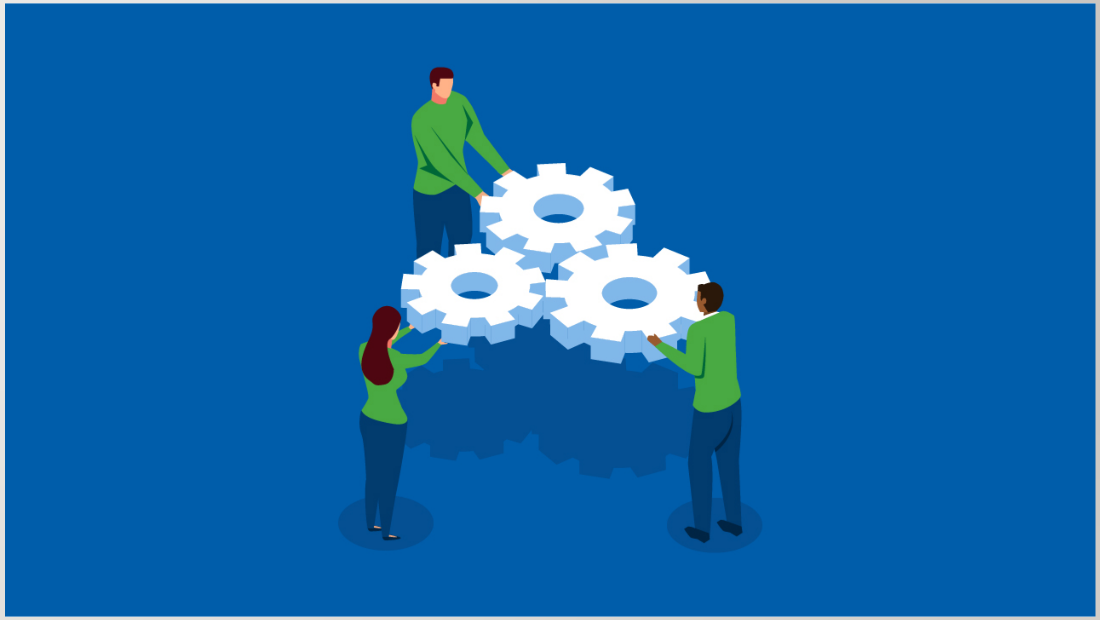
WHEN TO SELL STOCKS?

YANKEE MODEL INVESTMENT CLUB

SRIRAM MADABHUSHI OCTOBER 10, 2020

10 Tips for Operating a Stock Investment Club

By: Adam Ritt
September 2019
Time-tested club operations tips that will your club achieve long-term success.



8. Establish Written Guidelines for Buying or Sell Investment Decisions

Probably the No. 1 problem for stock investment clubs is knowing when to sell.

Develop written criteria for selling a stock and refer to this document often.

Why Individuals Sell Stocks?

- **Markets are volatile.** The stock market's way up, and bonds are down. Our carefully chosen mix is now out of whack and we need to rebalance the portfolio.
- **Change in personal status.** Moved, had a baby, lost a job or got divorced, need to beef up emergency savings.
- **Retiring.** Need to replenish the fund to tap for living expenses.
- **Windfall.** Won lottery, struck it rich or saved enough to meet all contingencies and need to relax about investing.
- **Something more important.** Want to invest in something that want or need. Health emergency or an urgent need.

Strategies for Selling Stocks

❖ Valuation-Level Sell

We sell a stock once it hits a certain valuation target or range.
Metrics such as: price-to-earnings (P/E) ratio, price-to-book (P/B), and price-to-sales (P/S).
This approach is popular among value investors who buy stocks that are undervalued. These same valuation metrics can be used as signals to sell when stock becomes overvalued.

❖ Opportunity-Cost Sell

We sell one stock when a better opportunity presents itself.

❖ Deteriorating-Fundamentals Sell

When certain fundamentals in the company's financial statements fall below a certain level or Management changed or operations approach changed that make the original fundamentals not true anymore.

❖ Target-Price Sell

Most widely used ways by which investors sell a stock, as evidenced by the popularity of the stop-loss orders with both traders and investors.

Why sell a stock?

- **Need cash.** A member is leaving the club and we need cash to pay off a club member.
- **Keep portfolio fresh.** To make room in the portfolio for better, higher performing stocks. A once a year purging of losers to make room for winners is a good idea.
- **Better growth or better price.** The price of a stock has gone up so much that there's an equally good investment at a significantly better price or one showing significantly better growth (30- 40% more) at the same price. (The upside/downside ratio is lower than 3:1)
- **Change in Fundamentals.** The fundamentals (sales, profits and PE) are worsening for two quarters to two years.
- **Offsetting capital loss.** We want to take a capital loss to offset capital gains for tax purposes.

When not to Sell a Stock?

- **Paper gain:** Just because the stock has doubled in five years doesn't mean you should get rid of it. Let the winners run, as long as the PE doesn't get too high.
- **Paper loss:** Stocks can move ±30% (may be up to 50%?)
- **No price appreciation:** As long as earnings and sales are increasing, that may mean a buy signal, not a sell. We may want to add to our position in the stock.
- **Because of temporary bad news.** March 13 Amazon was at $1,785; now $3,286
- **Just to do something.** Our club did not purchase anything in awhile and we have $ in the cash account.

When to sell a stock?

- **Analysis:** An updated SSG indicates the company results show that business trends are deteriorating. (quarterly reports). Look into reasons.
  - Declining earnings?
  - Management good or changed?
  - Price lower than originally projected?
  - Is the change temporary or long-term?
  - A hard metric: P/E is ≥ 1.5 (5-year average high P/E)
  - Value Line safety rating of 4 or 5.
  - Value Line Financial strength below average (B+ is average)

- **Lack of diversification:** One stock is more than 10 to 20% of the portfolio

- **Too much diversification:** Stock is less than 2% of the portfolio

When to sell a stock ? **Continued …**

- **Stock spin-off:** Stock spin off – add or sell?

- **Industry:** Industry is overall in a stagnation or not growing

- **Adverse management changes:** The genius who started the company has retired and his incompetent grandson is the CEO.

- **Ethical and honesty reasons:** Accounting or other practices indicate

- **Company is at a point of no return:** Had a great history and now is out of favor. (Kodak to Cannon or Blockbuster to Netflix).

- **Competition growing:** Moats to entry are disappearing and the earnings are not attractive anymore.

When to sell a stock ? **Continued …**

❖ **Product pipeline deteriorating:** Drug companies with declining product line and increasing competition for generic brands**.**

❖ **R & D Budgets decreasing:** Technology and innovation companies.

❖ **Slowed growth:** Terrific earnings history, but now company is so large to sustain the same growth and earnings rate.

❖ **Company cuts its dividends:** After several years of good dividends, sudden reduction in dividends, which used to be a large portion of the earnings.

❖ **Sector or Industry outliers:** Company is moving opposite to the rest of the industry or sector. Analyze fundamentals.

❖ **Other?**

Bottom line:

- ❖ **When we bought the stock, we did our research and expect it to be a long-term investment**
  - ❖ **We checked the boxes per our understanding of the study we did with our judgement.**
  - ❖ **Results are different**
  - ❖ **Now what?**

- ❖ **Time to revisit and make a decision to sell – better we plan, easy the decision**

Recommendation:

- ❖ **Let us establish rules for when to sell and refer to it on a periodic basis**