

Toughest Investing Decision: SELLING



Presented by
Bob Houle
Director, North Florida Chapter



Proud RM for the Northwest Buckeye Chapter



Celebrate SELLING !!

Winners Know How to Sell



Presented by
Bob Houle
Director, North Florida Chapter



Proud RM for the Northwest Buckeye Chapter





Disclaimer

- The information in this presentation is for educational purposes only and is not intended to be a recommendation to purchase or sell any of the stocks, mutual funds, or other securities that may be referenced. The securities of companies referenced or featured in the seminar materials are for illustrative purposes only and are not to be considered endorsed or recommended for purchase or sale by BetterInvesting™ National Association of Investors Corporation ("BI"). The views expressed are those of the instructors, commentators, guests and participants, as the case may be, and do not necessarily represent those of BetterInvesting™. Investors should conduct their own review and analysis of any company of interest before making an investment decision.
- Securities discussed may be held by the instructors in their own personal portfolios or in those of their clients. BI presenters and volunteers are held to a strict code of conduct that precludes benefiting financially from educational presentations or public activities via any BetterInvesting programs, events and/or educational sessions in which they participate. Any violation is strictly prohibited and should be reported to the CEO of BetterInvesting or the Director of Chapter Relations.
- This presentation may contain images of websites and products or services not endorsed by BetterInvesting. The presenter is not endorsing or promoting the use of these websites, products or services.

3



What We're Going to Cover

What Are We Really Doing When We Buy a Stock?

**Why is Selling a Stock
More Complicated than
Buying a Stock?**

**Are Buy & Sell
Judgments Different?**

**Why Sell a Stock
We Own?**

**How Do We Know
When to Sell a Stock?**

**Sell Signals
ON
the SSG**

**Sell Signals
NOT ON
the SSG**

**Not
Sell
Signals**

**Bad Reasons
for
Keeping a Stock**

4



When We Buy A Stock

We're taking an **ownership position** in a company that we highly regard and we're adding it to our existing portfolio **of owned companies** because we believe:

- It has high quality growth potential, and
- We're confident that management can continue to deliver this performance, and
- That, when added to our existing portfolio, it will contribute to the portfolio achieving our
 - target rate of return ...
 - ... at an acceptable level of risk

5



Why Do We Buy Stocks?

We buy stocks to **SELL** them in the future at a profit

- We are **NOT COLLECTORS**
- We are **SELLERS**

HOLDING is a buying decision

SELLING is a reversible decision

SELLING is about locking in your gains

6



Buy and Hold -- *bad advice*

Wrong attitude since “Hold” is often “Hope”

Buy and Hope is not a useful investment strategy:

- “Hope” shields our ego
- It often damages our wealth
- At best, “hope” prevents considering potentially better opportunities

7



Buy, Don't Hold



“Should you find yourself in a chronically leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks.”

- Warren Buffet

Always strive to be a **SMART SELLER**

8



Buying requires us to make judgments on:

Company expectations

- Growth rates (sales, profits, earnings)
- Operating metrics (margins, taxes, leverage, capitalization, payouts)
- Management performance (did they do it? can they do again? can they be trusted to act on our behalf?)

External factors

- Industry expectations
- Market expectations
- Competitor expectations
- Regulatory expectations, etc, etc



9



Selling Is More Complex Than Buying

Selling a stock requires us to:

- **Re-assess our current stock holding expectations**
 - Why did we buy it?
 - What did we expect it to do?
 - What did it do?
 - Why are we considering selling it?

10



Selling Is More Complex Than Buying

Selling a stock requires us to:

- **Re-assess our current stock holding**
 - Why did we buy it?
 - Why are we considering selling it?
- **Deal with the human emotions associated with selling**
 - Accept that our initial judgment was wrong
 - Learn from our “mistakes”
 - Apply the lessons learned to a new buy

11



When we consider selling we're often confronted with the reality that ...



The company isn't performing as I projected so . . .

- ... I must have made a mistake in buying it
- ... because my analysis was faulty
- ... and I should have known better
- ... and more guilt trip stuff

12



Selling Is More Complex Than Buying

Selling a stock requires us to:

- **Re-assess our current stock holding**
 - Why did we buy it?
 - Why are we considering selling it?
- **Deal with the human emotions associated with selling**
 - Accept that our initial judgment was wrong
 - Learn from our “mistakes”
 - Apply the lessons learned to a new buy
- **Buy a replacement stock**
 - The cycle repeats

13



So, Why Sell a Stock We Own?

Only three reasons to sell:

- We need the money



14



So, Why Sell a Stock We Own?

