The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

⇒ *Big stocks are about to get weak while small caps are gaining strength*

⇒ *Small caps' valuations are low and 2H16 EPS growth rates are strong*

⇒ *Sentiment has turned upside down. Pros are more bearish, individuals more bullish. That is a bearish sign.*

⇒ *All stocks could see weakness later this quarter but enjoy a great late 2016/2017*

⇒ *Pick of the week has beaten forecasts four straight quarters*

THE MAJOR INDICES

Index	Close	2016
DJIA	18,004	3.3%
S&P 500	2092	2.3%
NASDAQ	4906	-2.0%
Russell 2000	1147	1.0%

(figures are rounded)

When Size Matters...

Only the NASDAQ Composite failed to show a positive return for the week. This was due, in large part, to the terrible post-earnings report performances of **Netflix (NASDAQ—NFLX)**, which was down 14%, and **Microsoft (NASDAQ—MSFT)** which dropped 8%. In contrast, the Russell 2000 Index was the best performer of the major indices. Here are 3 reasons why small is better than big right now.

<u>Reason #1: Business Abroad</u>

Multinationals are hurt by slower growth abroad let alone currency translation. Most small caps do not face this problem

<u>Reason #2: Valuation</u>

The Price/Sales Ratio on the S&P 600 (small cap index) is a major discount to the S&P 500 index. Plus, the expected average earnings growth for the second half of the year is substantially greater for small caps than the large cap index (average of 13% versus 7%).

<u>Reason #3: Technicals</u>

The small cap indices are screaming buys while some big cap indices, like the NASDAQ Composite is on shakier ground.

The Stock Market Today

U.S. Stock Market Index Performance
4/22/2016

Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% off High	% from Low	% Above 200-DMA
DJIA	18,004	18,351	15,370	5/19/15	8/24/15	1.9%	17.1%	5.2%
S&P 500	2,092	2,135	1,810	5/20/15	2/11/16	2.0%	15.6%	3.8%
NASDAQ	4,906	5,232	4,210	7/20/15	2/11/16	6.2%	16.5%	1.2%
Russell 2000	1,147	1,296	943	6/23/15	2/11/16	11.5%	21.6%	1.6%
Average						5.4%	17.7%	2.9%

Sources: www.BarChart.com, Goldman Small Cap Research

Yes, we have been pounding the table on small caps for weeks. As expected, the Russell 2000 finally broke through its 200 DMA and is now above its 2015, close. Not even the NASDAQ Composite can ay that. Moreover, small stocks have had the biggest run since the mid-February 2016 low, as the key index is up nearly 22% in the last 8 weeks or so. With small cap earnings season yet to really start, we expect that the space will continue its run, albeit at a less than torrid pace.

While the next few weeks are likely to be solid for small caps, we see a trend just starting to occur with their larger brethren, which will then affect small caps. Already we are seeing calls for, and actual action in big cap profit-taking, in conjunction with quarterly financial reports. Perhaps some of the moves are related to the “Sell in May and Go Away” strategy. However, as you will see in Notable Numbers, investment pros are becoming more cautious while retail is more optimistic—that is a bad sign.

To be sure, we are not calling for a May correction, but we could see weakness in the second half of May/early June. The one saving grace is that the market looks six months ahead and the future is bright. Q4 quarterly earnings for the key indices ranges from 9-14%, and quarterly EPS is expected to jump by 20-28% from Q1 to Q4. Plus, with earnings projected to grow by solid double-digits in 2017, we may be experiencing the trough level for earnings (losses.)

Say What?

Great info, insights, and hard-hitting stories make up this week's *Say What?* feature...

Bloomberg

http://www.bloomberg.com/news/articles/2016-04-24/aging-baby-boomers-push-spam-diaper-stocks-to-record-valuations

An odd phenomenon.

The New York Times

http://www.nytimes.com/2016/04/24/business/fantasy-math-is-helpingcompanies-spin-losses-into-profits.html?ref=business&_r=0

Not new news per se, but you need to be aware, nonetheless.

The New York Post

http://nypost.com/2016/04/23/its-been-one-of-the-worst-years-on-record-for-tech-ipos/

Yet, stocks are up. Market needs this segment to work to succeed going forward.

Marketwatch

http://www.marketwatch.com/story/the-most-hated-stock-rally-could-be-primed-for-a-may-correction-2016-04-22

Trying to scare us, but it is definitely a possibility.

