Goldman SMALL CAP RESEARCH

The Goldman Guide

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KEY TAKEAWAYS

- ⇒ *All eyes on Brexit this week. Investors should expect lots of volatility ahead...again*
- ⇒ *S&P 500 Index looking weak*
- ⇒ *Changes to Russell indices creates opportunities*
- ⇒ *Earnings season will be in focus sooner than you think and certain segment should kick butt*
- ⇒ *We profile a new Russell Microcap addition that is cheap, growing like crazy, and is a company any father would love*

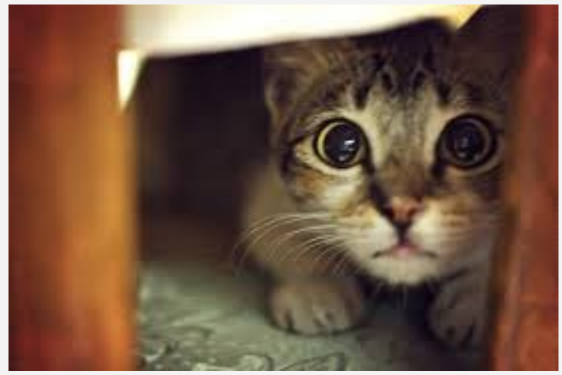
THE MAJOR INDICES

Index	Close	2016
DJIA	17,675	1.4%
S&P 500	2071	1.3%
NASDAQ	4800	-2.2%
Russell 2000	1145	0.8%

(figures are rounded)

Predicting The Market In 50 Words

To all the dads out here, Happy Father's Day. Being a father can be rewarding, scary, and thankless all at the same time. And I am sure we wouldn't trade it for the world.



I hate saying I told you so...actually that's a lie. I enjoy it. Anyway, much of what we espoused last week came to fruition and the bottom line is there is a lot of fear out there. Investors are as skittish as the scared kitten above and I can understand why. This week could prove to be the most volatile, crazy week we have had in a long time and its dénouement will likely set the stage for the rest of summer. With that in mind here are the 7 things you need to know regarding stock market direction for the foreseeable future:

1. **Brexit does not mean a mass stock exit.**
2. **The U.S. economy is only ok, and that is okay.**
3. **Russell Index changes create opportunity.**
4. **The S&P 500 Index technicals are at risk.**
5. **Earnings suck, except for these…**
6. **Lots of cash on the sidelines is good.**
7. **Even risk oriented investors are afraid.**

Bonus: Summer solstice and full moon mean crazy investors may act a little crazy early this week.

The Seven Things...

#1: Brexit does not mean stock exit. June 23rd is Decision Day. Will the U.K. exit the EU? If it does how bad is it for the EU and the U.K., and the rest of the world? Are there other shoes to drop with other EU members? If it stays, what happens next ?

Stocks are going to be volatile until D-Day because the decision is a toss-up. Still, we hold that some of the downside in a Brexit vote is already reflected in stocks and downturns would only be short term in nature if voters elect to leave. I would be more concerned about fallout with other countries and talks de-stabilization of the EU. That is the biggest, and unlikely risk at this stage. Of course, staying in the EU would be a positive.

#2: The U.S. economic situation is only ok, and that is okay. A number of investors are really worried about the historically slow economic growth, slowing employment, concern that the consumer can no longer drive the economy, etc. I think most investors are resigned to the notion that we are mired in a multi-year, low growth environment, regardless of who is in office next year. As long as the bottom does not fall out, stocks will eke out modest gains this year.

#3: Russell Index changes create opportunity. Adjusting your portfolio to the additions could prove to be profitable as they could represent future winners, while the deletions could represent current losers, and if they return to form, future winners. So, even they are to be monitored.

#4: The S&P 500 Index technicals are at risk. The index is about to drop below its 200 DMA after dropping below the 20, and 50 DMAs and that is not a good sign. Don't look for anything beyond earnings fundamentals to help out for a while.