Only three reasons to sell:

- We **need** the money
- We **need** to protect the portfolio from harm



15



So, Why Sell a Stock We Own?

Only three reasons to sell:

- We **need** the money
- We **need** to protect the portfolio from harm
- We **want** to improve the portfolio




16

	Why Buy?	Why Sell?
	We bought because <u>ALL</u> of these were true	
	We had extra money to invest	
	We found a high quality growth company that was an industry leader	
	Based on our SSG judgments, the price of the stock suggested the potential return was adequate ...	
	... and that the potential for loss was acceptable	

17

	Why Buy?	Why Sell?
	We bought because <u>ALL</u> of these were true	We sell because <u>ANY</u> of these are true
	We had extra money to invest	We want or need the money
	We found a high quality growth company that was an industry leader	The quality (fundamentals) has serious problems.
	Based on our SSG judgments, the price of the stock suggested the potential return was adequate ...	Replacing a stock would improve the quality or potential of our portfolio.
	... and that the potential for loss was acceptable	It is grossly overvalued with little remaining upside potential.


18



When to Consider Selling?

We NEED the Money	PROTECT Portfolio (Defense = Quality Issue)	IMPROVE Portfolio (Offense = Valuation Issue)
When the need arises subject to tax and other considerations	<p>This is an urgent process that needs to be done every quarter as new fundamental data is made available:</p> <ul style="list-style-type: none"> based on quarterly SEC reports not driven by price or cost considerations not driven by market gossip 	<p>While this is an important process it can be done anytime:</p> <ul style="list-style-type: none"> Current price is a driver, but only for those high quality stocks that passed the Defense screen This is a valuation issue only (quality was already considered by successfully clearing the DEFENSE screen)



19





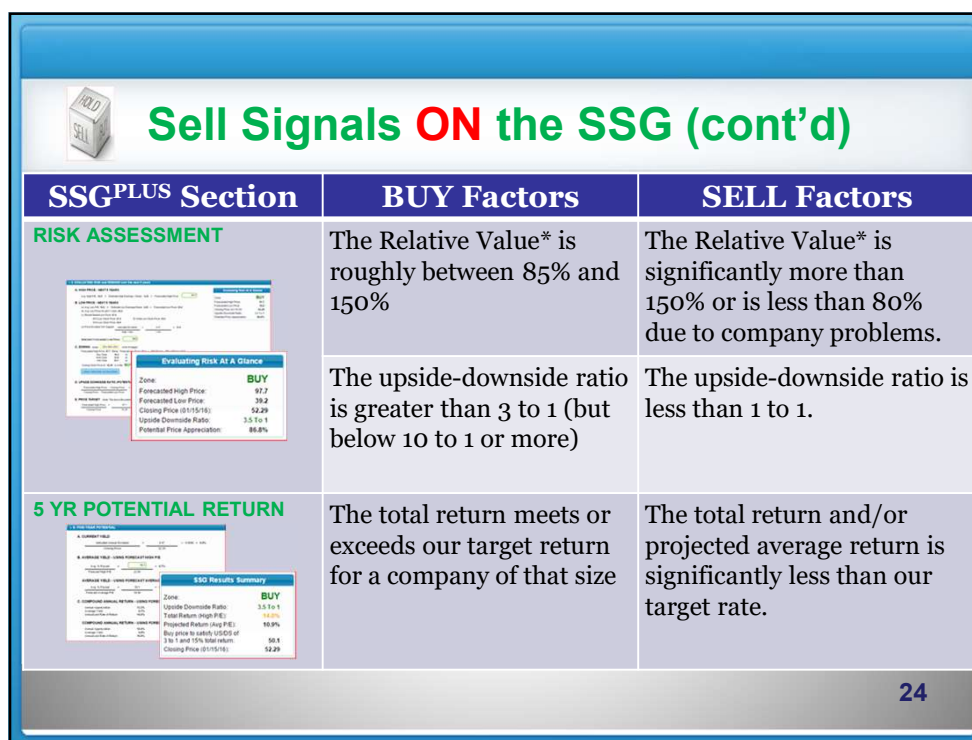
How Do We Know We Need to Sell?

