TRICKS OF THE TRADE

WHEN TO SELL AN INVESTMENT

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I often jokingly said, “the easiest thing to do is buy a stock, but the hardest thing to do is sell it”. Why? Typically for the “average” investor, the single largest impediment to successful investing is their emotions. When the stock is up, “I don’t want to sell it, the stock is doing well!”. Or when the stock is down, “I don’t want to sell it, it will come back”. Does this sound familiar?

Let’s turn the clock back to the tech bubble in the late 90’s, and the subsequent bubble burst from 2000 – 2002, as I have two anecdotes. Lucent Technologies stock rose from about $10 per share to $200 per share, only to drop back to $1 per share. Would you have sold the stock when it reached $200 per share? Or did you ride it back down to virtually nothing like many investors’ stories I recall at the time? Similarly, Qualcomm rose 2800% in 1999, so if one were to invest $10,000 in that stock, it would have finished the year at $290,000. Qualcomm’s stock price then decreased by 66% in the next six months, and a total of 85% in less than two years.

Think to yourself - what would YOU have done if you owned those two stocks? One thing is for certain – if I invested $10,000 in Qualcomm, I wouldn’t have finished with $290,000. In all likelihood, I would have sold pieces of it as the stock went up, so I’m playing with house money, so to speak.

In the movie, “Wall Street”, Gordon Gekko (played by Michael Douglas) told Charlie Sheen that greed is good. When it comes to investing, I beg to differ, because greed is the single greatest emotion that gets in the way of good investing. In fact, my father taught me a lesson in 1994 when I sold Cisco stock for $45 a share, and the stock quickly rose to $47. I griped that I “lost” money when, but he quickly reminded me that I just gained 15% on my investment in less than a month. “Don’t be greedy!”, he said.

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So when do you sell your investment? For starters, before purchasing an investment, it is important to understand whether this is designed to be a long term buy-and-hold, or if it designed for short-term investing. If for short-term investing, you should already be thinking of what you would want to gain, or be willing to lose. Bill O'Neil, successfully won an annual investor competition ***three years in a row*** and subsequently founded the Investors' Business Daily newspaper, which is a competitor of the Wall Street Journal. When selecting a stock at the time, he immediately set a disciplined loss limit of 7%, so the stock would be sold if it fell 7% below its purchase price. In short, he limited the downside of any investment he made. Also, when asked if someone should sell their stock, I have half-jokingly suggested to sell half of it. Heck if it goes up, at least you kept half of it – and if it went down, at least you sold half of it!

For those investors who purchase stocks for the short term, here are three disciplined strategies they could use for selling the stock:

1. Limit Orders - A limit order is a method for investors to set a desired price (above the current price) they would like to sell the stock for. So, if the stock reaches that limit, then it is sold. Thus, the limit order is a method for investors to sell their stock at a desired price.
2. Stop Orders – A stop order is placed at a specific dollar amount below the purchase price, so that if the stock drops to that price, then it is sold (note that there is some unlikely risk that goes along with this tactic that is beyond the scope of this article). In short, the stop order limits how much you will lose on the stock, similar to Bill O'Neil's strategy.
3. Trailing Stops – This is a version of the stop order that allows the investor to benefit from the stock rising in value, but provides a limit on how much they "give back" if the stock price subsequently drops. Trailing stops can be in the form of specific dollar amounts or percentages. For example, an investor owns share of XYZ company worth $100. The investor does not want to lose more than 10% on this investment, so they place a 10% trailing stop order. If that stock reaches $90, it triggers the stop order and it is sold. However, if the stock price goes up to (say) $150, then the 10% trailing stop follows the stock price up, so the stop order is triggered at 10% below its peak of $150, so the stop order would be triggered at a price of $135. The same can be with specific dollar amounts, so using the previous example with a $10 stop limit, then the stock would have been sold at a price of $140 per share.

As with any strategy, there are always pitfalls that could happen. Specifically, stop orders could be triggered by a short or sudden drop in the stock price causing the sale of the stock, only to have it rise again. That said, these strategies are terrific, particularly if you're not watching your investment every minute of every day. If you have any questions regarding these strategies, ask your investment professional, or feel free to call us.