Louis Paquette's

EGS EMERGING GROWTH STOCKS

"Finding Extreme Value in Small Caps"

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Tale of two Canadian Indexes

Composite soars to new highs while Venture flounders

The last couple of Issues, in addition to obsessing over gold as we do almost every time, we took a look at the CRB Index as a gauge of the overall commodity markets. This Issue, I thought we would take a look at the two main Canadian stock Indexes to give readers a feel for where we are at. We are constantly exposed to the major U.S. Indexes such as the DJIA and the S&P 500. But most of our stocks are Canadian listings so we should keep a close eye on the Canadian indexes as well.

As you can see, the **S&P TSX Composite Index** (top chart) has just reached new record highs. In itself, is a positive sign technicians take as a buy signal. As a cheap contrarian who prefers to buy only when on sale - it makes me nervous. Does the break-out have momentum to carry on to new higher highs, or is the chart really forming a large lopsided triple top? A longer term look at the chart shows it has more than doubled in the past 5 years. Is this kind of growth sustainable? Of course it's not, unless supported by corporate earnings growth at a similar 20% annual rate.

Other concerns would include the lack of breadth (half of the Index gains lately have come from just five stocks such as **Encana**, **Potash** and **Research in Motion**). Also notice how the long term upward sloping trend line was violated, if even only temporarily during the first half of the year. While the Index quickly regained its composure, one has to wonder if the shot across the bow earlier was a warning of more to come.

And even as the Composite Index has made new all-time highs, the Venture Index is hovering just above its 52-week lows. Since mid-2007 where it peaked, the Index has been forming a descending triangle with a series of lower highs and a bottom just below 2,500. The Index is at a pivotal point, at the end of the large triangle where it either has to break out or down from soon.

...Cont'd on page 2. See: Venture Index

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Venture Index, Cont'd from Page 1.

There are a number of reasons for the poor performance compared with its senior brethren. Topping the list would be the general move away from riskier investments since the credit bubble burst last August. And since smaller caps are deemed higher risk than larger more established companies, capital is being diverted away from them. You can put some blame on the proliferation and popularity of ETFs which are diverting capital away from gold stocks. The failure of gold to get back to new highs like crude oil did isn't helping matters any either.

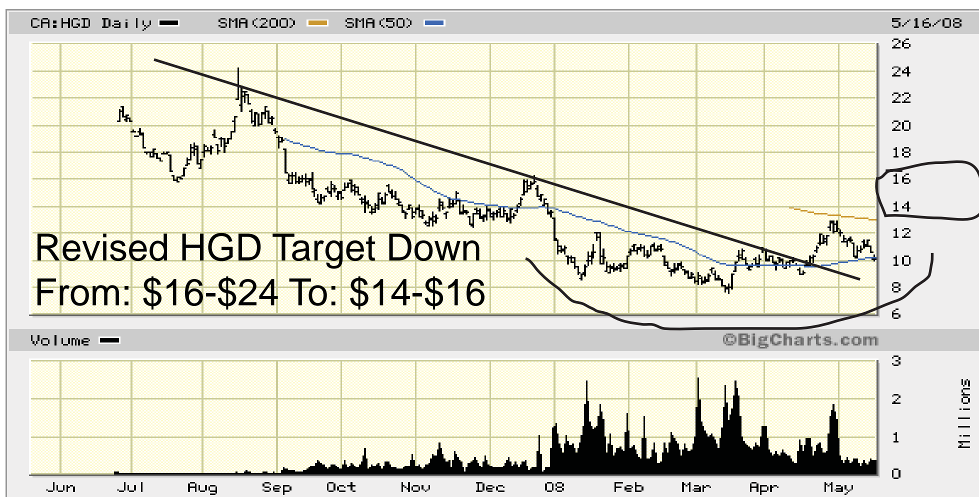
My guess is, if Gold makes a new low below the recent $850 low last month, then so will the gold exploration company laden Venture Index.

GOLD, HUI AND HGD Revised Targets

Immediately after the April Issue was printed, several items we anticipated happened. The U.S. Dollar Index has actually rallied and Gold has stair-stepped its way down to as low as $850 before rebounding. As we go to print the rally has gained steam. So I'd like to take this opportunity to revisit the charts and revise the targets we gave last Issue in light of the progress to date.

Gold - The chart has now completed the "A-B-C" formation we anticipated and has formed a downward sloping channel heading to the 200-dma which continues to rise. What it looks like now is that the A-B-C wave is also now forming the A wave of a larger formation. "B" wave, starting now could retrace 50% of the A wave from $1,000 down to $850 or $75 back up to $925 or so. Then a Wave C down would commence into the summer months and ultimate seasonal low. This would be the exit target for HGD.

The 200-dma is moving up towards $840 so we are revising our previous target of $800 up to $840. The recent low around $850 just may be the low of the trading range going forward. I'm torn between this scenario - or one where we see one more big leg down (C Wave) that penetrates the 200-dma, if only by $5 or $10.



HUI Index - Closed at 434 just below the 50-dma at 442 - previously support but now becomes resistance. I would revise the HUI Index target down just a notch from 380 to 375 if the low range for gold turns out to be $850, lower if not.

