

ANALYZING MINING STOCKS

Finding those resource diamonds in the rough. Have you ever wondered if there is a way to quickly and easily find resource stocks that have the highest potential for gains?

by Matt Blackman

How often have you bought a stock on a hunch or after hearing a “hot tip” only to watch helplessly as it drops in price? This brings up another interesting question. How do you pick stocks?

Some simply rely on recommendations from their brokers. Others rely on financial TV programs for their research. If the system you use is consistently making you money, congratulations! You are member of a small but elite group of investors. But the reality is that playing the stock market is no simple task, especially considering that most TSX Venture companies are exploration companies with little or no earnings. Pouring over financial statements and filings is usually of little help. While no system in the world will remove the risk of loss, here are a few ideas that will help you find winners while keeping you from losing your shirt.

SEASONS IN THE SUN

Before deciding what to buy, it helps to know if a stock is cyclical. The chart below indicates the cyclical nature of resource stocks. Seasonal cycles will often move the stock.

We analyzed various resources for the evidence of seasonal cycles. While seasonality is not the only consideration when deciding when to buy or sell, it is important in providing a timing backdrop. It is also important to point out that seasonal cycles are not ironclad. They change over time as conditions change so it's important to con-

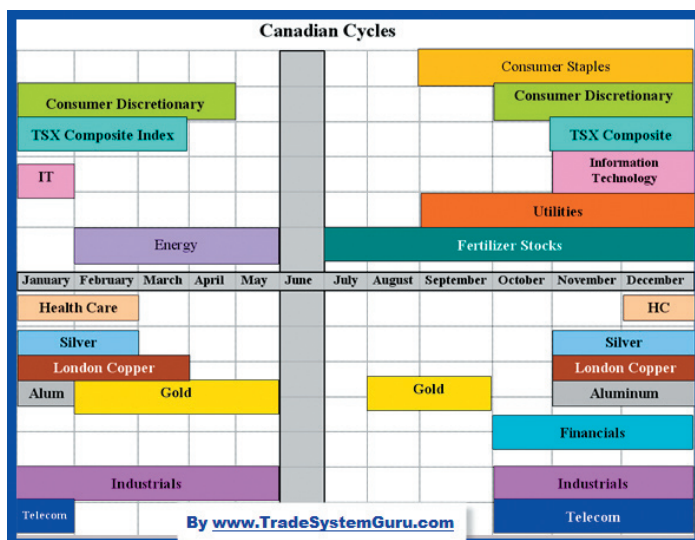


Figure 1 – Graph showing cyclical periods for various sectors on the Toronto Stock Exchange. Chart by www.TradeSystemGuru.com

duct periodic tests to insure they are still in vogue before relying on them to time your trades. Figure 1 shows the patterns we found in backtesting for stocks and commodities on Canadian markets.

SCREENING FOR SUCCESS

Stock trading record holder Dan Zanger who turned \$11,000 into a cool \$42 million in 23 months in 1999-2000 tells an interesting story about a call he got from regulators a few years ago. He'd sold a rather large position in a stock that got pummeled a couple of days later. Suspecting that he might be operating on inside information, they wanted to know why he'd sold when he did.

“The stock was no longer going up and I make it a habit of getting rid of any stocks that have stopped moving higher,” he told them. It was a short phone call but clearly demonstrated his momentum policy. If a stock isn't moving up, why continue to hold it?

Here is our shopping list used to build our stock screener. While the one we used (VectorVest Canada) is subscription based, there are some free screeners available that do a reasonable job of helping in the task (please see link at the end of this article). The difference is that they require more manual work.

- 1 Exchange – TSX Venture Exchange.
- 2 Industries – Energy and mining-related stocks.
- 3 Price – \$0.05 or higher.
- 4 Volume – To facilitate quick and easy entries and exits with a minimum spread cost, we want liquid stocks that trade an average of 50,000 shares per day.
- 5 Momentum 1 – Since we are looking for short-term trades we used a weekly gain of 5% as our performance or delta parameter. If you're looking for a longer hold, use a longer period but remember that this group tends to be very volatile. The longer you are in the trade, the greater the risk.
- 6 Momentum 2 – To eliminate stocks trending lower, we searched for stocks that have not dropped significantly in the last four weeks.
- 7 Momentum 3 – To find stocks in near-term uptrends we added the condition that the 5-day simple moving average (SMA) was above the 10-day SMA. Moving averages are a great way of smoothing a volatile stock and providing a clearer picture of what is going on. Stocks in an uptrend have shorter-term moving averages above longer-term.
- 8 Fundamental criteria 1 – TSX Venture resource stocks don't generally have earnings, so using price/earnings, price-earnings-growth or other traditional ratios won't work. But we want to

Selected Date	Parameter	Operator	Value
Date of Search	Stock Exchange	=	V
Date of Search	Industry Group	=	Selected Industries
Date of Search	Stock Price - (Actual)	>	0.05
Date of Search	Stock AvgVol - (50 day moving Average Volume)	>	50000
Date of Search	Stock Price - (Actual)	5 Day Delta	> 5.00%
Date of Search	Stock Price - (Actual)	4 Week Delta	>= 0.00%
Date of Search	5 Day MA(Price)	>	10 Day MA(Price)
Date of Search	Stock GRT - (Growth Rate)	>	0
Date of Search	Stock EPS - (Earnings Per Share)	13 Week Delta	>= 0.00%
Date of Search	Stock RV - (Relative Value)	4 Week Delta	>= 0.00%

Table 1 – VectorVest stock screener showing parameters used. For definitions of each please see <http://www.vectorvest.com/definitions/>

avoid those stocks bleeding cash. To eliminate these stocks, we searched for those with rising earnings per share (EPS).

