KNOW WHEN TO SELL, WAIT, HOLD, OR BUY

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IN THIS SESSION

- Strategies for handling "maybe zone" stocks.
- Understanding uncertainty when making stock decisions.
- Making better decisions when stocks are "on the cusp."
- 5 categories of valuation to help identify areas of risk.
- Portfolio "baskets" into which uncertain holdings can be sorted.

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ARE YOU OFTEN UNCERTAIN ABOUT BUYING, SELLING, OR HOLDING A STOCK?

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BUY, SELL, OR HOLD IN YOUR PORTFOLIO?

- Investment decisions you make may seem clear-cut with 3 options:
  1. **<u>Buy</u>**: stocks you believe have satisfactory future upside potential.
  2. **<u>Sell</u>**: stocks you believe have significant chances of declining.
  3. **<u>Hold</u>**: stocks you believe are worth holding for potential upsides & have low chances of significant declines.

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BUY, SELL, OR AVOID NEW STOCK?

- When researching & reaching conclusion on potential new portfolio holding, you either:
  1. **<u>Buy now</u>.** Price looks good & fundamentals are strong.
  2. **<u>Don't buy now</u>.** Price looks high and/or fundamentals are "iffy."
- But there is also a 3rd choice:
  3. Stocks that aren't buys now **<u>might</u>** be buys if price or fundamentals improve… **<u>MAYBE.</u>**

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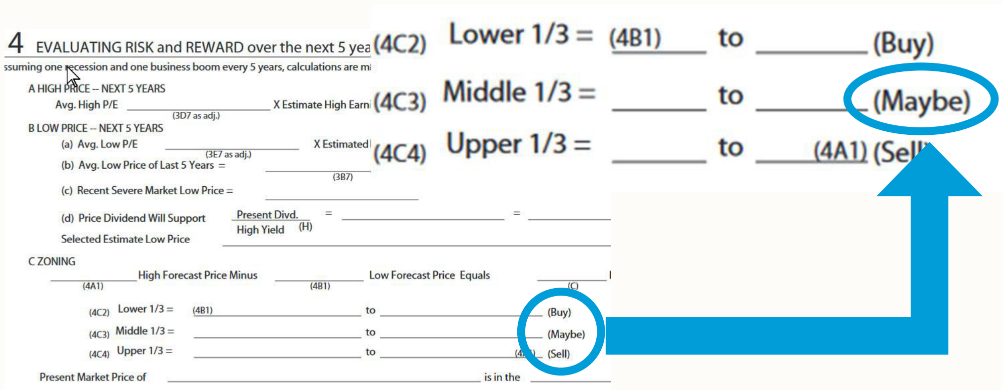
MAYBE ZONE ON "ORIGINAL" SSG



NOTE: SSG Plus now calls **MAYBE** zone "HOLD" zone.

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"MAYBE" IS NOT SAME AS "HOLD"

- Original "**MAYBE**" zone suggests each investor perceives different attributes that impact decisions, such as:
  - Different judgment applied about future prospects.
  - Whether stock held in taxed or tax-advantaged account.
  - Whether gains/losses if sold would be short- or long-term.
  - Understanding of external issues affecting company.
  - Impact of sale on portfolio diversification.
  - General uncertainty about company or stock valuation.
  - *Etc., etc.*

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STOCK DECISION TRADE-OFFS

- "**MAYBE**" zone also reflects multitude of factors that come into play in all stock decisions.
  - We strive to find opportunities driven by **tailwinds** ***despite*** evident **headwinds**.
  - Huge warning sign: When ***everything*** looks good -- sure indication that something was missed or analysis is overly optimistic.
- Remember: SSG is "Aid to judgment, not replacement for it."

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GETTING STUCK IN MAYBE ZONE

- Confidence leads to action—but **uncertainty** ("maybe") causes inaction.
- Paralysis driven by uncertainty is **detrimental** to performance:
  - We hold underperformers too long, worsening returns.
  - OR we hold outperformers too long, worsening returns.
  - OR we don't buy when we should, missing opportunities to improve returns.

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ACKNOWLEDGE UNCERTAINTY

- **Uncertainty** is inherent in stock analysis & investing.
- Investors must accept that they are seldom 100% "certain" about any investing decision.
- Always acknowledge that investing decisions are based on weighing both positives AND negatives.
- So how uncertainty be resolved about stocks in MAYBE zone?

