Goldman SMALL CAP RESEARCH

The Goldman Guide

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INSIDE THIS ISSUE:

KEY TAKEAWAYS

- ⇒ *History regarding Time Warner M&A is bound to scare some people.*
- ⇒ *We view the deal as a good sign of future M&A of all sizes but we foresee someone ruining a rally .*
- ⇒ *The proposed TD Ameritrade/ Scottrade deal is concerning to us*
- ⇒ *When free is bad*
- ⇒ *Recent fund flows data and market sentiment seem to be keeping stocks in a narrow range for the near term*

THE MAJOR INDICES

Index	Close	2016
DJIA	18,146	4.1%
S&P 500	2141	4.5%
NASDAQ	5257	5.0%
Russell 2000	1218	7.2%

(figures are rounded)

Good M&A and Bad M&A

Over the weekend, we had 2 major M&A announcements. Are they good or bad for stocks? Yes to one, no to another, in our view. No we are not being coy. Here is why.

It was nearly 17 years ago today (January 10, 2000 to be exact), when AOL and **Time Warner (NYSE—TMX)** announced a $156 billion merger. Bulls hailed it as an incredible deal—old school media with new media. Pragmatists viewed as egregious and quizzical. Considering the market hit an all-time high a couple of months later and it is no wonder that some market watchers seem to fear that history is repeating itself with news that **AT&T (NYSE—ATT)** and Time Warner are combining in an $80B+ combination.

I see why there is concern here but we do not believe it is the beginning of the end. In fact, it is the end of the beginning the division of service provider and content provider. Now, success is about critical mass, subscriber loyalty, content and time/attention, targeted and higher fee advertising, etc. We view it as a catalyst for more service industry and content provision players of all sizes to combine. Outside of the big players, internet ad dollars are just dreams. Asset leverage, along with fees and ad revenue models are keys to survival and success. Look for future M&A in tech and media of all sizes, buoying the space.

The Stock Market Today

U.S. Stock Market Index Performance
10/23/2016

Index	Close	52-Wk Hi	52-Wk Low	Hi Date	Low Date	% off High	% from Low	% Above 200-DMA
DJIA	18,146	18,668	15,451	8/15/16	1/20/16	2.8%	17.4%	2.7%
S&P 500	2,141	2,192	1,810	8/15/16	2/11/16	2.3%	18.3%	3.3%
NASDAQ	5,257	5,343	4,210	9/22/16	2/11/16	1.6%	24.9%	7.1%
Russell 2000	1,218	1,263	943	9/22/16	2/11/16	3.6%	29.2%	6.7%
Average						2.6%	22.4%	4.9%

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

Bad M&A

The other announced deal, TD Ameritrade potentially buying Scottrade for $4 billion, is more problematic to us. On the surface, this appears to be an extension of some smaller M&A deals of late. However, a combination of 2 of the largest discount brokerages signals to us the continuing decline in individual –directed trading, particularly in smaller stocks where volumes remain down, again. Does this mean the companies need to combine in order to maintain reasonable margins and business? I would feel more comfortable if we had a lot more IPO activity and a more favorable environment for venture capital. Hell, I would prefer if hedge funds were having greater success because that would actually be good for the market at large.

Is “Free” a good thing? Taco Bell is offering free tacos based on an obtuse marketing campaign tied to stolen bases in this year’s World Series. Will it come with or without Tums? **When Chipotle (NYSE—CMG)** gave away free burritos recently to try and get customers to return to the store that didn’t work out too well either. While these foods may not be appetizing, I am curious to see how many voters answer Madonna’s call for the Democratic vote in exchange of, um, oral service that has nothing to do with singing.

Say What?

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

The New York Post

http://nypost.com/2016/10/23/why-a-democrat-controlled-senate-would-sink-wall-street/

How interesting.

Barron's

http://www.barrons.com/articles/faster-smarter-better-the-next-chip-revolution-1477108879?tesla=y&mod=mktw

A must-read!

USA Today

http://www.usatoday.com/story/money/markets/2016/10/23/stocks-fiscal-stimulus/92464802/

A possible market driver?

Bloomberg

http://www.bloomberg.com/news/articles/2016-10-21/hedge-fund-managers-struggle-to-master-their-miserable-new-world

No sympathy.

ZeroHedge:

http://www.zerohedge.com/news/2016-10-23/risk-mass-exodus-doctors-medicare-looms

Ruh-roh.

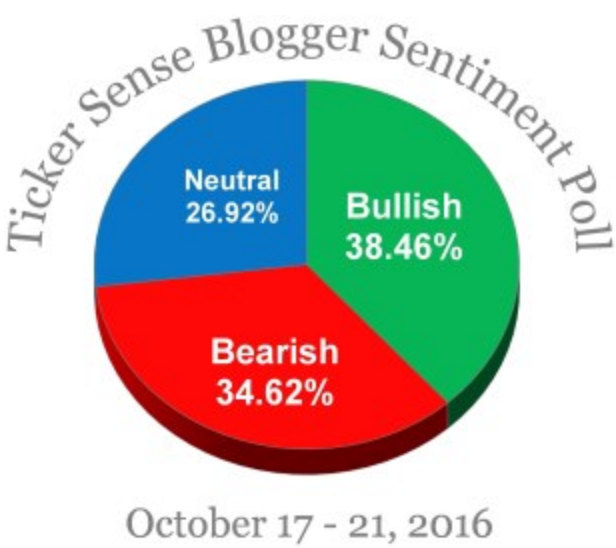
Notable Numbers

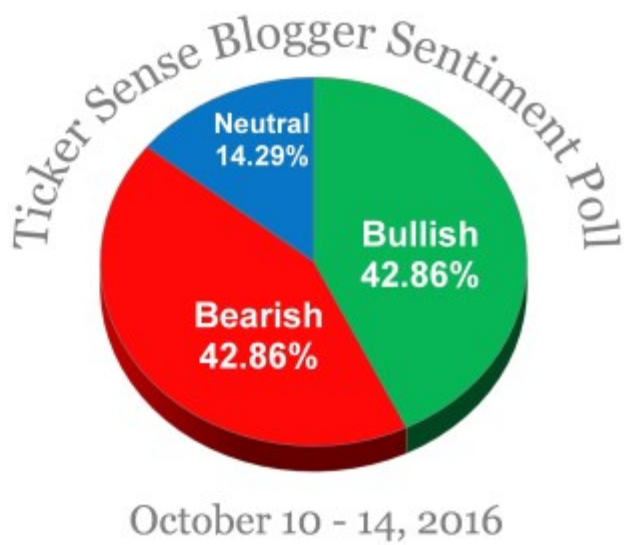
AAII Sentiment Survey (figures rounded)

	Current	Last Week	*Long Term Avg*
Bullish	24%	26%	*39%*
Neutral	38%	41%	*31%*
Bearish	38%	34%	*30%*

Numbers sometimes make no sense. For example, according to the latest Lipper Fund Flows data, the total equity fund outflows last week were $3.4 billion, which happened to be the same figure recorded twice in the previous four weeks. Moreover, taxable bond inflows of the past week were are also $3.4 billion. How weird is that?

Perhaps this equilibrium is further proved by the latest Ticker Sense poll which seems to indicate confusion regarding market direction. We look for M&A activity to serve as a booster of sorts, at least until someone lifts up the hood and ruins even a short-lived rally for everybody.





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