

Buy, Sell, Hold?

**Portfolios heavy with under-performing stocks almost never outperform the market.
Ignat's Law**

"It is the "holds" that are too cheap to sell but not cheap enough to buy, that clog and clutter up your portfolio and retard your performance."

Barton Biggs

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Market Dynamics

www.relativestrength.net

7325 S. Jackson St.

Phone: 303-804-0507

clayallen@msn.com

What is the investor to do when an analyst changes his rating to "hold?" Years of experience watching Wall Street analyst's ratings strongly indicates that the investor cannot accept a "hold" rating at face value. To believe that everything is OK with the stock because of a "hold" rating is extremely naïve.

First of all, it makes a lot of difference whether the "hold" rating is the result of an upgrade or a downgrade by the analyst. There seems to be a very strong tendency for analysts to downgrade a stock to a "hold" rating, but very seldom do they go all the way to a "sell" rating.

This widespread behavior of avoiding "sell" recommendations is the result of many factors and business "facts of life" that an analyst has to consider. "Sell" ratings often negatively affect the Wall Street firm's investment banking relationship with a company. It is no secret that the management of a company is usually offended by an analyst who issues a "sell" rating on their stock and in some cases they might retaliate against such a brash analyst. In the past, some firms have instituted a policy against written "sell" reports using legal issues as a justification for the policy when investment banking business is the primary consideration.

Therefore, it seems that the investor must fall back on his own resources when an analyst issues a "hold" rating on a stock. This is true for institutional investors as well as individual investors. It is necessary for the investor to do his own research to evaluate whether the stock is truly a "hold" or not.

What is the best way for the investor to determine whether a stock should be held? Seasoned investors have learned that it is best to evaluate the trend of performance that is being recorded by the stock in the market. If the stock is

outperforming the market then it is probably OK to hold it. If it is showing a negative trend of performance relative to the market it is probably not wise to hold the stock.

I have prepared a daily report over the past three years that reports on the long-term trend of performance for stocks that have received a rating change by a Wall Street analyst and the conclusions are crystal clear. The report covers fifteen to twenty stocks per day and upgrades as well as downgrades are evaluated. The preparation of this report began in August 2005 and the trends on literally thousands of stocks have been evaluated.

It has not been uncommon for analysts to downgrade a stock to "hold" after a failed "buy" recommendation. Many times the trend of performance is straight down and yet the rating is maintained at "hold." This seems to happen about 80% of the time with a "sell" rating appearing in only about one stock in five.

After all, analysts are only human and no one likes to admit making a mistake. The analyst's job is also affected by the psychological tendency of the analyst to become overly committed to the "buy" recommendation. This commitment is reinforced by the act of writing a report and discussing the merits of the stock with clients. This verbal advocacy of the "buy" recommendation makes it almost impossible for the analyst to reverse his opinion on the stock and a downgrade to a "hold" rating offers a graceful "way out."

Sometimes, a "hold" rating is given for a stock that the analyst thinks has become overvalued but where the trend of performance is still strong. In this instance the trend of performance confirms the "hold" rating on the stock.

There is also the case in which the stock's trend of performance is within a sideways, back and forth, trading range. There is no persistent trend of performance in one direction or another. The investor will probably be better off if he ignores the "hold" rating and moves to a stock with a better trend of performance.

In all of these situations, it is important for the investor to evaluate the trend of performance to determine whether it is best to follow the "hold" rating or to ignore it. The issuance of a "hold" rating is only the beginning of the decision-making process and the critical factor is the actual trend of performance by the stock in the market.

W. Clay Allen CFA