (cont'd)

As you can see from the BigCharts.com image below, only **iPath S&P GSCI Crude Oil TR ETN (NYSE—OIL—$12.28)** moved in lockstep and with a similar percentage gain. while bellwether ETFs **Energy Select SPDR (NYSE -XLE)** and **SPDR S&P Oil and Gas Exploration and Production (NYSE—XOP)** did not fare nearly as well.



This numbers spin happens with company press releases as well. A common practice when firms miss quarterly estimates is to raise guidance for future quarters or on an annual basis. To be candid, this is a ploy to soften the blow and keep the stock from getting hammered, which it usually does by week's end anyway.

Bottom line? If you look deep inside stories and data instead of just viewing information on a surface-based level, you usually won't get burned.

Say What?

Each week we identify must-read stories, including some great ones which may fall a bit under the radar.

The Wall Street Journal

http://www.wsj.com/articles/how-everyone-gets-the-sharing-economy-wrong-1432495921

An uber slam on Uber, Lyft and the like. Ouch.

Marketwatch

http://www.marketwatch.com/story/its-time-to-dispel-the-myth-of-the-summer-rally-in-stocks-2015-05-22

Thesis might be wrong if June ends up being a week month, but it provides good insight.

ZeroHedge

http://www.zerohedge.com/news/2015-05-25/isis-planning-us-nuclear-attack-next-12-months-report

For you domestic security followers out there...

The Daily Telegraph

http://www.telegraph.co.uk/finance/economics/11625098/HSBC-fears-world-recession-with-no-lifeboats-left.html

Just the Stats!

This section is dedicated exclusively to data, either generated and credited by other organizations or by Goldman Small Cap Research that we deem useful for the purposes of economic, market, sector, or individual stock direction and trends.

By the Numbers

It is hard to believe that the year-to-date NASDAQ performance is more than 3x greater than that of the DJIA and more than double that of the S&P 500 Index. Something has to give here. Sometimes what "gives" is the achievement of the most innocuous of figures. At current levels, NASDAQ and the Russell 2000 are both trading a tad under 20x P/E on forward 12 month EPS while the S&P 500 is essentially at 18x. Will breaking through the 20x mark become a sell signal of frothy valuations?

AAII Sentiment Survey (courtesy of AAII.com, figures rounded)

Recent trends getting stronger…is that a downturn confirmation?

Last Week	Long Term Avg
Bullish 25%	39%
Neutral 50%	31%
Bearish 25%	30%

This latest survey indicates that individual investors are truly conflicted. It really is the ultimate Neutral stance...50% neutral, and 25% each for bullish and bearish. Wow. Something has to give and I suspect that we will start to see the bearish figure rise. By the way, this makes seven straight weeks that the percentage of neutral investors has been above 45%, with the actual number, 49.8% at a crazy figure.

Important: This week's TickerSense Blogger Sentiment Poll shows 25% bullish, 33% bearish and 42% neutral. I suspect that this poll is more of a leading indicator than AAII.

Stats and Thoughts

Lipper Fund Flows Survey (courtesy of Lipper.com)
(as of 5/20/15)

Here we go again...all Equity funds reported net outflows totaling $0.7 billion, with Domestic Equity funds reporting net outflows of $1.7 billion and Non-Domestic Equity funds reporting net inflows of $1.1 billion. Inflows abroad were higher than the week before but domestic outflows were lower, likely due to the extended holiday weekend. I sense we are nearing a "capitulation" stage with outflows which could spark selling.

The narrow nature of the current market performance is maddening for stock pickers and for those waiting for bargains. Both the NYSE and NASDAQ recorded 81 new highs on Friday and almost the exact same number of lows. But, advancing/declining volume had a major divergence. For the NYSE, declining volume was nearly double the advancers while NASDAQ's advancers were about 15% higher than the decliners.

For those investors that like to hedge their bets, it is probably a good idea to start following and preparing to take positions in equities that represent a bearish stance on equities, an increase in volatility, and perhaps lower oil prices as well.

Recent Picks
Speaking of which, last week we highlighted a leveraged ETF (it was TVIX) as a potentially lucrative but very risky trading vehicle in case volatility in the VIX increased. How did it go? It was a freaking disaster as the VIX hit a low! Keep it on your screen because if that volatility and downward pressure return, it will move faster than *hit through a goose.

By the way, last week we released the latest issue of *The 30-30 Report*. Not only did we have a winner in just 3 weeks in the last issue, but one of Thursday's picks already rose nearly 15% in two days. Not a subscriber?

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The Investor Academy

Beginning with this issue, we are featuring a teach-in section called *The Investor Academy.* Depending upon the topic, this segment can be viewed as Investing 101 or serve as secrets of a former Wall Street insider that leverages our many years of experience in senior positions on Wall Street, including analyst and mutual fund manager.

Stock Buybacks Are No Longer a Good Thing

Aside from the obvious low economic growth and high P/E multiples for equities, one of the problems with the current bull market is that a series of stealth events has likely prolonged its duration and its magnitude. Unfortunately, these events may soon come to a close and take the bull market with it.