ZeroHedge

http://www.zerohedge.com/news/2016-04-24/what-charts-say-no-bull-evidence

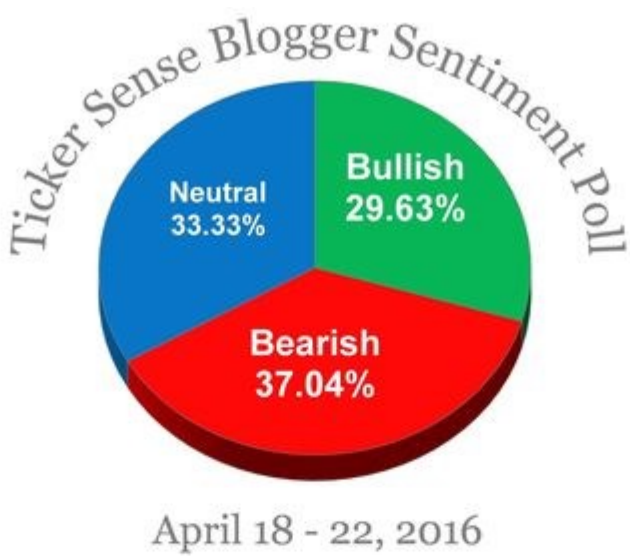
If you like charts, this story is for you. Whether or not it is accurate is another story.

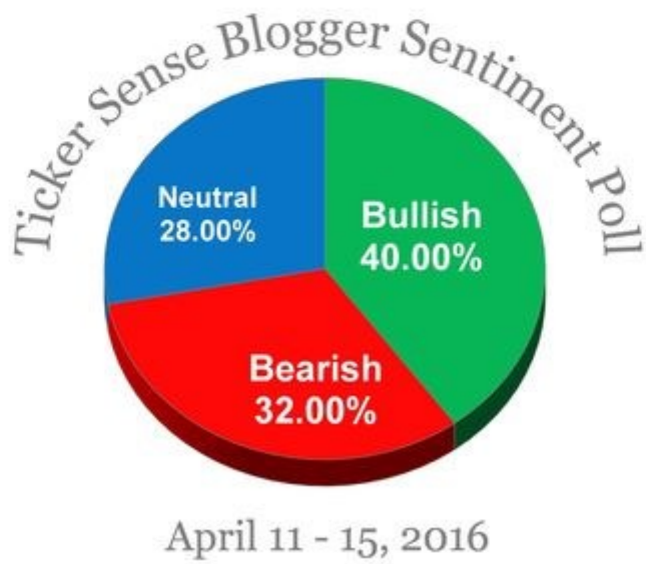
Notable Numbers

AAII Sentiment Survey (figures rounded)

	Current	Last Week	*Long Term Avg*
Bullish	33%	28%	*39%*
Neutral	43%	47%	*31%*
Bearish	24%	25%	*30%*

Ok, this is just about the worst case scenario. The retail investors have grown more bullish, while the pros are more bearish. In a matter of a week, the Ticker Sense poll has Bulls dropping from 40% to under 30%. Conversely, Bulls in the AAII survey rose to 33% from 28% while Bears stayed essentially the same. Worse still, the Investors Intelligence Bull/Bear ratio, as noted by Yardeni Research, skyrocketed from 1.48, to 2.18. We note that this ratio is not considered over-extended until it hits the 3.0 mark, but this past week's move is huge, in our view. All I know is that if we don't see meaningful corporate buybacks in the coming weeks, it could be a rough ride for a spell.





Pick of the Week

Our financials pick **Banc of California (NASDAQ—BANC—$19.96),** kicked ass in its quarterly report, released on 4/21/16. We believe that the stock still has 15% upside but its trading may be more indicative of future small cap stock trading in general. On the day it soundly beat forecasts (by $0.05), the market sold into the news, with volume, 40% greater than the three-month average, and the stock ending down for the day. The next day, it hit a new high on a key investment bank upgrade.

The key takeaway is that if investors are selling strong stocks on great news, headwinds are likely ahead. Moreover, you too should consider selling into strength.

After perusing the hundreds of stocks slated to report quarterly financials this week, we have settled on one stock that could emerge as a solid winner, performance-wise.

Cohu, Inc. (NASDAQ—COHU—$11.55) is a leading supplier of semiconductor test and inspection handlers, micro-electro mechanical system (MEMS) test modules, test contactors and thermal sub-systems used by global semiconductor manufacturers and test subcontractors. In fact, **COHU** is the global technology and market leader in Semiconductor Final Test and Inspection Handlers. The handler market alone is estimated to be $750M annually and with the entrance into new segments, the total opportunity approaches $2 billion.

COHU is enjoying growth in key markets such as the mobile space with the aid of new products and synergies in the industry. With over 10,000 active clients, the Company continues to expand its market share both organically and through acquisitions. Cohu boasts $117M in cash, which is almost half of the current market cap alone, and has no bank debt.

Quarterly results are due out on Thursday and Wall Street is looking for $0.05 in EPS versus $0.03 in 1Q15, on revenue of around $64M. We should note that **COHU** has strongly beaten estimates four straight quarters which bodes well for the upcoming reporting as well.

From the technical perspective, it has traded in a narrow range (50-200 DMA are $11.59—$11.37). In our view, a strong financial report will move the stock sharply, which is where technicals and momentum could kick in, and take it to the $13-14 level, despite a series of potential resistance points.

The Goldman Guide

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