CHAPTER 1

The Big Business of Penny Stocks

PENNY STOCKS ARE BIG BUSINESS

Experience Level I

They may sound small, but penny stocks are big business. The phrase "penny stocks" is one of the most popular financial searches on the Internet. In fact, it gets more searches than terms like "stock picks," "stock quotes," "New York Stock Exchange," or "stock broker."

This translates into tens of millions of investors in America, and millions more worldwide, actively searching for information and guidance on penny stocks. Unfortunately, hidden motivations abound, and misinformation outweighs the amount of proper analysis. As the Penny Stock Professional, I am actively working to change this state of affairs.

My team and I help people avoid some of the common dangers, and find the best penny stock companies with the greatest upside. You'll find that it is quite simple—it's extremely lucrative to get involved with the best 5 percent of penny stocks. These companies will have:

- Strong management teams
- Good upside potential
- Proven revenues

- Patented technologies
- Solid financial trends

Finding and investing in the best penny stocks is one of the most lucrative ways to make money on the stock market, or to make money at anything for that matter.

Experience Level I

Broad Appeal of Penny Stocks

I love the broad appeal of penny stocks. Unlike most investment vehicles, which get the attention only of specific types of people, penny stocks seem to generate interest among all types of investors, of all skill levels and all financial situations.

If you are a beginner, you'll learn about trading quite quickly, because penny stocks move faster and are more volatile than more conventional investments. Your learning curve will be much shorter than if you just put money into IBM and let it sit there for a year or two.

If you have limited funds to invest, penny stocks give you the potential of actually making something out of your money. A $1,000 investment can multiply many times over, compared to putting that cash into a slow-moving blue chip or a super-safe bond, even if you let it sit there for years and years.

If you are an experienced trader, penny stocks are appropriate for a portion of your portfolio because they add excitement and big-gain potential to your investments.

If you know what to look for, and thus get involved with really high-quality companies, it can translate into massive gains. So many of these high-quality penny stocks are trading for pennies a share simply because they are:

- Overlooked
- Undiscovered
- Unfairly valued
- Sold off in sympathy with a sector or the overall market

Look, I've been involved with investing from all angles, and still am, including:

- Real estate
- Derivatives/options
- Penny stocks
- Large-cap stocks

Based on extensive personal experience, and the many years of analysis/research/editing I've done at PeterLeeds.com, I've come to the rock-solid conclusion that:

Penny stocks are the most lucrative and realistic method for building wealth that I've encountered.

With penny stocks, gains come more rapidly and the returns are greater. What's the point of putting $500 on some massive company, and a year later you've made 10 or 15 percent on your money? And that's considered a good return? *Hello, 45 bucks*—big deal!

All you've done is tied up your money for a year to make an insignificant profit (or maybe even took a loss) and given up the opportunity to have that $500 potentially do something more. Maybe something *much* more.

Especially if you have a small portfolio, the gains you will probably get from blue-chip stocks are going to seem insignificant. They aren't going to change your life. There's no excitement in it.

Yet people are afraid of penny stocks, and might argue that blue-chip stocks, like GM and IBM and Exxon, are better investments because they're based on better companies. Yes, blue chips are a lot better than 95 percent of the penny stocks out there. However, in terms of upside potential, growth of your investment, and life-changing profits, the 5 percent of penny stocks that make the Leeds Analysis cut represent far more compelling investments, and very often are far superior companies. They're just smaller. Much smaller. And the best part is once you find these high-quality penny stocks, you get to pick them up for pennies a share!

As the Penny Stock Professional, my job is to help steer you toward the 5 percent of penny stocks that may dramatically outperform every other investment option that's out there, including so-called "safe" blue chips.

Experience Level I

The 5 Percent Rule

Only about 5 percent of penny stocks pass Leeds Analysis. Those that pass the test are:

- Significantly more likely to outperform the rest
- Fundamentally very strong
- Less likely to suffer downside price moves
- More likely to enjoy massive upside potential

Some of the criteria we look for with Leeds Analysis include, but are not limited to:

- Strong management teams
- A track record of gains in revenues
- Accelerating increases in earnings
- High barriers to entry to the industry
- Company approaching profitability or already profitable
- Low or no debt load
- Patented technologies and/or strong intellectual property rights
- Involvement in a growing industry or market
- Strong and long-term competitive advantages
- Superior and effective branding, positioning, and marketing

