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Performance Management System

The Advantages Of Being A Good Seller

Portfolios heavy with under-performing stocks almost never outperform the market.

Ignat's Law

"It is better to stay out of trouble than to have to try to get out of trouble."

A maxim often repeated by a lawyer friend of mine.

A collection of recent newsletters is available on the web site.

I had a long talk earlier this week with a good client who attributes his success as a money manager to being a good seller. I thought it was worth discussing.

First of all, in my experience working with institutional portfolio managers for a very long time, I believe that many portfolio managers have a serious weakness when it comes to the sell decision. Almost all of their time is spent on trying to find stocks to buy and the sell decision is often neglected.

Charles Ellis in his now famous piece "The Loser's Game" (FAJ August 1975) advised institutional investors to spend more time on the sell decision. He wrote about and confirmed the unbalanced allocation of time by professional investors to heavily weight the buy decision. He felt that an edge on the competition could be gained by becoming a better seller. His article is now a classic but many investors miss it.

I believe that better risk management is a direct result from attention to the sell decision. Problem stocks are weeded out of the portfolio before they become a serious problem. Mistakes in stock selection are unavoidable and should be planned for. The focus on the sell decision provides this extremely important portfolio management tool. Peter Lynch's famous comment about portfolio managers pulling the flowers and watering the weeds is apropos.

There are other significant advantages to spending the time to become a good seller. One of the most important is, if you know which stocks need to be sold, you also know which stocks not to buy. This allows the portfolio manager to concentrate his time on researching the good stocks and avoiding the other stocks with the characteristics of a stock that should be sold. This results in fewer problem stocks finding their way into the portfolio and that makes the portfolio manager's life much easier.

Another advantage of being a good seller is that problem stocks are removed from the portfolio and a source of potential client dissatisfaction is removed from the portfolio. A big loser in a stock portfolio tends to poison the relationship with clients and degrade their confidence in the manager. It is far better to recognize that the stock needs to be sold and eliminate it from the portfolio. This is not window dressing. It is better for the client to have the bad stocks removed from the portfolio as soon as practical.

Another advantage of being a good seller is that the strategy of averaging down is eliminated. If the portfolio manager knows that the stock should be sold, any thoughts of buying more are quickly banished from further consideration. In my experience, averaging down is almost always a serious mistake. It is better to conclude that the stock should be sold and act accordingly.

Becoming a good seller usually requires becoming adept at chart reading. This is not to predict the future but to evaluate the trend of performance by the stock. When the long-term trend of performance turns down, experience shows it will probably continue. This is not a prediction but a recognition that the stock should be sold.

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