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HOW TO ESCAPE FROM "MAYBE ZONE"

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BETTER METHODS MEAN BETTER DECISIONS

- According to BetterInvesting (BI), long-term stock investing success with Stock Selection Guide (SSG) comes from 2 things:
  1. Find good companies.
  2. Buy them at great prices (i.e., at good values).
- BI approach to identifying "great prices/good values" begins with understanding P/E ratios & their trends.

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REVIEW: WHAT IS A GREAT PRICE?

- SSG uses Price/Earnings (P/E) Ratio as key valuation measure.
- General rules of thumb:
  - If P/E is around average, stock may be fairly valued.
  - If P/E is lower than average, stock may be undervalued.
  - If P/E is higher than average, stock may be overvalued.
  - Reminder: Potential total return is calculated using estimated future highest P/E at which stock is reasonably expected to sell.
- Can these rules be refined a bit further?

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P/E RATIOS MEASURE STOCK'S POPULARITY

- P/Es measure of popularity & investor expectations about company's future performance.
  - Companies like Nvidia, Apple, Microsoft have higher than average P/E ratios now because interest is high.
  - Companies in housing & RV industries have lower than average P/E ratios now because of expectations that economy may linger at lower levels.
  - Company with problems may see EPS decline & yet have higher than average PEs because of expectations that problems are temporary & will be resolved.
- Interpret P/Es on relative (not absolute) basis.

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MEASURING "VALUE" WITH RELATIVE VALUE

- Relative Value (RV) describes relationship of current P/E to past P/Es.
  - `RV = (Curr P/E ÷ Avg P/E)*100`
- On SSG, RV around 100% says "current price is around average levels of past relative to earnings."
  - RV < 100% says is stock is under-valued, selling at **discount**.
  - RV > 100% says stock is over-valued, selling at **premium**.
- Usual recommendation: **Buy if stock is selling near or below 100% RV.**

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RV ON SSG PLUS (IN RATIOS TAB)

Valuation Ratios

RELATIVE VALUE ?

Current P/E: **34.0** / Average 5 Year P/E: **30.1** X 100 = **113.1%**

PROJECTED RELATIVE VALUE ?

Projected P/E: **29.6** / Forecast Average P/E: **24.0** X 100 = **123.5%**

CUR RICE (09/06/24): 40 31

5 Years / 10 Years	A	B	C					
Year			**Earnings**					
	High	ow	Per Share					
2020	20	130.8	5.76	35.5	22.7	1.99	34.5%	1.5%
2021	27	196.3	8.05	33.7	24.4	2.19	27.2%	1.1%
2022	34	241.5	9.65	36.2	25.0	2.42	25.1%	1.0%
2023	35	213.4	9.68	36.3	22.0	2.66	27.5%	1.2%
2024	45	309.4	11.80	38.7	26.2	2.93	24.8%	0.9%
5 YEAR AVERAGE		**218.3**		**36.1**	**24.1**		**27.8%**	
CURRENT/TTM			11.81	29.7	26.2	3.00	25.4%	
5 YEAR AVERAGE PRICE EARNINGS RATIO: 30.1				**CURRENT PRICE EARNINGS RATIO: 34.0**				

MONITORING VALUE WITH PROJECTED RELATIVE VALUE

- Once stock is owned, use **Projected RV** to quickly assess value.
  - Projected R/V = (Proj P/E ÷ Proj Avg P/E)*100.

  Where Proj Avg P/E is average of **user-chosen future high & low P/Es**.

- **Why use Projected RV?**
  - Accounts for expected **future contraction or expansion of P/Es** compared to past, according to your SSG judgment.

RV IN PORTFOLIO MANAGEMENT

- PERT (Portfolio Review) Report flags stocks when Projected RV is at either excessive end of ranges:
  - Proj RV is <80% — stock is in "**warning**" territory.
  - Proj RV is >150% — stock is in "**overvalued**" territory.
- Seems straightforward, but…

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HIGHLIGHTING ON PERT REPORT

Summary | PERT | Diversification

BetterInvesting

Report Details

Any I.C.