#5: Earnings suck, except for these…According to Factset: The Consumer Discretionary sector is expected to report the second highest earnings growth at 6.8%. At the industry level, Internet & Catalog Retail is forecast to jump 41%.

#6: Lots of cash on the sidelines is good. Institutions have the highest cash percentage (5.7%) in 15 years. That bodes well for future rallies.

#7: Even risk oriented investors are afraid. Big discount on small cap secondary offerings illustrate fear/concern about valuation and direction in the near term.

The Stock Market Today

U.S. Stock Market Index Performance 6/17/2016								
Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% off High	% from Low	% Above 200-DMA
DJIA	17,675	18,189	15,370	6/23/15	8/24/15	2.8%	15.0%	2.8%
S&P 500	2,071	2,133	1,810	7/20/15	2/11/16	2.9%	14.4%	2.7%
NASDAQ	4,800	5,232	4,210	7/20/15	2/11/16	8.3%	14.0%	-0.4%
Russell 2000	1,145	1,296	943	6/23/15	2/11/16	11.7%	21.4%	2.7%
Average						6.4%	16.2%	1.9%
Sources: www.BarChart.com, Goldman Small Cap Research								

All eyes are on the U.K., and rightfully so. The good thing is that small companies do not have much exposure here, so regardless, they are unlikely to be affected. Factset estimates that the aggregate revenue exposure of the entire S&P 500 Index membership is around 3%. However, that number is a bit deceptive, as energy, IT, and materials could be impacted the most since they derive 4.0—6.5% of revenue from Britain.

All this Brexit talk has prompted investors to take their eyes off of earnings and that could provide a real opportunity for aggressive investors. The current 12-month forward P/E on the S&P 500 Index is just a tad over 16x, which is essentially fair value, relative to historical multiples and when taking into account the low interest rate environment.

So where does that leave us? While Brexit will dominate stock direction in the near term, earnings will quickly play a role, although it will be dicey because of the calendar. The Brexit vote is Thursday, which means the most volatile days could be that day and Friday. The week after is really a 4 day week because so many will be taking Friday off for the July 4th holiday on Monday.

This all means we could be digesting the Brexit outcome until just before the holiday weekend. July has had some huge returns of late. Since 2000, there have been 7 up years and 4 down years but the up year returns have average nearly double that of the down years. Wanna focus on earnings ahead of it? Think internet, autos, and non-apparel retailer consumer discretionary stocks.

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/2016/06/19/business/dealbook/after-147-years-goldman-sachs-hangs-a-shingle-on-main-street.html?ref=business&_r=0

Never thought I would see this.

Marketwatch

http://www.marketwatch.com/story/investors-fearing-summer-shocks-are-hoarding-the-most-cash-since-2001-2016-06-14

Could this be a bullish sign?

Bloomberg

http://www.bloomberg.com/gadfly/articles/2016-06-17/trade-of-the-week-whatever-the-bookies-say-next

Short and very informative.

USA Today

http://www.usatoday.com/story/tech/news/2016/06/17/microsoft-makes-bold-move-into-marijuana-biz/86034484/

Does this legitimize the industry?

ZeroHedge

http://www.zerohedge.com/news/2016-06-18/tensions-between-usnato-russia-are-flaring-dangerously

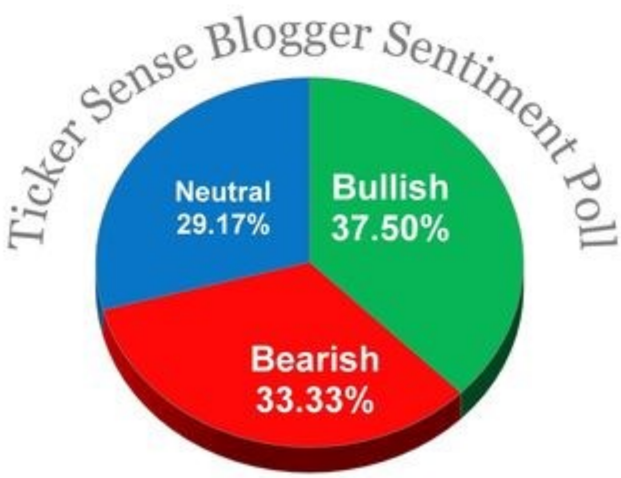
Fear a different kind of bear?

