When to Sell

Selling is the hardest part of portfolio management because we tend to fall in love with our stocks. Remember to buy and watch, not buy and forget.

Why sell a stock?

1) You, or your club, need the cash, perhaps to send a child to college or to pay off a club member who's leaving the group.
2) You want 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. Selling is essential to keeping a portfolio fresh.
3) The price 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)
4) The fundamentals (sales, profits and PE) are worsening for two quarters to two years.
5) You want to take a capital loss to offset capital gains for tax purposes.

When to sell a stock

1) When you do a new SSG and the company results show that business trends are deteriorating. (quarterly reports) Look into the reasons. (declining earnings two quarters in row) Be more optimistic in this SSG than when you were looking to buy the stock. (If the PE's are declining, use the most recent one. If they are rising, use the average.) If you really trust management, don't sell it lightly. The issue is how well the company is doing, not the price of the stock or how much you paid for it. This SSG should have the most recent quarterly results. Use the Preferred Procedure form in Toolkit 6. Is the price now lower than the projected low? Sell. Are there persistently declining profit margins and return on investment (2 year data)? Sell
2) Don't wait until it gets back to the price you paid for it; that may never happen. Most growth companies return only halfway, if at all.
3) When a stock becomes more than 10 to 20% of your portfolio, you are no longer diversified. At least sell some of it.
4) Lumbering giants - terrific earnings history, but now are so large that it's very hard to increase growth and earnings rate. (WalMart, Pfizer) Its best days are behind it. Look for more small and mid-cap companies that can grow at a faster rate.
5) When the problems the company is having drag on for years.
6) When the industry becomes very mature.
7) If you receive a spinoff in stock, either sell it or add to the position to bring it to a reasonable size. Less than 2% of the portfolio doesn't make sense.
8) Adverse management changes (The genius who started the company has retired and his playboy grandson is now in the CEO seat.)

9) Company cuts its dividends.
10) Competition growing - moats to entry are disappearing
11) Product pipeline deteriorating (drug companies)
12) R & D (research and development) budget **de**creasing
13) Questions about accounting or dishonesty
14) Value Line **safety** rating of 4 or 5.
15) Value Line Financial strength below average (B+ is average) .
16) When you see a trend that you know is going to finish a company off (Kodak to Canon, Blockbuster to Netflix)
17) The current PE is 1.5 x or greater than the five year average high PE.

Don't sell

1) 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. Don't sell because of a paper gain.

2) Just because the price has not moved. As long as earnings and sales are increasing, that may mean a buy signal, not a sell. You may want to add to your position in the stock.

3) Because of a paper loss. Stocks can move 50% in either direction.

4) Because of temporary bad news.

5) Just to do something.

General wisdom

When you bought it, did you pay too much? Average PE's higher than the 20's usually can't sustain high growth and earnings for an extended period. There are exceptions to this, like Apple.

There's little long tern overall growth to be had from commodities. (oil, gold, etc.)

PEG ratio (PE divided by projected sales growth) below 1.5 is desirable, even better if it's 1.2 for less consistent growers. Example: Average PE is 17. Projected 5 year growth rate is 12%. PEG is 1.42.

Prepared for the BetterInvesting Western Michigan Model Club by Jane Johnson April 23, 2012 Revised Jan. 12, 2015.