Show All entries

Search all columns:

Company Name	Div	% Yield	Est EPS Nxt 12 Mo	EPS: Qtr End	EPS: $	EPS: % Chg	Sales: Mill $	Sales: % Chg	Pre-Tax Profit: Mill $	Pre-Tax Profit: % Chg	Pre-Tax Profit: % Sales	TTM EPS: $	TTM EPS: % Chg	Proj PE	Price	Proj RV	Proj 5Yr P/E Ratios: Hi	Proj 5Yr P/E Ratios: Avg	Proj 5Yr P/E Ratios: Low	Est EPS Growth	PEG Ratio	U/D Ratio	% Total Return	Lo Pri
Walmart	0.83	1.1	2.04	07/24 07/23	0.56 0.97	-42.4%	169335.0 161632.0	4.8%	6213.0 10727.0	-42.1%	3.7% 6.6%	1.92 1.73	11.0%	37.6	76.64 9/6/2024	138.4	31.0	27.2	23.3	6.0	6.3	0.1	2.6	
Ollie's Bargain Outl	0.00	0.0	3.58	07/24 07/23	0.79 0.68	16.2%	578.4 514.5	12.4%	64.7 55.9	15.6%	11.2% 10.9%	3.28 2.40	36.7%	24.4	87.31 9/6/2024	72.4	39.0	33.8	28.5	9.0	2.7	Invalid	17.7	
NVIDIA	0.04	0.0	2.56	07/24 07/23	0.67 0.25	170.2%	30040.0 13507.0	122.4%	19214.0 6981.0	175.2%	64.0% 51.7%	2.13 0.41	414.7%	40.2	102.84 9/6/2024	154.4	35.0	26.1	17.1	20.0	2.0	1.2	12.8	
PaySign	0.00	0.0	0.16	06/24 06/23	0.01 0.00	--	14.3 11.0	29.8%	0.9 0.0	2,141.3%	6.6% -0.4%	0.14 0.03	460.0%	26.1	4.17 9/6/2024	87.1	40.0	30.0	20.0	14.0	1.9	4.2	21.0	
Miller Industries	0.76	1.3	6.72	06/24 06/23	1.78 1.29	38.0%	371.5 300.3	23.7%	26.2 19.0	38.3%	7.1% 6.3%	6.22 3.37	84.6%	8.6	57.73 9/6/2024	69.3	15.1	12.4	9.7	8.0	1.1	37.7	21.1	
Skyworks Solutions	2.80	2.8	5.34	06/24 06/23	0.75 1.22	-38.5%	905.5 1071.2	-15.5%	133.4 222.1	-39.9%	14.7% 20.7%	4.85 6.49	-25.3%	18.5	98.82 9/6/2024	109.9	21.1	16.9	12.6	10.0	1.9	2.1	12.1	

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WHAT ABOUT IN-BETWEEN PROJECTED RV FIGURES?

- How should Projected RV be interpreted if stock is somewhere in enormous range between 80% & 150%?
- Simple under-/over-valued framework fails to capture nuance or provide clear guidance for action in portfolio.
  - Especially for stocks reporting non-recurring events or that are in fringes of above ranges.

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REDEFINING VALUATION CHARACTERISTICS

MY FIVE LEVELS OF STOCK VALUATION

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"OVER-", "FAIRLY," OR "UNDER-" VALUED?

- Can we capture nuance & provide **better insight** into buy/sell/hold definitions with by redefining/recategorizing stock valuation metrics?
- When we apply labels, we give meaning & create better understanding—**making sense out of "maybe."**

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MY 5 LEVELS OF STOCK VALUATION

Proj RV Range	Valuation Category
< 80%	**Busted Valuation**
80% - 100%	**Undervalued**
90% - 110%	**Reasonably Valued**
110% - 150%	**Overvalued**
> 150%	**Hypervalued**

NOTE: Values exist on continuum, never in absolute numerical ranges, & always subject to interpretation.

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DEALING WITH BUSTED VALUATION STOCKS

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BUSTED VALUATION

- P/E-based valuations cease to provide valid comparisons when Projected RV falls below 80%.
- Something negative happened (or expected to happen) to company fundamentals, so stock has sold off.
- Could be very severe overreaction from market, & may offer long-term opportunity…
  - But depends on depth & severity of company's problems.
- Even so, market has long memory & may remember problems longer than fundamentals may warrant.