9 Fundamental criteria 2 – To locate companies that are growing, our search eliminated companies that have declining stock growth rates (GRT).

10 Value – Our last parameter was to find companies in which the relative value (RV) based on analyst estimates was increasing.

For a more detailed explanation of these definitions please refer to <http://www.vectorvest.com/definitions/>

Last, but certainly not least, we need to give each chart the visual once over. Ideal candidates should show a strong chart without too much noise.

AND THE WINNERS ARE...

Since gold and energy have similar seasons (seasonal cycles that start at the end of January and end at the beginning of June), we used the period from the end of January to May 2007 for our backtest.

In all, five companies came up in our search on January 29. Aeroquest International (AQL), a commercial airborne survey company that utilizes sensitive equipment to search for new mineral deposits by aircraft (see Figure 2) was on top of the list. Wyn

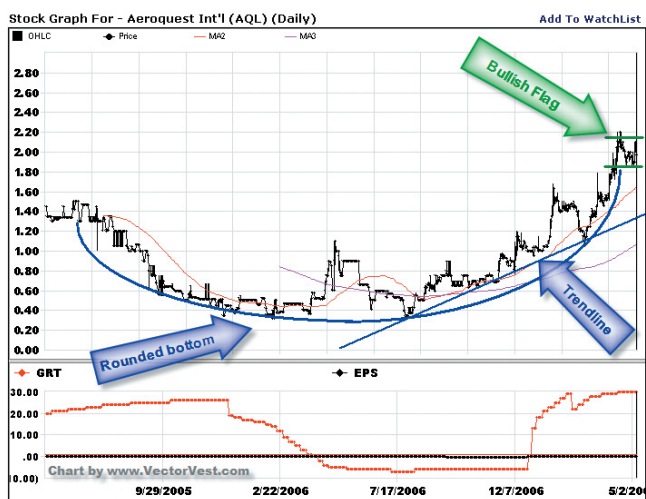


Figure 2 – Aeroquest (AQL) came up in our search. Not only does it demonstrate positive chart patterns such as a bullish rounding bottom and positive flag pattern, it also possesses some impressive fundamentals in the way of an accelerating growth rate and positive earnings per share. If price breaks below a support trendline or moving average, it is best to exit and wait for the rise to resume.

Developments failed the visual chart test.

In backtesting the four stocks making the cut, only one stock lost money. They gained a total 16.13% between January 23 and May 1, which is impressive considering the meltdown we experienced in the final week of February. Energold Mining (EGD – Figure 3) was the top stock gaining 32% over the 13 week period.

SYSTEMATIC INVESTING

Buying on tips or hunches may work for some but it has a number of challenges. Here is an approach that takes the emotion out of the process and should help you find winners on a more consistent basis.

It is important to utilize a stop loss no matter what you buy – sell the stock if the expected move does not materialize within a week or two. By using a system that combines the best of stock momentum, chart patterns and fundamental parameters, you greatly increase your chances for success.

STOCK SCREENERS AND EXTRA STOCK CHARTS

For links to free and subscription stock screeners online, please go to: <http://tradesystemguru.com/content/view/45/9/>

The program used for this article is VectorVest Canada (Subscription based) <http://www.vectorvest.com/products/onlineca.htm>

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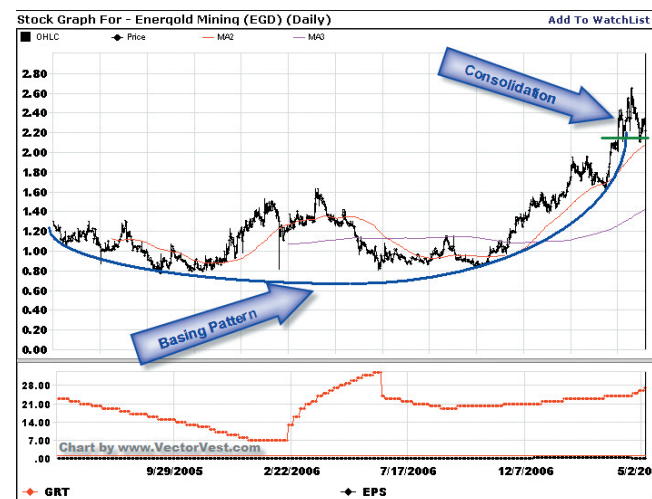


Figure 3 – Energold Mining (EGD) is another stock that came up in our search. This company also has positive earnings per share (\$0.17) and an accelerating growth rate (GRT – red line). This stock has a relative value (RV) of 1.53 which means that based on three-year price appreciation potential computed by Scotia Capital, the stock should continue to rise.