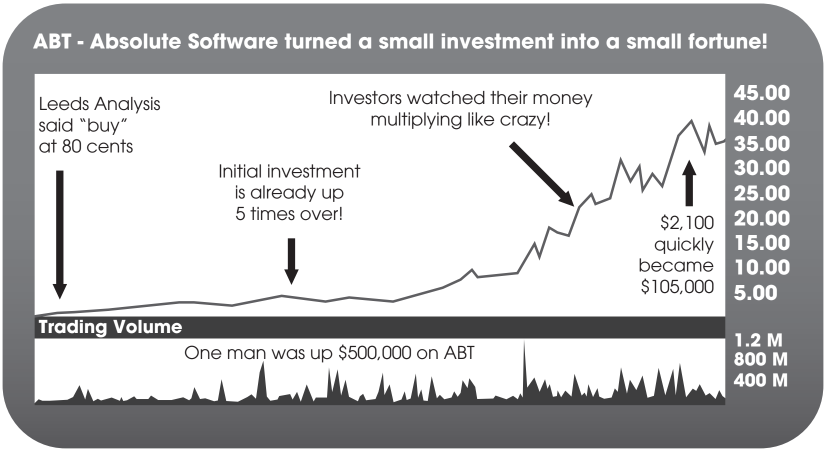

Figure 1.1 Absolute Software Trading

Subscribers to Peter Leeds may remember some of the home-runs we've hit using Leeds Analysis, like Absolute Software, which went from $0.80 to $40.64! (split adjusted). (See Figure 1.1.)

Another great example, Disc Inc., spiked from only $0.38 per share all the way up to $9.93 for a 2,500 percent gain! (See Figure 1.2.)

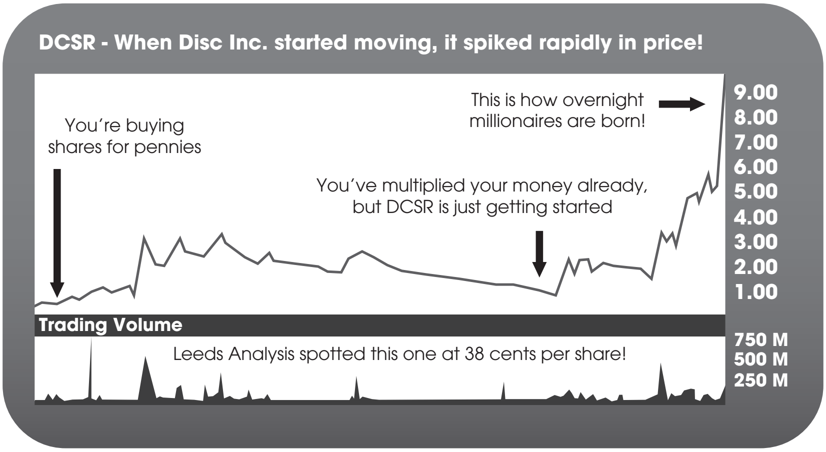

Figure 1.2 Disc Inc. Trading

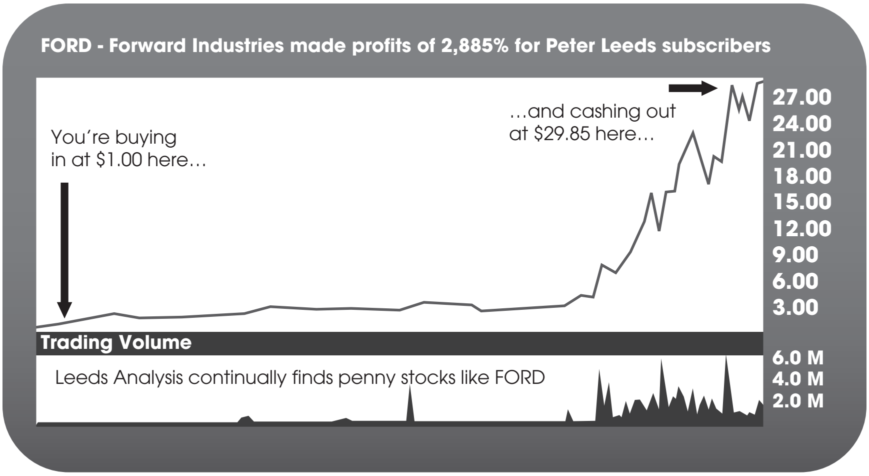

Figure 1.3 Forward Industries Trading

Or take Forward Industries, which we revealed to Peter Leeds subscribers when it was trading at $1.00, before it absolutely exploded to $29.85 for a total gain of 2,885 percent! (See Figure 1.3.)

