Goldman SMALL CAP RESEARCH

The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *There are 3 signals that stocks are headed for more retreats*
- ⇒ *Equity/retail investor risk is reaching a new high with commencement of revised crowd-funding rules*
- ⇒ *Even when things are good they are bad*
- ⇒ *Investors seem to ignore these events and their potential impact*
- ⇒ *Our pick this week is a real bottom fish, oversold candidate with angry activist investors*

THE MAJOR INDICES

Index	Close	2016
DJIA	17,535	0.6%
S&P 500	2047	0.01%
NASDAQ	4718	-5.8%
Russell 2000	1102	-3.0%

(figures are rounded)

3 Market Signals Causing Insomnia

I am typically a glass half full kind of guy, but recent market signals and events are keeping me up at night.

Maybe it is the fact that it rained for 15 days straight recently. We have also had period of “sun-showers”, or as my father would call it, times when “the devil was beating his wife.” Not exactly a politically correct statement these days but being PC is pretty bullshit anyway.

Anyway, if I were you, I’d mentally and *investmently* (should be a word) prepare for more retracements. Here’s why we will be down before up:

Sentiment breadth sucks. As noted in *Notable Numbers*, the Ticker Sense poll (investment advisers) indicates 50% of respondents are bearish for the first time since the market trough of mid-February. This time, it does not follow a major sell-off; thus we believe it portends future selling.

Retail sales are great but they are not. Like the devil beating his wife, retail sales were up nicely for April but driven by internet sales, while bricks and mortar dropped. That means closings, layoffs, etc. ahead. Terrible weather also means apparel sales will still be rocky. We have been preaching this for months so use the high consumer confidence and retail figures as a kind of a false positive.

New crowdfunding means more risk. I love the new crowdfunding rules which now allow the Average Joe to invest in private deals. But, this means that risk opportunities are at their highest, which is sometimes a signal for a market top. (See our *Say What?* Section.)

The Stock Market Today

U.S. Stock Market Index Performance
5/13/2016

Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% off High	% from Low	% Above 200-DMA
DJIA	17,535	18,351	15,370	5/19/15	8/24/15	4.4%	14.1%	2.4%
S&P 500	2,047	2,135	1,810	5/20/15	2/11/16	4.1%	13.1%	1.7%
NASDAQ	4,718	5,232	4,210	7/20/15	2/11/16	9.8%	12.1%	-2.2%
Russell 2000	1,102	1,296	943	6/23/15	2/11/16	15.0%	16.9%	-1.6%
Average						8.3%	14.0%	0.1%

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

Although the big cap indices closed above their 200 day moving averages (DMA), they aren't exactly screaming buys. And, for that matter, the NASDAQ Composite seems to be a screaming sell. I wonder how the DJIA and S&P 500 Index react to new, adjusted 200 DMAs later this week. Considering they reached their 52-week highs almost exactly a year ago, and these highs will drop incrementally from current levels, technicians will follow trends closely. If stocks remain weak, it could begin a path towards more positive sentiment territory, as the current RSI (Relative Strength Index) on all four indices is in the low-mid 40's. A RSI score below 30 is usually considered an oversold condition.

Meanwhile, even when things are good they are bad. The unemployment rate for April remained steady at 5% but the labor participation rate declined. The University of Michigan Consumer Confidence Index rose sharply last month, which was a surprise. But, the consumer growth and rise in confidence was driven by low-income and young consumers. Not exactly what we are looking for as the ones leading the charge.

With most of the Q1 earnings season behind us, it will be interesting to see how stocks perform during this high volume conference and roadshow season, and if stock buybacks commence again. Anything could help because we are seeing bids run away from even small sell orders as market makers have reverted to their Chicken Little forms again. Be cautious but mindful that GARP stocks are the best plays in this environment.

Say What?

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

The New York Times

http://www.nytimes.com/2016/05/15/business/dealbook/new-crowdfunding-rules-let-the-small-fry-swim-with-sharks.html?ref=business&_r=0

The most important investment change in years.

The Wall Street Journal

http://www.wsj.com/articles/the-wicked-humor-of-party-games-1463153007

Off the beaten path but way cool.

The New York Post

http://nypost.com/2016/05/14/investors-could-yank-as-much-as-500b-from-hedge-funds-in-2016/

Uh-oh. Add in the leverage used by hedgies and this could escalate quickly.

Marketwatch

http://www.marketwatch.com/story/jim-cramer-doesnt-beat-the-market-2016-05-13

What savvy investors always knew...Bet he won't scream these numbers...

ZeroHedge

http://www.zerohedge.com/news/2016-05-14/how-baby-boomers-blew-stock-market

Not a new notion, but very thought-provoking.

Event, Impact

Event: There is some talk (see the next page) that with redemptions coming into the hedge fund world, to the tune of tens of billions, if performance continues to suck eggs, as much as $500M could be redeemed.

Impact: There are often redemption restrictions (such as annual or semi-annual opportunities) so the big potential sales could be more Q4 than Q2 or Q3. What is disturbing is the leverage used by hedge funds. For every dollar in assets, 3-5x could be used for purchases. As holdings are unwound it could have a big negative effect on stocks. For me, that would be a 2017 issue.

Event: The price of oil is over $45 per barrel.

Impact: The market's assumption was anything over $40 would put oil companies in danger of failing on semi-solid ground. Or, at the least, stem the bleeding. Not only could oil prices decline, but even at the $45 per barrel level, bankruptcies could still occur.