Notable Numbers

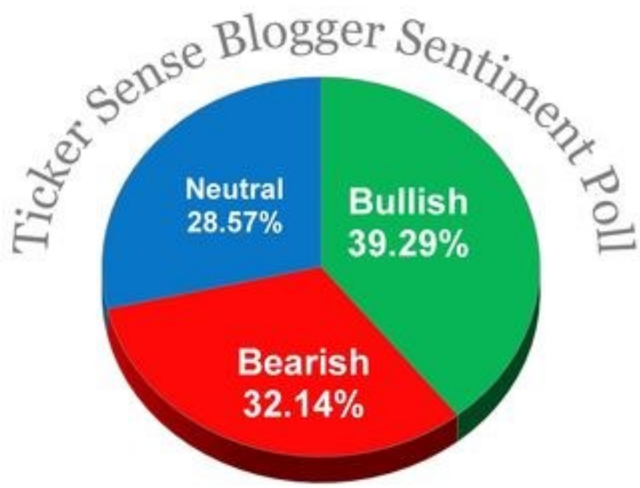
AAII Sentiment Survey (figures rounded)

	Current	Last Week	*Long Term Avg*
Bullish	25%	28%	*39%*
Neutral	37%	44%	*31%*
Bearish	38%	28%	*30%*

Little change was recorded by Ticker Sense but the AAII survey demonstrated that the Neutrals are turning Bearish. It's about time, if you ask me. At least for this group. The Investor Intelligence survey has shown an incremental upward change in the percentage of advisors expecting a correction, which we view as ok, but not material. Equity funds sales have leveled off ad volume has not really changed much. The big change has been in the VIX, which was up 14% for the week. It is hard to believe it would not generate similar returns this week, given the Brexit concerns.



June 13 - 17, 2016



June 3 - 10, 2016

A Russell Addition A Father Can Love

Of the 20 pending consumer discretionary category additions to the Russell Microcap Index, 6 of them are restaurant stocks. With such a large percentage devoted to one segment of this large category, we thought it would be a good idea to profile one of them. Naturally, we selected a stock with which we have had familiarity and what is sure to be one a father would love—if he loves a good steak, that is.

The ONE Group Hospitality, Inc. (NASDAQ—STKS—$2.44—NR) operates upscale, high-energy restaurants and lounges and provides hospitality management services for hotels, casinos and other high-end venues both nationally and internationally. The ONE Group's primary restaurant brand is STK, a modern twist on the American steakhouse concept with locations in major metropolitan cities throughout the U.S. and Europe.

The varied restaurant concepts are great, financials are solid and growing like crazy, and the metrics/valuation are very attractive. On top of a good 1Q16, management recently licensed concepts to outside parties which should provide additional revenue streams.

For 2Q16, the lone analyst estimate calls for EPS of $0.05 versus a loss of ($0.03) on a 22% rise in revenue to the $18M mark. For the full year 2016, sales are forecast to jump from $60M to $76M, with $0.21 in EPS while next year's projection calls for $91M in sales and EPS of $0.34. At current levels, the stock trades 12x this year's EPS estimate and less than 1x sales—and this is before the news about the Microcap Index addition.

Furthermore, the stock has a RSI of 50 and 16% institutional share ownership, which should now rise. The stock is 10% above its low and doesn't have the greatest looking chart or average daily volume. Nonetheless, we target $4 by year end for these shares, which would reflect 12x next year's EPS.

The Goldman Guide

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