HGD/ETF - The targets I gave for this Inverse ETF were way too high! Gold would need to get down to $650 to reach the high end of our $16 to $24 target range.

Let's bring that down to **$14 to $16,** since this is where it traded when gold was last at $800 to $850. Still, not a bad return, considering when we gave HGD the real hard sell in the middle of March with gold at over $1,000, it was at $7.88, translating into just over a $6 gain or +77% return if it reaches our lower target and a double at the high end, and all in just six months or less (by August).

Is crude oil a cruising for a bruising?

Should HOD be our next victim?

NEW PICKS

Let me say off the top that I doubt we'll resolve the fundamental bull and bear debate here. That might take a book. On the one hand we have pretty smart guys like **Jeff Rubin** and **Don Coxe** pounding the table and still bullish. And we've heard the rest so many times now; the insatiable China/India demand, Peak Oil theory, etc. On the other hand, we have good old fashioned non-linear thinking, combined with Economics 101. Sooner or later, demand gets destroyed, substitutes get made, increased investment boosts supply, and before you know it, the bull transforms into a bear.

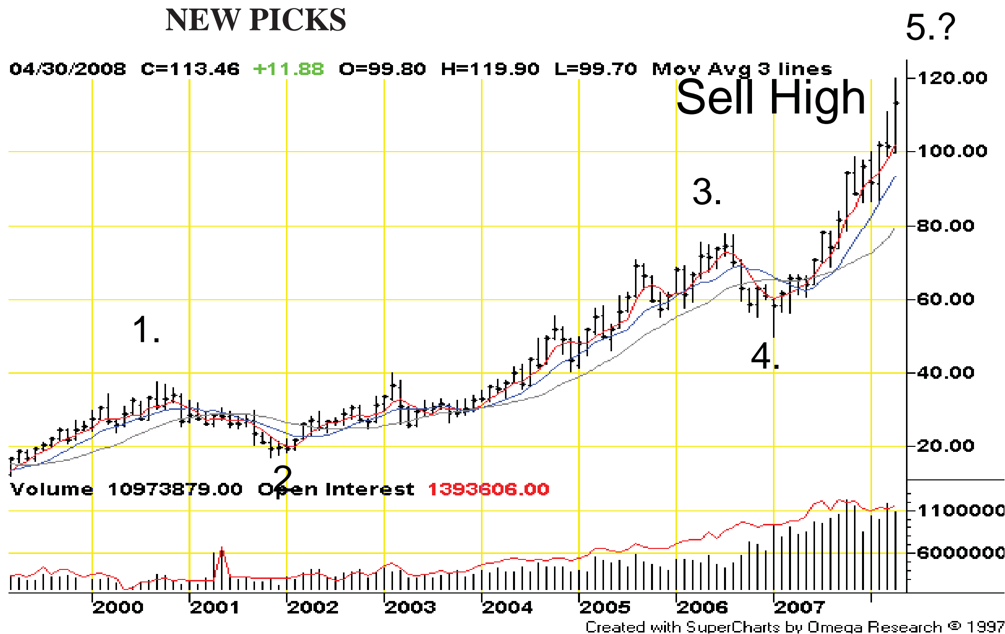
I don't know which is the right answer to that question. Let's just call this more simple case of the **Frank Holmes** method of spotting oversold situations - *"Prices always revert to the mean."* Anytime some Index or commodity gets parabolic and moves 20%, or 25% above its 200-dma, it's usually cruising for a bruising (sharp reversion to the mean).

Speaking of Frank, he has an article on Kitco entitled: **Odds Favor Short-Term Slip for Oil** (www.kitco.com/ind/Holmes/holmes_may152008.html) with a more sophisticated tool, a long term oscillator chart which has only been more overbought on two other occasions over the past 20 years. And on both occasions, prices subsequently tumbled back to the mean.

Here's my quick summary of reasons for why oil may be close to correcting;

1. U.S. to stop adding 70,000 b/d to Strategic Petroleum Reserve (a modest but symbolic act)
2. Saudis to boost shipments by 300,000 b/d
3. Oil and gas prices typically correct after the Memorial Day weekend
4. Demand destruction is starting

Not to mention, the unsustainably steep rate of incline of the 10-year chart above, since early 2007. Or the way the chart seems to be tracing a Wave 5 of what appears to be a large, Elliott wave pattern.



So the next question is how to play this. The passive investor uses this to just stop entering new long positions until after the anticipated correction runs its course. The more aggressive and adventurous might want to play it exactly the same way we played the downside in Gold; the Horizon BetaPro Oil Bear Inverse ETF, **HOD.TSX $9.20 -$0.41**, see the chart above. As you can see, it's falling even more rapidly than the price of crude is rising. A couple of comments though, about this strategy.

First off - this could be early - the trend remains down (up for crude) and purchasing now is bottom fishing and the price could fall further.

