

Today's Notes:

1. Discovery Investing

1. DISCOVERY INVESTING

About a decade ago I began to realize that there was a big hole in investing theory and practice. At the time I didn't realize that my ideas would morph into a new approach that I have named Discovery Investing. The question you might ask is how this investing discipline is different and, more importantly; how is it better than strategies that academe has provided.

First, though, we must define the technique. Discovery Investing is a discipline that seeks significant value creation through market recognition of a world class discovery. For example the discovery of a cure or effective treatment for cancer would be worth billions of dollars as in the recent case of Imclone and its pancreatic cancer treatment Erbitux. More recently we recommended Western Silver as a Discovery company. After 6 years of drilling in Zacatecas, Mexico the company, under current Quaterra Resources CEO, Dr. Thomas Patton had discovered millions ounces of gold and several hundred million ounces of silver.

Some of the most interesting discovery names today include companies such as MegaWest Energy, Revett Minerals (Mining silver and copper), Quaterra Resources (diversified world class metal discovery), Senesco Technologies (Cancer), Neuralstem (ALS), Silver Wheaton, Endeavour Silver, Ventana (Gold) and Antioquia (Gold).

Discovery Investing seeks these types of wealth creating opportunities. They may be found in the natural resource sector, the bio tech sector, high tech or, today, in the infrastructure space. The reformation of the Utility sector (the development of the electrical grid) is a good example of how the Discovery Space tends to expand and change over time. Almost universally a major discovery pays a wealth dividend. The recent focus on health care and alternative energy discoveries has spawned dozens of new discovery companies.

This is virtually an untouched investment space. Usually these stocks of discovery companies are small and illiquid micro caps especially at the beginning of their life cycle. Nobody cares about them. They are "under the radar screen." I developed a ranking mechanism to identify the best of these opportunities. It is called the Ten Point Discovery Grid. It is easy to use just look at the grid's analysis points listed below. Each discovery factor is rated by its potential between 1 and 10 (10 points being the optimal rating).

1. Discovery potential: Does this discovery, in your analysis, have world class value creation potential?
2. Ownership share: Does the company own control of the asset? Is it close to 100%?

3. Is the potential discovery a game changer? Is it revolutionary? What is the immediacy of its use and the current progress toward its realization?
4. Is there diversification of discovery risk? Is there a chance for serendipity (good luck)? Are there multiple opportunities?
5. Management and the Board of Directors: What is the track record of management, ownership, insider buying and management option strategy?
6. Can you identify a driving cycle (e.g. the Global Quality of Life Cycle) and a Catalyst (the discovery)?
7. Is this a Contrarian discovery play? Are you buying into this for pennies?
8. Is there financial strength, superior balance sheet and income statement management, sustainability of operations and dilution strategy?
9. Does the company communicate adequately with employees, shareholders and customers in its stakeholder relations program?
10. Does the investor exhibit self control, patience, courage, the ability to sustain loss and the ability to continue to invest?

Using the Discovery Grid defined above you will be able to rank order your prospective discovery companies. Initially you will want to own 6 to 12 companies – no more. Diversification is critical but “closet diversification” is deadly. In D.I. it is most important to invest as early as possible (the grid helps immeasurably here) and to buy a large enough position to **MAKE A DIFFERENCE**. When you begin to invest using this discipline buying a hundred shares will help you learn the technique. Once you think you have mastered the process you will want to own much larger positions – the true value of Discovery Investing.

I provide one word of warning to the investor. Just as in baseball the most successful batters fail 7 times out of 10, so too in D.I. you will fail a like amount. Diversification and the tremendous risk reward ratios in D.I. will work in your favor on those two to three big wins that the investing discipline offers. You will also find that by selling to recoup your original investment on share price gains of 100% to 200% you will lessen the pain of any downside losses that may accrue.

We have found this Grid technique to be extremely useful in both buying and selling discovery companies. In the next few weeks we will be offering a series of Case Studies using the Grid that will help you to practice the technique. Good Luck in your discovery investing.

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