Market Dynamics

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Knowing Which Stocks To Sell

Performance Management System

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

Buy stocks with good performance and hold them for as long as the good performance lasts. In order to do that, the investor needs to continuously monitor the performance of every stock in the portfolio.

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It seems that many, if not most, investors fail to develop the essential skills that enable the investor to know which stocks should be sold and when. This is unfortunate and causes many investors to have a very bad experience in the stock market.

First of all, good sell decisions require a facility with different methodologies than those used on the buy decision. Most investors approach the buy decision with pure fundamental analysis. The sell decision requires skill with performance analysis usually presented as a chart of performance. Experience shows that poor market performance will usually lead the public release of fundamental data that accounts for the poor market performance by a stock.

Since the academic community, for the most part, condemns the use of charts, they cannot teach investors how to make better sell decisions. There are few books that are devoted to helping the investor learn how to make better sell decisions and those are primarily within the realm of technical analysis. The academic community's aggressive indoctrination of students that teaches potential investors to shun the use of charts often keeps many investors from even a casual review of the literature of technical analysis.

Long-term experience in the field of investment management indicates that many purely fundamental investors have serious trouble with the sell decision. They tend to sell their good stocks too soon or they will hold their bad stocks too long. Not only that, but many purely fundamental investors will actually increase their holdings of bad stocks trough a technique called "averaging down." If the original purchase was based on the idea that the stock was cheap, then the stock must be even cheaper now because the price has gone down.

This is where performance analysis becomes absolutely essential. The primary difference between good stocks and bad stocks is not whether they are fundamentally cheap or not, but how are they performing in the marketplace. A good stock is performing well and a bad stock is performing poorly and that is the primary difference between the two. It is essential to record and measure the performance of every stock in the portfolio. The performance measurement process for long-term investors should remove the minor squiggles or noise from the price data and show the performance of the stock relative to the market.

When the investor becomes adept at the analysis of performance, he then not only knows what stocks to sell, he also knows what stocks not to buy. This skill allows the investor to concentrate his efforts on stocks that are promising and avoid wasting time on poorly performing stocks that may or may not be cheap.

Experience shows that the change from poor performance to good performance by a stock does not happen instantaneously. There is usually a period of transition between the period of bad performance and the emergence of good performance. The period of transition usually appears on the charts as sideways movement relative to the market that indicates that supply and demand for that stock has reached equilibrium. This sideways movement on long-term performance charts can take a long time to develop, usually months or even years. When the stock finally completes the base and turns up, the investor can conclude that the bad performance is definitely over and the stock has entered a period of good performance.

The emergence from the base is usually the most advantageous time to buy the stock. The investor cannot know how long the period of good performance will last, but if he continues to monitor the performance of the stock on the charts, he will know that he will see the change in the performance of the stock, if and when it occurs. The lesson is that the investor wants to hold stocks with good performance for as long as that good performance persists.

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