We NEED the Money	PROTECT Portfolio (Defense = Quality Issue)	IMPROVE Portfolio (Offense = Valuation Issue)
<p>The need arises external to the investing process:</p> <ul style="list-style-type: none"> Personal: buy home, college, travel, retirement income, harvest tax loss, etc Club: club withdrawal cash out 	<ul style="list-style-type: none"> Fundamentals not living up to our expectations, or A threatening trend in the fundamentals <p>-----</p> <p>Note:</p> <ul style="list-style-type: none"> - Can only be done quarterly - It has nothing to do with stock's current price - It has absolutely nothing to do with how much we paid for the stock 	<ul style="list-style-type: none"> Company's stock price is so high that there is insufficient future return potential Other companies offer better investment opportunities are available Portfolio diversification is seriously out of balance <p>-----</p> <p>Note: Can be done anytime, driven by current price. This only applies to companies that <u>passed</u> the Defense screen</p>

20

 Sell Signals ON the SSG		
SSG ^{PLUS} Section	BUY Factors	SELL Factors
QUALITY ANALYSIS: (Growth) 	Primary growth rates (sales, pre-tax profits, and EPS growth) increasing steadily at an acceptable rate.	Growth slows to an unacceptable rate.
	Growth is consistent.	Growth is erratic.
	Sales and EPS growing at a similar rate.	EPS grows much slower or faster than sales.
	Most recent quarter is equal or better than the historical and projected growth rates.	The most recent quarter is significantly less than the historical and projected growth rates
	Confirming growth rates are consistent with primary metrics and each other	<ul style="list-style-type: none"> * Net income is going down while EPS is steady or rising * Free cash flow is diverging from net income * Book value is diverging from free cash flow
		21

 Sell Signals ON the SSG (cont'd)		
SSG ^{PLUS} Section	BUY Factors	SELL Factors
QUALITY ANALYSIS (Management) 	Profit margin and ROE are stable or trend steadily upward.	Profit margin or ROE trend downward.
	Profit margin and ROE are above the industry average.	Profit margin and ROE are significantly below the industry average.
	Debt/Equity: no or low debt; debt declining from low level	Debt/Equity: high, increasing, well above historical levels for company and/or industry
		22






SSG Conservative Decision Making

Being “Conservative” means different things when BUYING or SELLING

SSG ^{PLUS} Section	BUY Judgments
Driving Concerns:	Paying too much
Judgments:	Assume low growth rates
	Assume little if any PE expansion
	Assume there there may be further significant further downside price drops

25



SSG Conservative Decision Making

Being “Conservative” means different things when BUYING or SELLING

SSG ^{PLUS} Section	BUY Judgments	SELL Judgments
Driving Concerns:	Paying too much	Selling too soon
Judgments:	Assume low growth rates	Project optimistic but still realistic growth rates
	Assume little if any PE expansion	Assume possibility of PE expansion
	Assume there there may be further significant further downside price drops	Assume future low price no lower than current price

26

Sell Signals **NOT** ON the SSG

- An adverse management change (eg, CFO suddenly resigns)
- Non-boilerplate auditor's letter
- Financial results show problems or worse - signs of manipulation
- Weird footnotes on financial statements
- Balance sheet issues (rising debt; inventories and accounts receivable rising faster than sales; etc)
- Unchecked raw materials costs
- Key management changes or they're making bad decisions
- Funding for R&D downward
- The price drops below our estimated low on the SSG for no apparent reason
- The customer base is shrinking
- Competition is tougher
- Product pipeline deteriorating
- Uncertain product cycles

27



What are **NOT** Sell Signals?

MAJOR POINT:

Once we own the stock the rationale for retention or selling should all be addressed in context with our portfolio risk and return requirements.

We need to:

- (1) **root out bad stuff** before it poisons the rest of our portfolio and
- (2) **continuously seek improvements** in our portfolio's quality and performance

Don't sell just because:

- the price hasn't moved
- the price has reached its target price
- of a paper loss or a paper profit
- of temporary bad news
- of analyst downgrades
- of insider selling
- everyone else is selling
- you want to do something

28



What are **NOT** Good Reasons for **KEEPING** a Stock?

- we're emotionally attached to a company
- we hate to admit that we made a mistake
- we hate to take a loss
- we want to wait until the price rises back to our purchase price before selling
- we don't know how to take advantage of a loss for tax purposes (wash sales rules, emotions, buy again)
- we don't know how to restructure the portfolio to improve quality
- we don't want to pay taxes

29



What to Do When Deciding to Sell

- Update not just the company SSG you are considering selling but all companies in your portfolio and on your watchlist -- *challenge!*
- Understand objectively why you are considering selling
- Except in extreme circumstances, such as to protect the portfolio from imminent harm, have a replacement identified

30



The Bottom Line

Good Sales:

- Any sale that results in a gain is a good sale
- Any sale that results in a loss but is accompanied by an understanding of why that loss occurred

Bad Sales:

- When sale is driven by emotion (fear and greed) vs data & analysis
- When we don't learn from the "bad sale" (or "good sale")
- Not knowing how to sell (eg, minimize fees & taxes)