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REMOVE BUSTED STOCKS?

- Stocks that have busted valuations may show excellent long-term total return potential on SSG.
- ***However, this may be misleading:***
  - Fundamental problems may **outweigh return potential**.
  - May be ideal candidates for **capital loss harvesting**.
  - Should at minimum be **automatic challenge candidates**.
- Use extreme caution when considering these stocks.

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RISKS OF HOLDING ULTRA-LOW RV

- Even if you decide factors affecting company are short-term in nature, market may not agree with you.
  - Once fundamentals improve, will market respond & lift share price?
  - Short-term problems have tendency to linger in minds of investors, so may be years before valuations recover after problems are "fixed."
- Buying stocks selling at low prices may be best considered part of speculative portion of portfolio.
- Avoid falling into trap of "How much lower could it go?"

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UNDERPERFORMERS "ON PROBATION"

- Companies that have stumbled or for which you are unsure of future prospects can be put **On Probation**.
- This means no action is expected (buy or sell) until more evidence is available, either continued downtrend or recovery.
- As evidence points increasingly towards removal, make stock "Available for Cash" (AFC).
  - Mental trigger to acclimate to removal & find replacement candidates.

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BUSTED VALUATION STOCKS MAY BE SPECULATIVE

- If after acknowledging problems, want to continue to hold stock even if it's "long shot" that it will recover, move to "Speculative" portion of portfolio.
- NAIC Founder George Nicholson recommended that 5%-10% of assets be invested in "speculative" portion of portfolio.
- Segregated from rest of portfolio to protect other holdings from continuing damage but allowing for big gains from current valuations.

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DEALING WITH UNDER- & REASONABLY-VALUED STOCKS

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UNDERVALUATION

- **Undervalued** = Projected RV between 80% & 100%.
- Stock selling at or slightly below average valuation.
- Stocks often sell at 10% - 20% discounts.
  - Optimal purchase level.
  - High-quality companies may not sell for long at significant discount to average valuation (IOW, "average" may mean that stock price & P/E fell for single day).
- For consistent-growing companies, buying when undervalued provides extra boost to total return that help portfolio returns exceed market over time.

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REASONABLE VALUATION

- **Reasonably Valued** = Proj RV between 90% & 110%.
- Stock is close to average valuation—not especially on sale nor overpriced.
- If fundamentals warrant, can be good time to initiate or add to position.
- Over time, stocks almost always return to these levels.
- **Some high-quality stocks never sell for long at much of discount, so paying ~10% premium may work out well over long-term.**

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A LITTLE DISCOUNT WOULD BE NICE

- Buying stocks in **undervalued** & **reasonably-valued** ranges almost always serve long-term portfolio returns.
- Don't be discouraged from buying well-managed company at slightly-high valuation—it can pay off to **pay for quality**.

Warren Buffet: "Better to buy **wonderful company at fair price** than **fair company at wonderful price**."

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HOWEVER, NOTE THESE CAVEATS

- Any time stock sells much below average P/E, understand why:
  - Has entire market pulled back?
  - Is sector or industry under pressure?
  - Has competitor/peer hit roadblock, & stock has fallen in sympathy?
  - Is stock "fallen angel" facing temporary issues?

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BEST PROSPECTS MAY BE IN PORTFOLIO

- Investors tend to ignore currently-owned stocks when they have capital to deploy.
  - Don't want to increase average basis or lower total return earned from stock.
  - Not confident enough about stock to make additional buy decisions.
- Logically, these are often best candidates compared to other opportunities—***don't pass them by.***

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DEALING WITH OVERVALUED STOCKS

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OVERVALUATION

- **Overvalued** = Projected RV between 110% & 150%.
  - Overvaluation level increases as Proj. RV gets closer to 150%.
- For stocks you own, this is great place to be!
  - Means that valuations have increased since purchase.

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OVER-VALUED STOCKS IN PORTFOLIO

- If task of company analysis is done successfully, many stocks will be "over-valued" with above-average P/E ratios.
- Usually solid "hold" candidates as long as fundamentals are strong.
- In BI's approach, we never sell purely to lock in profit.
  - This is cutting blooms off flowers in garden & letting weeds grow.
- BI suggests holding through periods of overvaluation & "hot" markets.

