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Carpe Diem

(…or at Least the Dead Cat Bounce)

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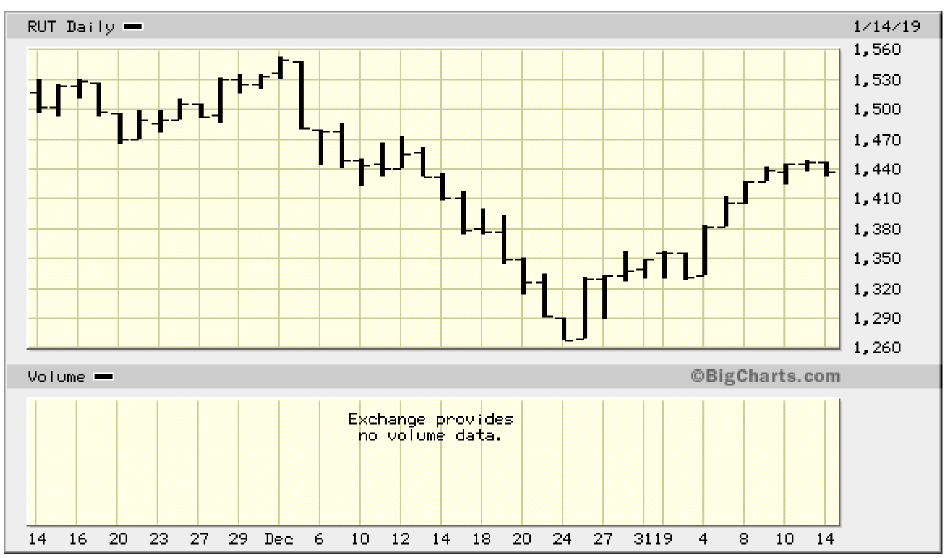
Last month I wrote about some of the stories I saw at the December LD Micro Conference, but I have to say in retrospect, I considered talking about tax selling pressure/opportunities that might unfold as we approached the end of the year. As it turned out, the period from our last letter to the end of the year was dramatically lower culminating in some opportune tax selling fire sales. (The chart below is for the Russell 2000, but the other equity indices were equally as bad):



On the other hand, the bounce coming out of the year and into 2019 has been stark as well, which brings me back to my point about tax selling opportunities. That is, there were several small companies on our radar that (presumably) saw some indiscriminate tax selling and have subsequently made nice moves coming out of the carnage. Here are a few examples. For edification, some of these are from my coverage universe (these are displayed in **BOLD**), while others are from last month's letter and as include some past conference presenters, as well as interesting names I saw at LD Micro and referenced in the December letter.

Stock	Symbol	Price @ 12/24/18 Close	Price @ 01/11/19 Close	% Change	Notes
AzurRx BioPharma	**AZRZ**	**$ 1.05**	**$ 2.28**	**117.1%**	**Coverage Stock, mentioned in last month's letter**
PetroShare	**PRHR**	**$ 0.40**	**$ 0.84**	**110.0%**	**Trickle Coverage Stock**
Cipherloc Corporation	CLOK	$ 1.15	$ 1.60	39.1%	mentioned in last month's letter
SRAX (Social Reality)	**SRAX**	**$ 1.70**	**$ 2.36**	**38.8%**	**Coverage Stock, mentioned in last month's letter**
Enthusiast Gaming Holdings Inc.	EGLX.V	$ 0.70	$ 0.89	27.1%	mentioned in last month's letter
Enservco Corporation	ENSV	$ 0.37	$ 0.47	27.0%	Trickle Conference Presenter, mentioned in last month's letter
Finjan Holdings, Inc.	FNJN	$ 2.21	$ 2.79	26.2%	mentioned in last month's letter
Lightbridge Corporation	LTBR	$ 0.57	$ 0.70	22.8%	mentioned in last month's letter
OncoSec Medical Incorporated	ONCS	$ 0.60	$ 0.73	21.7%	Trickle Conference Presenter, mentioned in last month's letter
Luna Innovations Incorporated	LUNA	$ 2.79	$ 3.38	21.1%	mentioned in last month's letter
22nd Century Group, Inc.	XXII	$ 2.15	$ 2.60	20.9%	mentioned in last month's letter
Command Center	**CCNI**	**$ 3.55**	**$ 4.26**	**20.0%**	**Trickle Coverage Stock**
Magal Security Systems Ltd.	MAGS	$ 4.27	$ 5.04	18.0%	mentioned in last month's letter
Russell 2000		**1,266.92**	**1,447.38**	14.2%	
S&P 500		**2,351.10**	**2,596.26**	10.4%	

To be sure, some of these returns in what amounts to less than a month are quite remarkable. Further, I limited the list to those that returned 18% or better for the period, but there were several others in this particular universe that returned between 15% and 18% during the time. Of course, each of these requires some context. For example, many microcap names trade with significant spreads, so sometimes the difference between a trade at the bid and another at the offer can be significant of itself. However, I think it is fair to say that 18%+ likely transcends that notion. On the other hand, as the last two rows above suggest, certainly some of these gains are attributable to the "rising tide lifting all boats". To *that* point, I would also submit that the group of stocks above were not the only stocks that saw some tax selling pressure at the end of the year, which is really the issue I am trying to illustrate.

In retrospect, this was probably one of those years where tax selling may have made more sense than perhaps others. I think it is reasonable to suggest that given the equity gains of the past few years, it is not hard to imagine that many investors may have taken some profits in early 2018, which left them with some gains to offset at the end of the year when prices began to deteriorate. Given the favorable tax treatment of capital gains beginning in 2018 as a result of the new tax laws, I am not so sure that tax issues weren't responsible in part for the weakness in the equity markets early in 2018 as people pushed gains into not just a new tax year, but a more favorable tax environment for some. (Recognize, that same argument might undermine my thesis that people were tax selling at the end of 2018 since the real impact of tax rates were also *minimized* by the new tax law).

While I think tax selling can be implicated in some of the yearend weakness, there is certainly reason to question just how much the issue impacted stocks in general. For example, there were plenty of other reasons for stocks to experience weakness in the final days of 2018. Recall, Apple's warning certainly provided a negative backdrop, as did further Fed uncertainty, weakness overseas (China most notably), government shutdowns and any host of other issues. Fundamentally, I still believe that Fed policy has led to extended valuations for many companies, and I don't think the recent market purge (especially given the stark recovery) has rectified that notion.

On the other hand, as perhaps this tax selling exercise demonstrates, while there are many stocks that I view as overvalued, some of them perhaps grossly overvalued, there are many others on the other end of that spectrum. As I have noted before, general illiquidity in the equity markets tend to exacerbate price weakness for many smaller companies. However, while that lack of liquidity may negatively impact temporary pricing for these companies, ultimately, fundamental success will drive valuations regardless of market environments and I think that is a cogent reason to pay attention to emerging names with the potential to generate marked fundamental gains that can translate into much higher stock valuations. In the same vein, I also think it is beneficial to develop a framework regarding those potential valuations so when general market conditions or other scenarios (tax selling) take those valuations to levels that substantially improve their risk/reward ratios, the opportunity becomes easier to recognize.