THE FORGOTTEN PART OF THE EQUATION: WHEN TO SELL A STOCK

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Every fund manager will have a fancy presentation on how they decide to buy a stock. Ask them how and when they sell and you will find many have not thought that through. From TV discussions to investment books almost everything about is about what stock to buy and when

Very little is written or understood about when to sell a stock

Even when something is written about selling a stock, it is usually asking you to look for turns in the business cycle or in the company financials or valuations. Many of these involve bets about the future, which is completely unknown.

Selling, is supposed to be even more of an art then buying. Then there are experts recommending a blind 'buy and hold' or 'buy and forget' strategy, usually with cherry-picked examples. Meaning they will only pick the success stories which demonstrate that holding something for ten years or twenty years has worked very well.

They will not discuss what happened to all the other companies or stocks that an investor would have bought at the same time which went nowhere.

The best thing you can do for your portfolio returns

So when should you sell a stock that you hold?

The very first thing to remember is that some of your buy decisions will go wrong, and this is meant to happen.

Warren Buffett sells nearly 80 per cent of his positions within two years. This means he recognizes that 80 per cent of his bets are wrong. Contrary to general opinion he does not 'buy and hold.'

Why you shouldn't have a price target. . .

Let's start with what not to do.
Don't decide at the time you buy a stock that you are going to sell it if it goes up to X.

If you're buying a stock at Rs 60, don't decide that you will sell it when it reaches Rs 100 or Rs 200, because that way you will miss out on the multibaggers.

So let your profits run.

As an aside, what most investors do is the opposite of this strategy – meaning, they let their losses run, at times waiting for their cost price to come back , whereas they book profits on their winners.

. . . But always have a stop loss

What you must have when you buy stocks is a stop-loss level. Decide what the stop-loss will be – say, 25 per cent or 30 per cent.

This has to be a trailing stop loss - not from your purchase price. If you buy at Rs 60 and have a stop loss of 25 per cent, it doesn't mean that your stop loss is fixed at Rs 45.

If a stock goes up from Rs 60 to Rs 200 and you have a 25 per cent stop loss, you will sell if it falls to Rs 150. You won't wait till it falls to Rs 45.

There may be cases when the stock keeps falling and there may be cases when the stock goes up again. But on the average, this strategy will save you serious money.

Averaging down?

Some 'experts' will advise that you average down in stocks that you have high conviction in when their prices fall.

This is an extremely dangerous strategy as your mind will always trick you into saying that your conviction was right and the market is currently wrong.

The exception to the rule

The exception to this rule is when a stock becomes an outsized part of your portfolio.

If a single stock becomes 40–50–70 per cent of your portfolio because it has gone up multiple times, then you might want to trim it and book some profits just so that you don't have such an outsized exposure to a single stock.

Another exception would be for small-cap stocks, where stop losses do not work well because when some of these stocks fall, they go down so fast that you are unable to exit. There, err on the side of caution. You may book part profits even when the stock is going up.