Event: Russia, China, and North Korea are all engaging in saber-rattling against the West, particularly the U.S.

Impact: Negligible, although anything related to trade between the U.S. and key partners seem to continue to have an external effect on stocks.

Event: Sell in May and Go Away seem to be a sound strategy as earnings and revenue guidance are not up to snuff.

Impact: GARP stocks, those with a history of meeting/exceeding expectations gain buyers as high growth high, value takes a back seat. The more stocks sell-off the more bottom-fishing becomes popular, albeit potentially dangerous.

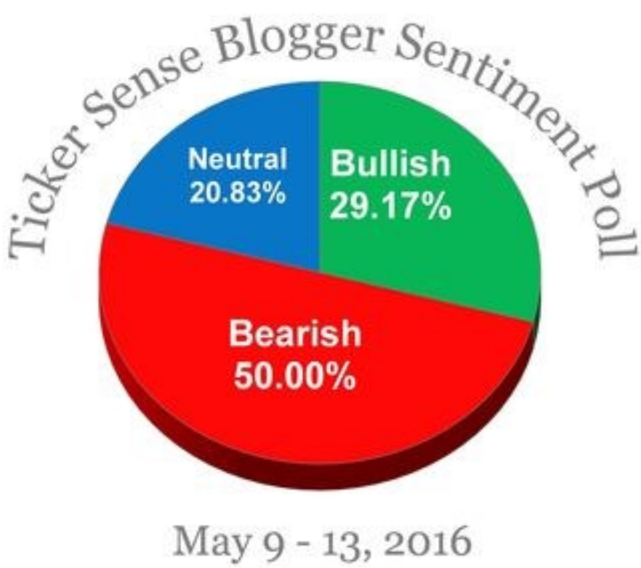
Notable Numbers

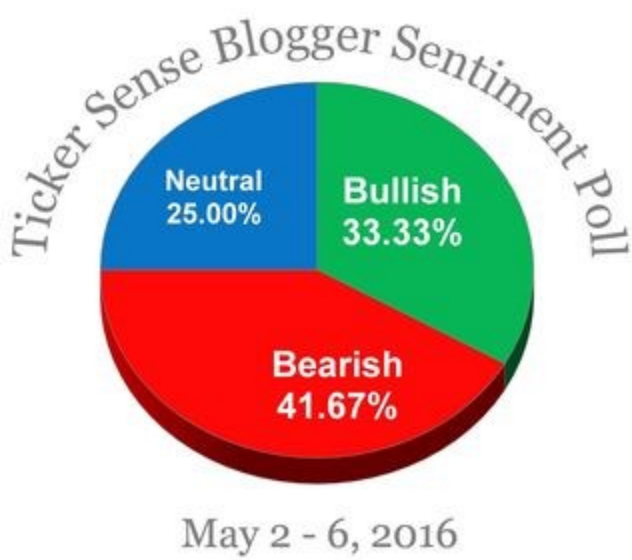
AAII Sentiment Survey (figures rounded)

	Current	Last Week	*Long Term Avg*
Bullish	20%	22%	*39%*
Neutral	48%	47%	*31%*
Bearish	31%	30%	*30%*

On December 31, 2015, the Neutral percentage for the AAII survey was 51% while the other two categories where roughly 25% each—the height of "I don't know where stocks are headed." Today's 48% level is the highest since then, which is interesting. The current 20% Bullish percentage is good, but for a quick bounce, we really need these Neutrals to jump to say, 45% Bearish. Unfortunately, it seems that Neutrals at this 48% level can portend a brief, near term selling run.

We have seen time and time again that the Ticker Sense poll can be just ahead of the curve. Therefore, its 50% Bearish stance also signals more pain ahead.





Which Kind of Bottom-Fishing?

There are two kinds of bottom fishing and they are both fun. The one to the right is after you get a few drinks in you...the one we are highlighting here is after a bunch of bad stuff has happened and a stock appears oversold,

Last week, our bottom fish candidate was **Perion Network Ltd. (NASDAQ – PERI—$1.39—NR)** which had a nice run after the results release but since sold off a tad. This was expected and may be more of a 1-2 quarter play, but a goodie nonetheless.

Not to be confused with **PERI is Perry Ellis (NASDAQ—PERY—$16.46—NR).** I know...we just slammed retail, especially apparel. Don't mock me just yet.

PERY designs, sources, markets, and licenses apparel products through its few dozen stores and major retailers around the world. We have written about PERY before, when it appeared that a hostile takeover was in the cards. That could still be the case because shareholders are totally fed up with management. Let me net it out for you. This valuable brand and other labels, distribution channels, etc. are projected to generated about $900M in sales in the current year ended January 2017, with EPS of $1.92 , and carries a low $250M market cap. **PERY** will release results on May 19th (along with a dozen other retail stocks) and Wall Street consensus calls for $0.94 versus $0.99.

Look, **PERY** is down 37% for the year, only 4% from its low, and I admit it looks terrible. Moreover, we would not be surprised, given the current environment, if management guides lower. My take is this. **PERY** has a RSI of 26, which indicates it is oversold. And, we predict **PERY**'s EPS for Q1 will be light, guidance to drop by 10%, and the stock to reach a trough of about 10-15% below its current price to $14-$15. But, with activist investors pissed, and the oversold/written off nature of this stock, we see a 25% or so move on a bounce from the low, over a 30-90 day period. So, consider playing it for a bounce, following the drop.

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