



Investment Insights

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When to Sell

Pick up a finance magazine, flip on a finance TV show, talk to your buddy at work about investing, and undoubtedly you'll get a hot idea for a great investment to buy. It's not hard to get myriad ideas on how to make a fortune in what surely will be the next Microsoft or eBay.

Once you've made that investment, however, advice on when to sell is much harder to come by. It's not a coincidence that buy or hold recommendations on stocks outnumber sells by an almost five-to-one ratio, according to First Call.

Whether it's a mutual fund, stock, or even real estate, here are a couple of good rules to follow.

Is it still right for you?

This is probably the most common reason I would recommend that a client sell an investment. If their circumstances have changed, the investment may no longer be appropriate for their new goals. An example would be the investments you hold in your IRA or 401(k) account. As you get closer to retirement, you want to invest in a way that limits the chances of a substantial decline in your nest egg. Thus, the stock mutual funds you might own in that account are no longer the appropriate investment vehicle for you. The funds may be wonderful funds, and they may work when you have many years to ride out the ups and downs of the stock market. However, as you become dependent on those retirement assets, down periods like the 2000-2001 timeframe can be devastating to your financial picture.

Has the investment changed?

This is the most subjective of the rules, but also arises very frequently: has the investment changed since you bought it? Change does not mean a change in value, but rather a change in the fundamentals of the investment itself. Fundamental change would include things like a dramatic change in earnings of a company you bought stock in, or a manager change in a mutual fund you own. If the change invalidates the reason you made the investment originally, it may be a reason to sell that investment. For example, many people own Berkshire Hathaway stock because they believe in the talents of Berkshire's Chairman, Warren Buffett. If Buffett were to retire tomorrow, it might be a reason to re-evaluate the investment and consider selling it.

Has the investment grown too large?

Diversification is a basic concept in investing, yet it is often violated, frequently to the detriment of the investor. This can arise if you are fortunate enough to experience substantial growth in one of your investment holdings. If a holding grows to the point where it becomes too large a part of your overall portfolio, you may want to reduce the holding to keep your portfolio balanced. This was a common problem during the technology stock boom in the late 1990's, when tech and Internet stocks grew so rapidly that they became a far larger part of a portfolio than intended. Had an investor been diligent about maintaining balance in their portfolio by selling off a portion of these stocks and rebalancing, the subsequent decline in tech stocks would have had a much smaller impact on their overall portfolio.

Finally, here are a couple of mistakes to avoid.

Profit or loss is irrelevant

Don't hold on to an investment simply because selling it today would result in a loss. If the holding should be sold, postponing a sale until you can "get back to even" will probably cost you even more in the long run as your intuition proves correct and the investment declines further in value. A common trait of many successful investors is their willingness to take a loss when they know something isn't working the way they hoped. In fact, many successful investors lose money on nearly half of the investments they make. The reason they are successful and profitable is their willingness to take small losses often, and let their profitable investments sit and grow.

Don't get emotional

Assuming you originally made the investment for good reasons, and those reasons have not changed, don't sell something simply for emotional reasons. This is one of the most common pratfalls individual investors make in investing. Emotions often cause investors to buy high and sell low, the exact opposite of what common sense says to do. At the peak of the stock market in January of 2000, mutual funds experienced record inflows of money, according to AMG Data. Conversely, at the recent lows of the stock market, reached in October of 2002, mutual funds experienced record outflows. Facts like these clearly show how investing emotionally can cost you lots of money over time.

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