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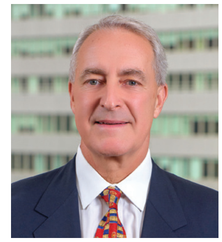
Thoughts for Investors



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When Should You Sell a Stock?

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Well, the most recent (fill in the blank) existential threat to the stock market seems to have passed for now. As the WSJ explained, investors are "probably relieved that the worst-case scenarios feared in recent months haven't come to pass." With many stocks and the market hitting new highs, caution is advised. Caution is always advised.

"It never hurts to take a profit."

– Wall Street proverb

Lately, I am asked more and more, "When do you sell a stock?" Does it *ever* hurt to take a profit? When does the S&P 500 Index sell? The Dow Jones Indices Committee (the entity that chooses what to add/remove from the index) rebalances the index quarterly, increasing or decreasing an individual stock's "weight" (significance) in the index as the company's "market capitalization" (size) changes.

The book *The Money Masters* by John Train is a concise summary of the investment philosophies and strategies of nine great investors. Each "Money Master" has a different "buy" discipline, and one may suit your temperament. Refer to our letter (Temperament as defined by nine great investors in the Money Masters) for guidance when selecting your approach. While their buy disciplines vary, as may be expected, their "sell" disciplines are more uniform, summarized into 4 main reasons.

1. You made a mistake in your analysis. This can occur for various reasons, including emotional and psychological. Perhaps you didn't have sufficient information. You will never have all the information, so don't succumb to "analysis paralysis." Or, you may have been overconfident, misinterpreted the information, didn't believe or ignored it, were purposely misled, or the information changed or became out of date. Companies and their competitors are constantly changing. That's why we spend so much time on research. Over time, the stock market can shift its perspective about what is important. A decade after the merger of Kraft and Heinz, they are considering divorce.

2. The fundamentals are deteriorating. This is different from cyclical ebbs and flows. Great companies navigate cycles. That's *why the strength of management* is one of our *Characteristics of Successful Companies*. Cycles (real or imagined) create volatility, which can confuse investors into "trading" stocks. A "selloff" may be an opportunity, not a problem. As we caution, *volatility is not risk unless you don't know the difference*. Some investors pride themselves on thinking, "Oh, I'll get back in." Occasionally, that happens. More often, like gambling, "trading" leaves investors with less and taxes. According to Invesco mutual funds, the "percentage of years US stocks (as represented by the DJIA, which exhibits survivorship bias) posted positive returns over rolling 15-year periods from 1901-2023 is 99.3%."[1] The moral is, unless you are certain fundamentals are deteriorating, all things being equal, stay invested.

3. You need the money. Retirement spending, a new car, tuition, and other expenses are valid reasons to sell. Carefully review your portfolio when choosing what to sell, keeping the investments with the greatest opportunity, perhaps even if you have a lot of it.

4. You found a better investment. This is the most difficult reason for selling. What if a stock has reached "fair value"? What is "fair value" for an innovative company? Many investors thought Amazon was just an "online book seller." Even Coca-Cola enjoys newfound success selling bottled water as sugary drinks decline in popularity. Finally, who would have thought one day you would ride in a stranger's or driverless car? What is the future of owning automobiles or an automotive stock? If you think a new investment is better, don't let tax implications cloud an investment decision. Buy it and sell the other.

"He should never buy a stock because it has gone up or sell one because it has gone down."

– Benjamin Graham, one of the "Money Masters"

That's often exactly what investors do! It's called FOMO (fear of missing out). Because a stock's price has risen or declined, is not automatically a reason to sell. If none of the 4 reasons apply, be patient and don't sell. "Price," as Benjamin Graham also advised, is a current measure of a stock's "popularity", not "value."

"Diversification is protection against ignorance."

– Warren Buffett, one of the "Money Masters"

What about selling for diversification? Some investors sell because a stock has risen, and they have "a lot" of it. They may have heard the phrases "it never hurts to take a profit" and "diversification reduces risk." Diversification doesn't reduce risk. It simply spreads risk out. Risk is when you don't know that you don't know. Depending on how it's defined, diversification may even *increase* risk if it distracts you from examining your existing portfolio for mistakes or deterioration, increases the number of decisions you need to make, or causes you to over-diversify or diversify into lesser opportunities or potential mistakes. While there are risks that may need addressing when a portfolio is overly concentrated, selling a stock for the sake of diversification may not always be the wisest decision. Allow me to give an example.

[1] Invesco. n.d. Why Long-Term Investing Is Like Going to Vegas — But Better. Accessed July 28, 2025.

Enron was once a popular stock and component of the S&P 500 index. In mid-2000, it reached a high price of over $90/share. On November 28, 2001, the committee removed Eron from the index, and it filed for bankruptcy a few days later. Enron was a fraud, and $1,000 worth of the stock became a near total loss at its bankruptcy. Never owning the stock because of your research (there were plenty of doubters) would have been best. Alternatively, selling because you realized you made a "mistake" would have also been good. Selling "some" for diversification didn't avoid a mistake.

Enron was replaced by NVIDIA in the S&P 500 index on November 29, 2001. A $1,000 investment in NVIDIA upon its inclusion was worth $1,147 by January 2015. Given the meager return, you may have been tempted to sell. Had you kept it because none of the 4 reasons seemed to apply, today it is worth $434,834, even after subtracting the Enron loss. By comparison, $2,000 invested in an S&P 500 index fund on November 29, 2001, instead would be worth $18,022 today. Now, NVIDIA is an extreme example, but it goes to show the power of concentration.

"I lost more money on the stocks I sold than the ones I bought."

– Anonymous

In summary, much has been written about the "affordability" of everything from houses to college tuition, healthcare, retirement, and food. Much has also been written about "preserving wealth." Consequently, knowing when to sell a stock is important. It **can** "hurt to take a profit" if you end up selling a wealth-creating stock by mistake or simply in the name of diversification. The risk of investing in <u>any</u> stock is it could be an Enron. Constant vigilance is needed. Diversifying into 500 stocks <u>spreads</u> risk rather than <u>reducing</u> it, "protecting against ignorance," but potentially diluting returns. You may never own enough of a great stock to create wealth, make up for mistakes, and attain your goals.

"If the job has been correctly done when a common stock is bought, the time to sell is almost never."

– Philip Fisher, one of the "Money Masters"

If you own what you believe is or may become a great stock, sell for the above 4 reasons. If none apply, remain patient and don't sell.

"Patience is an investor's greatest friend and emotion their greatest enemy."

– The Boris/Kaplan/Putrich Group

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"HEAR THE OTHER SIDE"

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