

THE PERILS OF “FEEL GOOD” INVESTING

As precious metals investors, we really do get to experience all the emotions associated with investing from irrational exuberance all the way through to irrational fear. I quite often find it amusing to watch the financial media reports on the news of an evening and hear about “slumps” or “surges” in some of the key profile industrial stocks. This might involve as little as a 1-2% daily movement in the share price! I guess when you consider how much money is parked in these companies you get a better appreciation of how major these moves can be. When investors become interested in the precious metals sector, many naturally bring this same risk-averse mindset with them. They invest similar amounts of money in companies with completely different risk profiles to what they are used to. This becomes the source of much anxiety and pain as they face the reality of 5-10% + daily price swings. When investing in a Google or a Microsoft, there is much less volatility and emotions consequently play less of an interfering role in the decision making process. In the precious metals sector, however, we tend to have an emotionally charged hot pot! This means the decisions investors make tend to be influenced far more by their emotions than any logical strategy. In the long term, this is a recipe for disaster. You may be wondering whether the precious metals sector being in a bull market negates any of this risk. My answer might surprise you.

The bull market in precious metals actually makes this phenomenon much worse! Many investors have a tendency to chase the stronger performing stocks with very much a short term mentality (instant gratification). They logically equate a rising share price to a “good” company. Now at this point it is important to realize that there are many reasons a share price can perform strongly over the shorter term. Not all of these reasons equate with the company having sound fundamentals. There are not too many companies I have followed over the years which haven't at some point experienced a doubling or tripling in their share prices regardless of the fundamentals. Now, from this point, you could mistakenly conclude that this game is easy. If you invest in any precious metals related company and just be patient, you will experience good times (many “investors” actually do this). Unfortunately, this is far from the truth. You see the gains I am talking about are short term in nature and generally not sustainable. They represent a short term rally in a much longer term decline. For a company to experience sustainable multi-year gains, they generally have to own something of substance and be well managed.

Over the past 18 months, we at the Global Speculator have had the pleasure of generating research reports from the GoldNerds database of fundamental information. These reports are made exclusively available to GoldNerds Pro subscribers. One of the most rewarding parts of being involved with GoldNerds is the opportunity to talk with other investors and share emails. These investors cover the full spectrum of experience and skill sets. In the past, we have taken the results of our research and compared them to a list of comparable companies in order to assess performance. One interesting thing I have detected in my conversations is the common desire of investors to focus their attention on the stocks at the top of these performance lists. That is, the better short term performers. Again, they draw the seemingly logical conclusion that if the share price has been rising, the company must be good and doing something right. On the flip side, they tend to ignore the companies in the bottom half of the list and associate these with being poorly run. Now there are of course instances where this rather absolute (black and white) way of looking at companies paints an accurate picture. If a company does the correct things for long enough, its share price will usually rise. Likewise, if a company keeps making mistakes its share price will invariably fall. However, short term price action, in my experience, is a particularly poor indicator of a company's overall strengths and weaknesses. We have found longer term price action to be a much more reliable indicator. Couple this

with basic sound fundamental analysis and you have yourself the makings of an effective investment strategy. The investors who concentrate on the better short term performing companies invariably lose money. They find themselves second guessing the market and getting caught up in the emotional volatility. When investing in companies that have doubled or even tripled in a 6-12 month period, you naturally wonder whether you may have paid too much. When an inevitable correction arrives, fear takes over and you sell your position. The higher a share price goes in the short run, the higher the volatility. Doubt (lack of conviction) and volatility are a very dangerous combination!

SO WHAT'S THE ANSWER?

When investing for the intermediate to longer term, you need the courage of your convictions. As much as you can, you need to put emotion aside and concentrate on the facts at hand which are the fundamentals. It should come as no surprise that 3 of the best performing companies on our current research lists were the bottom performing companies in the previous 12 month period. One was actually the worst performer! I always suggest to investors that it is the bottom half of the company performance list that deserves their immediate attention, not the top half. The other thing to note is the longer term price action of these stocks. Which companies have a history of growing shareholder value? The next obvious question should be why the market has ignored them over the shorter term (6-12 months). Are there problems? Are these problems irreparable or are they temporary in nature? Once you develop a better understanding of the circumstances, this allows you to take advantage of the often irrational short term price fluctuations for healthier longer term gains. There might be some patience required but the wait is usually well worth it. Profitable investing, in our experience, is more often than not counterintuitive. The research we undertake for the GoldNerds subscribers is very much based on this core principle. For the most part, we let the numbers tell the story. I liken it to a pilot flying by instrumentation in zero visibility. As much as they feel more comfortable using their senses and gut feel, they know it is far safer to rely on the instruments. The fundamentals, importantly, take some of the emotion out of investing. They give you the courage of your convictions to buy on irrational fear and sell into irrational exuberance. The fact that most investors can't be bothered getting a handle on this is why the precious metals sector offers so much opportunity for those that make the effort.

For anyone interested, we write a free monthly newsletter on the precious metals markets. This includes detailed technical analysis on where the precious metals markets are at. Alternatively, for all the latest fundamental information on gold/silver stocks and sophisticated tools in which to utilize it, I invite you to visit GoldNerds. Check out an extract from our brand new [North American Gold Stock summary](#) PDF report.

Troy Schwensen

Research Analyst
www.globalspeculator.com.au

Editor of GN North America
www.goldnerds.com.au

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