31



Keys to a Great Portfolio

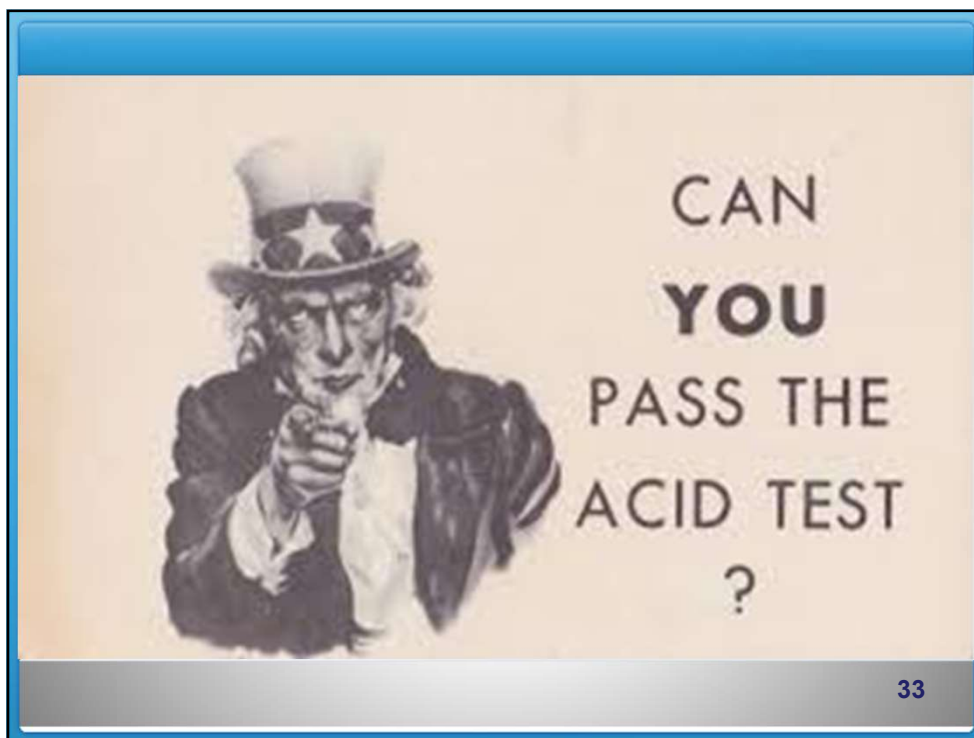
Don't fall in love with your stocks



Use (and trust) your SSG

Buy and Hold only if it makes sense

Don't be afraid to sell

32



 **The Acid Test** 

If I didn't own the stock, would I buy it at this price today?

If your answer is anything but YES! then it is time to start re-thinking your ownership position.

Be a Seller, not a Collector

34

What We Now Know

We know that being OWNERS (not TRADERS) should drive our decision making process

<p>Selling requires more from us than prudent buying</p> <p>We know that buying & selling are complementary, linked but different processes</p> <p>We know why we should and should not sell our ownership position in a company</p>	<p>Sell Signals ON the SSG</p>	<p>Sell Signals NOT ON the SSG</p>
	<p>Not Sell Signals</p>	<p>Bad Reasons for Keeping a Stock</p>

We have checklists to help take the emotions out of selling

35

The “6T” Key to Being a *Better Investor*

Through our participation in investment training we’ve demonstrated that we have the **TIME**, **TALENT** and **TEMPERAMENT** to potentially be a successful investor.

To realize our potential we need to master the **TOOLS** and **TECHNIQUES** available to us and that takes **TRAINING**.

The *Better Investing* world is all about **training** through a variety of venues.

If you want to be a better investor, take advantage of all that’s offered to you.

If you REALLY want to be a better investor, join the rest of the Volunteers in the Chapter who receive additional training so they may be even better able to help you.

Be a Chapter Volunteer!

36



The #1 Barrier to being a Good Seller

Your Emotions

The antidote?

Have your supporting Chapter visit your club and conduct an impartial

Portfolio Review

37



References

This briefing is entirely based on the seminal work of leading NAIC/BI members, most notably:

- “Take Stock” by Ellis Traub
- “BI Stock Selection Handbook” by Bonnie Biafore
- “BI Using Portfolio Management Wisdom” by Bonnie Biafore
- “Toolkit 6 Manual” by ICLUBcentral
- “Stock Selling Guide” by Douglas Gerlach
- [Considerations of Stock Sale](#)
- BIwiki.editme.com ([When to Sell](#))

38



Questions or Comments?

Bob Houle
bob.houle@gmail.com

North Florida Chapter of
BetterInvesting™
Volunteer