



Michael S. (Mickey) Fulp M.Sc., C.P.G.

MercenaryGeologist.com
contact@mercenarygeologist.com

The Power of Two: A Primer for the Lay Investor

A Monday Morning Musing from Mickey the Mercenary Geologist

Contact@MercenaryGeologist.com

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The most important concept of my investing philosophy in the junior resource sector is the Power of Two. It was first discussed in slightly different terms shortly after I launched my website a little over two years ago ([Mercenary Musing, May 19, 2008](#)).

The Mercenary Geologist investing philosophy requires actively trading stocks. There are no “buy and hold” scenarios in my portfolio. That said, there are trades and there are investments but that’s a subject to be tackled in a future musing. My trading methodology employs a very conservative strategy to speculate in a very high risk market sector.

As I have reiterated time and time again, junior resource “investing” is actually gambling. Use your discretionary funds, your “fun money”, money that you can afford to lose without risking the house, the wife, and the kids. My trading style is designed to skew the gambling odds in my favor and turn that fun money into *more money*.

Stocks in the junior resource sector are not suitable for your IRA, 401K, or RSP. Retirement accounts should contain lower risk, relatively safe investments. If properly managed, they will produce steady but unspectacular returns over the long haul. There is nothing “safe” about trading your hard earned dollars for a fancy piece of paper from a junior resource company.

Now let’s get back to the Power of Two. Here is a simplified example of how it works:

- Buy shares in a junior resource stock that you have researched thoroughly and think that it will double in price in 12 months or less. Let’s say you invest \$10,000 in a 20c stock, buying 50,000 shares.
- When the stock doubles, sell one-half of your position. Your cost basis for the remaining half position is now zero. You have taken all your money off the table and are playing this stock with house money; i.e., other people’s money. You now have \$10,000 cash and own 25,000 shares worth \$10,000.

- Take your original \$10,000, do detailed due diligence, and invest in another junior resource stock that you think will double in twelve months or less.
- Again sell one-half upon a double in price. You now own one-half of your original positions in two companies, have zero cost basis, and shares worth \$20,000. With your original investment of \$10,000 still intact, your worth in cash and paper is \$30,000.
- Do it all over again.
- Then again and again.

At iteration five, you have maintained but not increased your original \$10,000 investment. You have a zero cost basis and hold half of your original holdings in five stocks that are now worth what you originally paid for them. You have \$10,000 invested in company number six. In cash and paper your gross is now \$60,000. By trading five stocks at the point when they doubled, you now have the net worth of a five bagger and have preserved your original capital.

I'm ignoring brokerage fees in this analysis but even using a full-service broker, they should not amount to more than 2% of your gross trading amounts. You can add those fees into your selected sale price to achieve a net double on your trades.

While you play the market smartly, the average lay investor hangs on for two, three, or four years for the proverbial five or ten bagger that never comes with his warmed-over casserole of a dog's breakfast portfolio. Because he buys and holds and does not trade actively or efficiently, he wins some and he loses some *on paper*. The proportions of each are largely dependent on the overall bullish or bearish condition of the stock market. Most often he ends up holding a bunch of worthless paper in fly-by-night juniors since at least 95% of companies eventually fail in the sector.

However, doubles within twelve months are the general rule in the junior resource sector. Examine the 52 week high and low of all the penny exploration stocks that are active and try to find more than a handful that have not traded at two times their lows, or if you're a pessimist, one-half of their highs year over year over year.

Though doubles are the rule, five or ten baggers are a very rare commodity even in our most speculative of businesses. The fact that they happen occasionally is what attracts gamblers to our sector. And like the addicted gambler who fails to cash in his winnings and leave the table, the average investor waits too long to sell his paper gains and they eventually become losses. Meanwhile, you my friend have become a wildly successful speculator by employing a disciplined trading regimen.

In a bull market, this trading philosophy is an infallible way to make money. The continuing secular bull market in commodities, even with recurring 10-30% corrections and episodic bear phases, offers ample opportunities for the junior resource speculator to prosper. Market corrections and bear dips within the overall cycle present good buying opportunities.

The key for success is to pick good companies based on thorough research and due diligence into three criteria ([Mercenary Musing, December 15, 2008](#)):

- Share structure
- People
- Projects

Adopt a contrarian philosophy and buy particular issuers based upon these fundamentals when no one wants them, i.e., when volumes are low, the share price is down, and they are undervalued with respect to their peers. Sell half upon a double and do it again and again and again, *ad infinitum*.

A corollary to my trading philosophy is trading your zero cost basis shares. Program selling of tranches at regular intervals on the upticks and putting in trading stops to cover potential downticks will maximize your profits. Wealth is not and will never be made of paper in the stock market; otherwise the government surely would tax you on the value of your stock certificates. You must monetize those gilded paper certificates to realize gains or losses.

Programmed trading of stocks when they double and at regular intervals on the uptick leverages the Power of Two (and Three, Four, and Five!). Be logical, be disciplined, be systematic, and be unemotional in your trading patterns.

In other words, adopt a Vulcan philosophy. May you *live long and prosper*.



Ciao for now,

Mickey Fulp
Mercenary Geologist



The [**Mercenary Geologist Michael S. "Mickey" Fulp**](#) is a Certified Professional Geologist with a B.Sc. Earth Sciences with honor from the University of Tulsa, and M.Sc. Geology from the University of New Mexico. Mickey has 30 years experience as an exploration geologist searching for economic deposits of base and precious metals, industrial minerals, uranium, coal, oil and gas, and water in North and South America, Europe, and Asia.

Mickey has worked for junior explorers, major mining companies, private companies, and investors as a consulting economic geologist for the past 22 years, specializing in geological mapping, property evaluation, and business development. In addition to Mickey's professional credentials and experience, he is high-altitude proficient, and is bilingual in English and Spanish. From 2003 to 2006, he made four outcrop ore discoveries in Peru, Nevada, Chile, and British Columbia.

Mickey is well-known throughout the mining and exploration community due to his ongoing work as an analyst, newsletter writer, and speaker.

Contact: Contact@MercenaryGeologist.com

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