You wouldn't see gains like that in IBM or Exxon even if you waited a lifetime!

Experience Level 3

Trading Tactics: Averaging Down

Averaging down means buying more shares of a stock you already own if the price has dropped since you originally bought it. This tactic lowers your average price paid per share, but increases your exposure.

For example, you buy 2,000 shares at $2.00, and weeks later the stock drops to $1.00. If you buy another 2,000 shares at $1.00, your average price per share for the 4,000 units is now $1.50. In other words, if the shares make it back to $1.50, you are breaking even overall. (However, you now have an additional $2,000 invested.)

I have personally seen people average all the way down, with three or four or five new buy orders over months or years. They lost their shirts on stocks like Nortel and some of the Internet high-flyers.

Trading Tactics: Averaging Down (*Continued*)

Investors usually average down to make up for a bad trading decision. This can get pretty ugly when a stock is nose-diving toward zero, as they throw good money after bad.

I don't support the concept of averaging down. In fact, if you abide by the methodology of *limiting losses* that we describe later, you won't be in a position where you'd need to average down, because you already would have jumped from that sinking ship.

Bad investors average down, buying more shares of a falling stock to decrease the average price per share they've paid. This strategy is hardly ever effective. In addition, it magnifies your losses if the stock keeps dropping. Nevertheless, individual investors seem to continually engage in this practice.

When I trade, I'm much more likely to *average up*. I'll acquire more shares as the stock price climbs and the momentum of the company rises. The increasing share price is a confirmation of the success of my original analysis, and the company's progress, rather than a profit-taking opportunity.

Experience Level I

Penny Stock Phobia

People have a phobia of penny stocks. This fear has been instilled in them because they hear a lot of bad stories about people who have been "swindled," "ripped off," or otherwise "scammed." Other people may have had personal experiences, or heard stories of others that ended with lost money.

These may have been real experiences, and real stories, and that doesn't surprise me at all. I am telling you that **most people who trade penny stocks lose money.** This is almost always because they invest:

- For the wrong reasons
- At the wrong time
- (Most notably) in the wrong companies

For every nine people losing $1 on the market, the tenth person is making $9. That tenth person could be you, if you learn to invest:

- For the right reasons
- At the right time
- (Most notably) in the right companies

This book, with its explanation of Leeds Analysis, will help you do that. Not everyone is successful with it, and penny stocks can go up or down in price. However, I do have a track record of people whom I don't even know, who've never met me, sending me pictures of boats and cars and other things they bought with money they made trading penny stocks based on my guidance.

Some of these people have followed my picks at my online newsletter, *Peter Leeds Penny Stocks.* Others have read my earlier book, *Understanding Penny Stocks.* However they came to their penny stock successes, each one of them proves even more that Leeds Analysis works and can give investors of all experience levels, and from all walks of life, an unfair financial advantage.

Experience Level I

Penny Stocks May Not Be for You

Penny stocks might not be an appropriate investment vehicle for you, based on your experience level, risk tolerance, or personal investment strategy.

It's important that you know when *not* to trade penny stocks:

- You're losing sleep at night because you're stressed out.
- You wind up fighting with your spouse about it.
- You think about it so much that you aren't paying attention to your family.
- Your mind wanders while you're at work.

If you find yourself thinking about your penny stock investments too frequently, this type of investing may not be right for you. Of course, this doesn't apply to plain excitement, when your penny stocks are multiplying in value and your constant thoughts are positive ones. Rather, it's when negative associations start cropping up that you may want to take a break from the world of low-priced shares.

It is also important to have realistic expectations. A lot of less-experienced investors think they can turn $1,000 into a million bucks just by trading penny stocks. Many people have great success stories and make a lot of money, but it's not realistic to expect to make such ridiculous amounts.

Yes, technically, it is possible. It has happened. Of course, those are extremely rare situations. That will not happen to you. If you prove me wrong, that's fantastic, but it is not helpful to expect such a monumental degree of success. It's important that you have realistic expectations.