Secondly, compared with the reliability of the Gold seasonal cycle, I would consider crude more subject to the wild card of some abrupt geopolitical event blowing the lid off the price. You don't want to be long too much HOD in that case. One too many Nigerian pipeline explosions, a looming showdown and war with Iran, hurricanes in the Gulf of Mexico - any number of things could do it. Therefore I am not putting nearly as much into HOD as HGD. Finally, I suggest easing into it, buying a bit at a time, as crude makes successive highs and gets more and more overbought, with the idea of averaging in over the top.

.....New Picks Continued.

Sell in May and go away?

I'm not including any new stock picks this Issue; not because there aren't any relatively cheap juniors to look at. I just loath to add new stocks to our portfolio when history is telling us this is a really bad time of the year to buy them!

Evidence for the *"Sell in May and go away"* slogan was recently well documented in **John Mauldin's** publication dated May 17th, *The Fed at the crossroads*. According to a study he quoted by *Ned Davis Research*, had you put $1,000 into the S&P 500 on May 1st and sold it by October 31st, every year since 1950, you would have virtually no gains - today it would be worth $10,026. Whereas, had you done the reverse strategy and bought on Nov. 1st each year and sold by May 1st, your $1,000 would now be over $370,000 today. Virtually all of the gains take place in the more favourable six months of the year (Posted at: www.investorsinsight.com/).

And even as we aren't inclined to swim upstream against this current, I'm not all that sure about selling aggressively. After all, we were not treated to the usual spring rally as one can see from Venture Index, short circuited by the credit debacle and increased aversion to risk ever since last August.

I think it's just a matter of something else I read recently that seemed to make a lot of sense; that when it came to successful investing, it's often a matter of what you avoid, that leads to above average returns. And with a rally in the U.S. getting stretched, with the TSX at record highs, with gold and oil set to pull back, and the aforementioned seasonality so negative going forward the next six months, I don't think it hurts to step back and wait for lower prices to come to us. ;-)

UPDATES - Agriculture Picks

We've made five Agriculture-related picks to date, four of which are Fertilizer situations. These "ferts" have now appreciated by an average of 238% since they were picked. And even as the Agriculture theme may last for some years, it may be time to start getting more cautious on adding new positions. Prices of the grains and stocks have had terrific multi-year runs and some things such as Wheat have totally blown off and given back as much as 45%. And unlike energy (oil and gas) there is ample long term reserves of Phosphate and Potash. In time, the field will get crowded and prices will retreat. The easy money has been made. I would not hesitate to take profits on the ones that have delivered doubles or more and I would be more cautious about adding new ones.

PotashOne KCL.TSX-V $3.41

Picked: Oct-06 @ $0.25, Aug-07 @ $1.00

Finds new home for PH's 6M shares

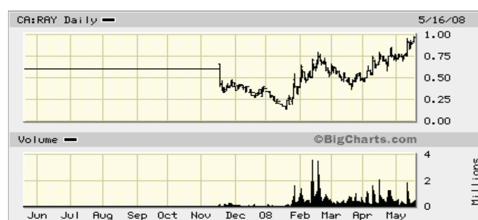
KCL remains our premier junior fertilizer holding with the greatest chances of going to production or getting bought out. Numerous newsletters have come in behind us recommending it. Still, it is struggling to hold $4.00. It's digesting previous financing at lower levels while awaiting new developments. Of course given our gains to date we'd be selling some by now and holding some too if a person wants continued exposure to this area.

Raytec RAY.TSX-V $0.97

Picked: Feb 3-07 EGSNEWS @ $0.47

Take the money and run?

I was looking for a possible double on this one, and we got it. Take it.



Legend Int. Hldgs. LGDI.OTC $3.32

Picked: Feb 2008 Issue $1.22

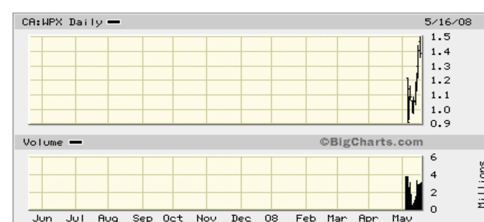
Signs sales contract with India

LGDI is rivalling KCL for our top performing fertilizer stock. It got to as high as $5.05 on the news May 5th that they have signed a multi-year contract to ship three million tonnes a year of phosphate concentrate to India's largest farm collective. I would suggest taking some off the table in strength and also holding some as this one may have what it takes to make it to production in this decade.

Western Potash WPX.TSX-V $1.32

Picked: May 4-08 EGSNEWS $1.10

Signs sales contract with India



When it finally was about to debut, we suggested buying as close as possible to the $1.10 IPO price. We got a brief window just below that, then just as we wondered if the IPO might have been too aggressively priced, investors swarmed the stock. I think investors sense this could be the next PotashOne with a hand full of drill holes. For now I stick with our previously stated $2.00 target.

Our fifth agriculture related pick, **Hodgins Auctioneers HA $0.34,** has had no significant developments since it was picked in April.

Next Appearance:

World Resource Investment Conference, World Trade Centre, Vancouver, BC June 15 - 16, 2008
Register at: www.goldshow.ca
Attend the free EGS Workshop:
Profit when Gold rises or falls with ETFs
11:00 am Monday, June 16
See conference materials for room location

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