Goldman SMALL CAP RESEARCH

The Goldman Guide

VOLUME 7 | ISSUE 32 | AUGUST 7, 2016

INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *Earnings growth has been anemic for year while valuations are high.*
- ⇒ *This trend will continue for the near term but we are getting closer to turning the earnings corner which will be a launch pad for stocks, after a pending decline*
- ⇒ *Don't buy big names, popular names, or neutral-trading stocks. Buy laggards with catalysts ahead.*
- ⇒ *Investor sentiment is sending us another set of signals*

THE MAJOR INDICES

Index	Close	2016
DJIA	18,544	6.4%
S&P 500	2183	6.8%
NASDAQ	5221	4.3%
Russell 2000	1231	8.3%

(figures are rounded)

WHERE'S THE GROWTH?

Just like the "Where's the Beef" commercials from the 1980's, isn't it time to ask, "Where's the Earnings Growth?"

After each quarter it just seems like, okay this quarter sucked but the next one will be awesome! Check it out, courtesy of Factset. Her are the annual S&P 500 Index earnings growth figures of the past few years:

2011: 12.7%

2012: 5.3%

2013: 5.3%

2014: 5.1%

2015: (0.8%)

2016E: (0.3%)

The average is 5.5%, and that is only because of the high 2011 figure. Anemic! And 2016 could be worse than 2015 if the estimates for Q3 and Q4 come up short. The earnings for Q3 is still projected to be a loss but the Q4 figure is a high 5.7%—so there is some risk there.

The plus side is growth is around the corner and the numbers have been dragged down by energy stocks which will finally have favorable comps beginning in Q4.

The Stock Market Today

U.S. Stock Market Index Performance 8/5/2016								
Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% off High	% from Low	% Above 200-DMA
DJIA	18,544	18,622	15,370	7/20/16	8/24/15	0.4%	20.7%	6.6%
S&P 500	2,183	2,183	1,810	8/5/16	2/11/16	0.0%	20.6%	7.2%
NASDAQ	5,221	5,227	4,210	8/5/16	2/11/16	0.1%	24.0%	7.9%
Russell 2000	1,231	1,233	943	8/5/01	2/11/16	0.2%	30.5%	10.1%
Average						0.2%	24.0%	7.9%
Sources: www.BarChart.com, Goldman Small Cap Research								

We hit some new 52-week highs last week and the major indices have made massive moves off of their lows from six months ago, as illustrated in the table above and some RSIs are getting frothy. There just seems to be greater risk than reward—for a little while.

Look, the 12-month forward P/E is 17.0x (versus the 14 and change 5 and 10 years averages) and with anemic growth, it just ain't good. But there is a silver lining, which is why we have been so time-sensitive to investing right now. For Q3, earnings for the index is slated to drop by (1.7%), down from a slight gain just 6 weeks ago, as sectors across the board had estimates slashed. However, with earnings growth returning in Q4, valuations can be defended and promoted as attractive. This is especially the case for 2017, with earnings growth forecasted to grow higher than the 12.7% in 2011.

So what do you do until we reach Q4 and 2017? Buy stocks that are not in favor. There is a tendency to buy big name and big-sized stocks that are big time in favor—the must-have names. We don't believe in such "idol worship" Moreover, they run the risk of being sold off in a liquidity/sales event in the market. I would also avoid stocks that are idling, in other words trading in a narrow range with few degrees of upward or downward direction or measurable catalysts ahead. They probably will just continue middling along. But, there are some intriguing consumer discretionary and energy stocks not in favor that are just a catalyst or 2 away from going to the next level.

Say What?

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

The New York Post

http://nypost.com/2016/08/05/dont-hold-your-breath-over-promising-federal-reserve-report/

Amen.

Marketwatch

http://www.marketwatch.com/story/sell-everything-this-stock-market-rally-dares-you-2016-08-06

It's worth it to click the link just because of the pic alone.

The Smoking Gun

http://www.thesmokinggun.com/documents/crime/ancient-john-reports-ripoff-647832

I am sorry but this is just too crazy and funny. And his peers are just hoping for jello.

Bloomberg

http://www.bloomberg.com/news/articles/2016-08-05/airbnb-files-to-raise-850-million-at-30-billion-valuation

Is this the top for the "sharing economy?"

ZeroHedge: 2 for 1 this week

http://www.zerohedge.com/news/2016-08-06/peak-hillary-reuters-baffled-clintons-lead-over-trump-suddenly-evaporates

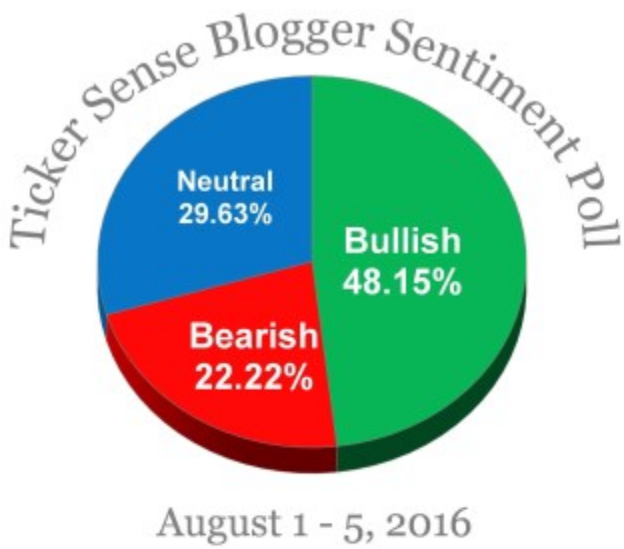
http://www.zerohedge.com/news/2016-08-05/lead-attorney-anti-clinton-dnc-fraud-case-mysteriously-found-dead

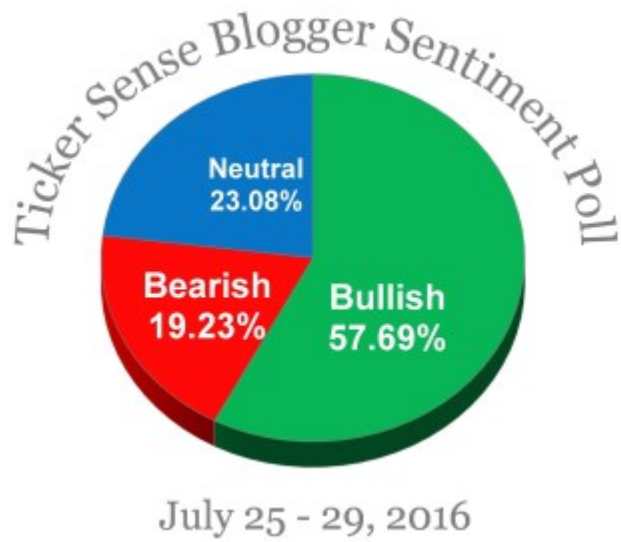
Notable Numbers

AAII Sentiment Survey (figures rounded)

	Current	Last Week	*Long Term Avg*
Bullish	30%	31%	*39%*
Neutral	43%	40%	*31%*
Bearish	27%	28%	*30%*

Well, we are still out of whack as compared with long term averages. Still, the trend in both surveys seem to dovetail with our caution. We even registered the first 2 week-consecutive teeny, tiny decline in the percentage of bulls in months, according to Investors Intelligence. And the correction camp is on the move higher too. The only "favorable" number is that while we continue to witness equity fund outflows (according to Lipper), the dollar amount excluding ETFs was under $7.1 billion for the first time in a month. Frankly, I would rather see a rise rather than a decline to give us a bigger bounce after the expected drop in market values.





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