Penny stocks go up in value very frequently, doubling or tripling in price. Very often penny stocks go down in price. You need to have a good comprehension of this. Don't enter the penny stock arena until you're ready to approach it with a sensible understanding.

You should get involved with penny stocks only with risk money, especially at first and certainly if you're a less experienced trader. Don't put money into penny stocks that you need for your children's education, or your retirement, or your mortgage. In other words, never put your grocery money into the stock market.

Should you talk to your financial planner? Absolutely. You could talk to them about penny stocks, but I'll save you the trip. I'll tell you what they'll say:

- "No, it's dangerous."
- "It's ridiculous."
- "Stay away from penny stocks."

Hey, I actually happen to agree with them! Penny stocks are dangerous, and ridiculous, and you *should* stay away from them. Most penny stocks will potentially cost you money. In that sense, I agree with the doom-saying financial planners.

Where I diverge from their generalized opinion is as follows: Once you know how to find the 5 percent of penny stocks that represent high-quality investments, penny stock investing becomes possibly the most lucrative way to build wealth.

Experience Level I

I Do Not Give Advice

Understand that anything you read or hear from me is not advice. I don't give advice. I don't know you. I don't know your trading style, your financial situation, or your time outlook (long term, short term, day trader). I can't know what kind of stock is best for you or what you should do with your money. I don't know the answers to these things, nor do I want to know.

I can't talk to you about what's best for your retirement, or what you should do with your savings, or how to make your money double the fastest. I'm just going to give you opinions and guidance, based on my experience and the results of Leeds Analysis. After that, it all comes down to your deciding what's best for you. At the end of the day you need to take responsibility for your trading decisions, regardless of where your stock picks first originated.

We've had subscribers at Peter Leeds Penny Stocks who have come to us complaining that they lost money on a stock pick we made. At the same time we have had subscribers who are providing testimonials because they are making money on that exact same stock in the same time period! Some people just traded it better than others. Your own personal skill level and trading strategy will come into play.

Over the years, the Peter Leeds Penny Stocks subscribers who have fared the best (by far) were the ones that used my research and analysis as one part of a more balanced, overall trading strategy. If we made a stock selection that they didn't love, they would pass and wait for a different pick. If we made a stock selection that appealed to them, they would look into it more deeply, and decide for themselves if it fit their trading style and investment goals.

In *Invest in Penny Stocks,* I'm not going to go into very much detail about how trading works and how the stock markets work. All of that information is available in my other book, *Understanding Penny Stocks.* I will merely touch on some general topics very briefly when I feel the need for a general explanation.

Mainly, I will focus on the more highly advanced techniques that have the potential to make you (or save you) a lot of money. These strategies have been very effective for me, and were developed over many years through trial and error as well as in the trenches with millions in live money.

From the defensive side, you're going to learn how to avoid the duds and dangers that are out there in the penny stock world. As well, you need to avoid the scams that you may encounter.

Then we're going to get into some really fun stuff. I'll explain the techniques that I use to turn penny stock theory into actual cash profits. From "Leeds Analysis" to "Trading Windows," from "Scaling In" to "Volatility Plays," I haven't held anything back.

So, let's get started!

Experience Level 3

Trading Tactics: Buy the Rumor, Sell the Fact

There is an expression in the stock market that says, "Buy the rumor, sell the fact." It's a lesson that all new traders should learn, because it will help them profit while avoiding selling too late.

The idea is simple. When there's an outstanding rumor about an upcoming event for a company, investors buy in once they hear about it through the grapevine, thus pushing share prices higher. Once the event itself is actually realized, the share price loses that upward buying pressure and the stock drops in value.

For example, ABC Inc. is likely to get FDA approval for its new drug. The upcoming ruling is widely expected, and many investors buy in,

(*Continued*)

Trading Tactics: Buy the Rumor, Sell the Fact (*Continued*)

speculating that the announcement will send the shares skyward. This starts pushing the stock upward.

Eventually, once the actual FDA approval comes out, the shares don't spike much higher since the speculators had already run the share price up so much. Now that the announcement is out, many of those same speculators start cashing out, putting a great deal of selling pressure on the stock. Thus, despite the release of some very positive news, the shares actually head lower!