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USE CAUTION WHEN BUYING OVERVALUED STOCKS

- Can be risky to buy stocks at these levels.
  - Ralph Seger: "High P/E stocks discount not only future but hereafter as well."
- Stocks at high end of Overvaluation stage are often "market darlings."
  - Don't jump off cliff just because everyone else is!

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DEALING WITH HYPERVALUED STOCKS

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HYPERVALUATION

- **Hypervalued** = Projected RV >150%.
- When stock reaches approaches this level, price is considered significantly "overheated."
- Risk from holding is **high**:
  - Level is unsustainable for long-term.
  - Downside risk is very large if something goes wrong.
- Considering these as more than simply "over-valued" helps with portfolio management.

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RISKS OF HYPER-VALUED STOCKS

- Stocks never stay hyper-valued for very long before pulling back.
- Risk is that valuations will regress to mean, which creates loss on paper (& regrets about what might have been!).
- As a result, these are often prime replacement candidates.
- However, hyper-valued stocks have way of continuing to increase in value, most noticeably right after you sell!

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"DOWNSIDE" OF INVESTING SUCCESS

- Unrealized gains may be high from stocks approaching or at hyper-valuation levels, which can inhibit selling:
  - Realizing gains will generate capital gains & resulting taxes.
  - Selling winners may leave portfolio overloaded with average performers or outright losers.
  - Selling good performers prevents future returns from those stocks.
  - You simply like having big winners in portfolio!

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GAIN/LOSS HARVESTING

- If portfolio includes **busted-valuation or stocks with unrealized losses** & **hyper-valued stocks**, then selling to generate offsetting gains/losses takes care of 2 problems at once.
- Consider sale as temporary & revisit sold stock only after 31 days (to avoid wash sale) to reconsider buying again.

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PROTECTION FROM HYPER-VALUED

- Selling stocks at or near hyper-valuation level will work out well in most cases.
- However, if concerned about missing potential future upside, consider using **Trailing Stop Loss Order** (TSLO).

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TRAILING STOP LOSS ORDER

- With TSLO, stop price changes as security price changes.
- Stop price can be set in 2 ways:
  - As percentage of current price.
  - As fixed dollar amount less than current price.
- Stop price goes up as stock price goes up but does not decline when stock price declines.

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TRAILING STOP-LOSS ORDER EXAMPLE

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WHEN SIGNS SUGGEST ACTION FOR "MAYBE ZONE" STOCKS

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"SELL" IS FOUR-LETTER WORD

- Investors often resist selling underperformers due to negative feelings sell action generates.
  - Holding still gives illusion of hope that stock will recover!
- A better approach is to strike "sell" from vocabulary.
- Instead, think "**replace**" or "**upgrade**."
  - Your portfolio can always be upgraded.

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REPLACE/UPGRADE UNDERPERFORMERS

- Remove "maybe zone" stocks by **replacing** for higher-quality, higher-total return stocks.
- Excitement around new stock pushes thoughts of prior holding into distant memory & reduces feelings of regret.

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STILL UNSURE? SHIFT YOUR THINKING

- Ask yourself why you are holding on to uncertainty
- If you are can't immediately reach decision, mark underperformer "Available for Cash" (AFC).
  - Then carry out search for replacement candidates.
  - Tagging stock helps brain & club members get accustomed to its removal.
  - New compelling candidates often provide ample rationale to replace underperformers in portfolio.

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SUMMARY OF STRATEGIES FOR COPING WITH MAYBE ZONE STOCKS

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STRATEGIES FOR "MAYBE" STOCKS

- Put "Maybe Zone" stocks with highly uncertain prospects "On Probation" & set plan/timeline for handling.
- Use TSLO on Hypervalued stocks to capture future upside but automatically sell on price declines.
- Do buy Reasonably Valued stocks when cash & portfolio diversification allows.
- Move questionable or stocks with busted valuations into Speculative portfolio.
- Seek to "Replace" (not "sell") stocks with uncertain prospects or busted valuations.
- Mark uncertain companies "Available for Cash" & seek replacements.

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QUESTIONS?

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STOCK IDEAS TO UPGRADE YOUR PORFOLIO

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