The first cause for concern is the stock buyback. Stock buybacks have been a steady feature of the stock rally which has definitely had an impact on stocks as companies that comprise the S&P 500 Index have spent hundreds of billions in stock buybacks over the past 6 years. With fears over the commencement of a market correction, management teams may elect to soon put the brakes on their buyback plans. If that were to occur, investors would surely recognize that liquidity, volume, and prices would drop, further exacerbating a stock market decline and potentially protracting a downturn.

Another byproduct of a stock buyback suspension is its impact on financial reporting. When a company buys back its shares in the open market that stock is returned to its treasury and the number of shares outstanding is reduced by that number. So, when a company reports financials that demonstrate a decline in shares outstanding from the year-ago period, EPS could be raised not by operating performance but simple math. Fewer shares in the share count results in a higher earnings per share. Once a buyback plan is suspended, that incremental EPS gain is lost, making it harder to outperform EPS recorded in prior periods.

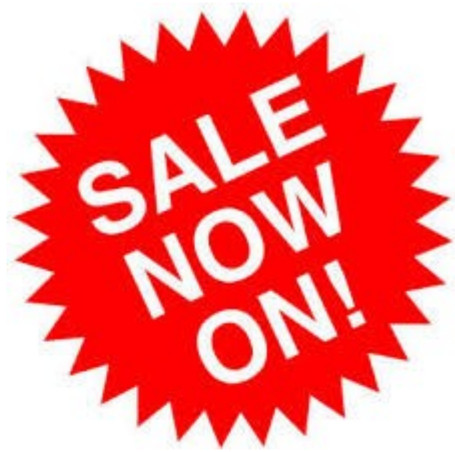
The Investor Academy (cont'd)

I am not implying that the bull market has been artificially aided by stock buybacks or that EPS growth has only been a result of the reduction in shares outstanding. After all, some companies merely announce stock buybacks but rarely engage in achieving the maximum number of shares allotted for open market purchase by the Board of Directors. These stocks tend to get an early but unsustainable boost in share price. However, since few shares are acquired during the stated period anyway, the negative effect of a suspension would be negligible. Still, it is characteristic that should not be overlooked.

Another driver of the market relates to company accounting. Publicly traded entities present their financial results via GAAP (Generally Accepted Accounting Principles) and non-GAAP. With a GAAP presentation, all expenses are outlined, including non-cash expenses such as stock compensation. Non-GAAP is designed to omit non-cash and other one-time expenses such as write-downs or restructuring costs.

Today, investors tend to ignore the GAAP figures and focus on non-GAAP, which can paint a much prettier picture. For example, a few quarters ago, Twitter (NASDAQ – TWTR) earned $0.02 on a non-GAAP basis but lost $144 million on a GAAP basis, due to some of the aforementioned stock and option compensation. It is easy to see how a non-GAAP presentation of numbers can make poor performance look good, driving stocks to higher values. But, if pros start to place more emphasis on GAAP figures we could be in for some serious pain with some of the high-flying stocks that have driven the NASDAQ Composite this year.

These Stocks Trade Under 10x EPS



Concerned about market and stock valuations? Here are two stocks trading under 10x 2015 estimated EPS.

We have mentioned **Orbotech (NASDAQ—ORBK -$19.44)** twice this year in these pages and noted it is our pick of the year. So far, it has not disappointed, as the stock is up 23% since our mid-February profile. Afraid you have missed out? No worries. At current levels this $800M market cap yield and production solution provider for PCBs and LCDs still trades less than 10x this year's EPS forecast. In 2014, the Company generated $583M in sales with EPS of $0.83. In 2015, sales are forecast to reach $750M in sales and $2.00 in EPS. Our year end target is $27-28.

If you don't mind a controversial story, **Global Cash Access Holding, Inc. (NYSE—GCA—$7.82)** provides cash access services and related equipment and services to the gaming industry. The company operates in Cash Advance, ATM, Check Services, Games, and Other segments. Its cash access products and services include Casino Cash Plus 3-in-1 ATM, a cash-dispensing machine that offers patrons to access cash through ATM cash withdrawals, point-of-sale (POS) debit card transactions, and credit card cash access transactions.

Sales are projected to jump 36% this year to $828M, up from $593M last year, while EPS is forecast to rise to $1.11, up from $0.88, which is a 26% potential gain. We should note that a big negative with these shares (aside from the industry sentiment) is its high debt level of around $1.5 billion, with $1.2B in long term debt. However, a closer look at the balance sheet illustrates a big increase in cash in 1Q15 versus 4Q14 so perhaps the balance sheet trends are improving. Finally, the stock appears attractive on a technical basis even though it is in the middle of its 52-week range. It currently trades just above its 20 and 50 DMAs, but a series of down days could torpedo this aspect. Still, the stock is being profiled because of its fundamental attributes more than technical characteristics. Our year-end target is $10-11.

Remember: Do your own due diligence! Have a great week!

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