Examples of What Might Drive Buying Interest

- Impending patent award
- Potential dismissal of major lawsuit against the company
- Expected strong financial results
- New major customer or contract win widely anticipated
- Upcoming release of a new version of the company's technology
- Anticipated FDA clearance

Any such widely known and expected event would gradually push share prices higher. This would have steam until, and only until, the expected event itself finally comes to pass. For this effect to actually occur, the rumor or event needs to be:

- Widely known
- Growing in probability
- Noteworthy (potential for a major impact)
- Nearing the date it's expected to occur

The merger between the satellite radio companies XM and Sirius is a good example. There was unprecedented discussion in the media and among the investment community about the combination of the two companies. It was a noteworthy event since it would help both companies survive, and was expected to have major benefits such as millions in cost savings. The CEO of Sirius, Mel Karmazin, made frequent updates in press releases about the progress of the merger talks, and provided dates for when he expected that the regulatory bodies would rule on the matter.

The result was a widely followed rumor that excited investors. Traders held shares, or bought more, waiting for the good news of a

Trading Tactics: Buy the Rumor, Sell the Fact (*Continued*)

merger to be announced. The expectation was that shares of both companies would spike upon any announcement.

Shares were trading as high as $2.75 the day before the merger announcement.

However, on July 25, 2008, when the merger was finally approved, the shares started falling.

Short-term traders had been anxiously waiting for the announcement so they could make a quick profit by selling into the news. Long-term investors looked to the merger as the beginning of a long, sustained uptrend in price. Both were surprised as the merger announcement actually set off a downward slide for the shares. The trading price of the merged company sank all the way down from its post-merger high of $2.75 to $0.11 within five months. (See Figure 1.4.)

What was the difference in Sirius at $2.75 and Sirius at $0.11 soon after? Nothing, besides the long-awaited and sought-after merger, which was supposed to take the satellite radio companies to the next level. Well, I don't think they expected the next level to be a share price that was 95 percent lower.

At the time of the merger announcement, there weren't any other major events in the near future that might help spike the prices.

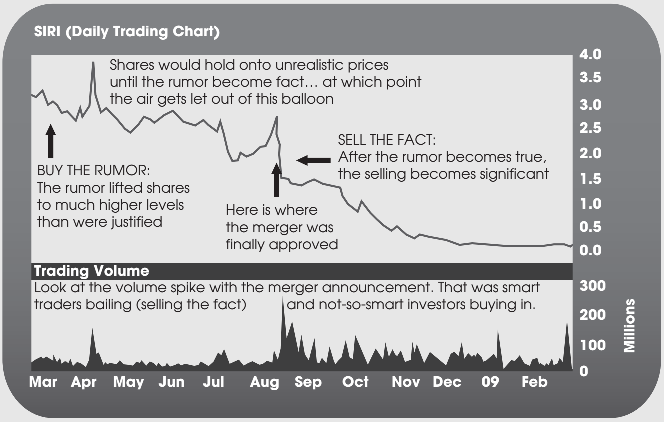

Figure 1.4 Sirius Satellite Radio Trading

(Continued)

Trading Tactics: Buy the Rumor, Sell the Fact (*Continued*)

Speculators and long-term shareholders alike didn't have much to look forward to, now that the merger announcement had been made.

Overall, the stock suddenly didn't seem as exciting. The amount of optimistic speculation in the shares took a big hit, and investors were now forced to look at the company's fundamentals. The financials couldn't be ignored any longer.

The merger caused shares of Sirius and XM, which until now had been treated by investors as speculative plays, to be traded based on their operational results. In other words, the post-merger world didn't have any more speculative optimism. Instead, investors now started to look at the very ugly reality of the debt-ridden financials.

In fact, I wrote a lengthy article about the absolutely ridiculous balance sheets of the two companies on July 30, 2007. It was called "Sirius Trouble." Here are some excerpts, to give you an idea of the tone of my message:

> After extensively looking at the financials of both companies . . . they are both pretty brutal. So, what do you get when you combine two financially suspect companies? One bigger financially suspect company. . . .
>
> . . . via creative financings (such as issuing shares), they will heavily dilute the company. The surviving company steams on, but the value of the shares will be worth significantly less than they are now.

With satellite radio, everyone was buying the rumor. The smart money knew to sell the fact.

"Buy the rumor, sell the fact" plays out again and again on the markets. It's certainly not the exception, but rather the rule. Keeping this in mind will help you identify penny stocks that may trend upward, allowing you to ride the shares up for profits. Just make sure to escape your position before they come crashing back down to earth and to more realistic valuations.

In other words, buy the rumor, and sell the fact.