Newsletter

To sell or not to sell – that is the question?

Have you been caught out…selling your shares at a loss only to see them rise, or holding onto them (hoping they will recover) only to see them fall lower!

My hand is up – mostly because I haven't take the time to set up a Game plan. Last week we talked about having a plan, and my portfolio shows the importance of this. *No planning equals a very badly performing portfolio*.

As a part of your investment plan it is important to know what stocks you are going to buy and have a strategy, however along with this, it really does help to know when you are going to sell, and this means not just when to take your profits, but also when to cut your losses.

It is often said it is good practice to have your sell decision made before you even buy. This helps take the emotion out of the decision.

The funny thing is, selling can be the biggest element that we have a problem with. Just take a look this example:

"The reason why many have trouble selling is rooted in an innate human tendency to be greedy. For example, an investor purchases shares of stock at $25 a share, and tells themselves that if the stock hits $30, they will sell. What happens next is all too common. The stock hits $30 and the investor decides to hold out for a couple of more points. Surely, the stock reaches $32 and greed continues overcome rationality. They hold out for more.

Suddenly the stock price takes a turn downward and is back at $29. The investor then tells themselves that once the stock hits $30 again, they will sell it all. Unfortunately, this never happens and the stock price continues to drift lower. Succumbing to their emotions and frustrations, the investors sells at $23, below the initial buy price. As greed and emotion overcame rational judgment, sound investment principles were replaced by casino-like tendencies. The initial result was a loss. And while the investment loss was $2 a share, the true loss was $7 because the investor had the opportunity to sell at $30, but refused."
[When to sell stocks by Sham Gad]

Does this sound familiar?

For many of you I am sure it does…so not allowing the emotion to kick in and having a plan that you stick to is vital…as it will ensure that you lock in your profits or reduce the likelihood of incurring a major loss.

So what should your sell decision be based on?

As a risk management strategy you may find it helpful to have a predetermined falling sell (stop loss) in place, where you decide that if a stock falls to a certain level, you will sell – this can help remove the emotion out of the decision. Decide how low you are prepared for the stock to fall before the falling sell kicks in.

Selling to lock in your profits, may be a little harder to determine as 'emotions can easily kick in…but if you can make a decision as to what profit you would be happy with, even if the stock continued to rise, be disciplined and take the action.

There are a variety of different strategies you can use so it is definitely worth doing further research and study so you can decide what works best for you.

You can read more below as Simply Wall St. expands on the topic. Plus here are a few articles we found:

- Selling Shares: When is a good decision by Melanie Timbrell
- When to Sell Stocks – 6 Questions to Ask Before Selling Your Shares by Hank Coleman
- Knowing when to sell your shares. Five common mistakes by Lincoln Indicators
- The Stop-Loss Order - Make Sure You Use It by Investopedia staff

- How to Use Stop Loss Orders and Increase Trading Profits by Ryan Mallory

Hopefully this gets you started on working out when you are going to sell, and rather than reacting to the market (like I have) you have a good solid strategy to follow this will help with your overall trading plan and is definitely something to consider on your share trading journey. It would be well worth doing further reading on this, so that you can set a solid strategy in place that works for you.

More on buying and selling

Last newsletter, we looked at how to conduct research and to select the companies to actually invest in.

However, after you've selected the stocks you think are worthy of your investment, how do you know when to buy? Additionally, if you've bought the stocks, how do you know when to sell out of your position?

In this article, we are going to use retail company JB Hi-Fi to demonstrate when you should buy and sell a stock. Note that the following information about JB Hi-Fi is completely fictional and should not be interpreted as a stock recommendation.

Have a strong thesis and catalyst

Before you buy a stock, you always need to have an investment thesis and catalyst. This will be the backbone of your investment and will be a guiding force that will determine whether you should buy or sell a stock.

An investment thesis is a set of reasons for why you are investing in the stock. The catalyst is a set of events you think will cause the share price to move because of your investment thesis. An example of a fictional investment thesis for JB Hi-Fi would be that the next iPhone will be a larger success than most anticipate and your catalyst would be that JB Hi-Fi will exceed its profit guidance in the upcoming results announcement from strong iPhone sales, causing the share price to increase significantly.

It is important to have several investment ideas for each stock so that if one fails to materialise, there are other ideas to fall back on.

When should I buy?

Are the catalysts within my investment horizons?

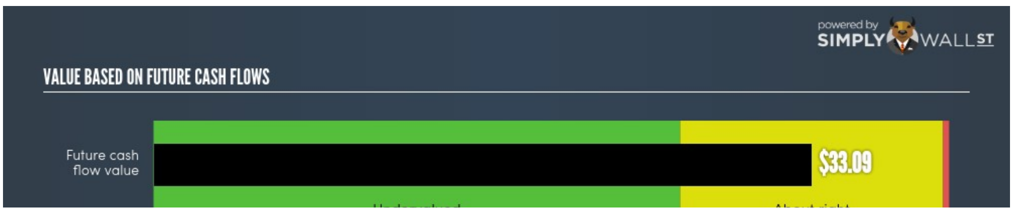
Now that you have established your investment thesis, you should evaluate whether your ideas will materialise within your investment horizon. In the context of the ASX share market competition, our investment horizon would be the timeframe of the competition. Even if you have a fantastic idea about a company, which may come true, if your catalyst is many years away, the share price will not benefit until that day comes. In JB Hi-Fi's case, if the upcoming results announcement is well beyond your investment horizon, it might be wise to pass on the stock for now.

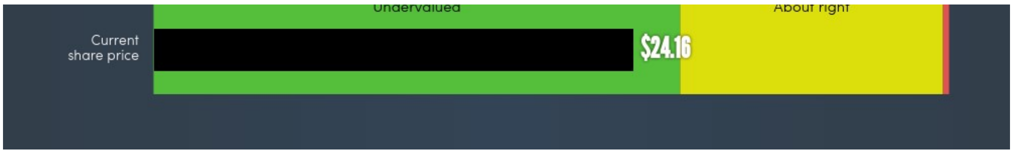
Check the valuation

Once you are happy with your investment thesis and catalysts, you should also double-check the valuation of your stock to ensure that there is still room for the share price to grow. If the company is already being overvalued by the market, it may be possible that your investment thesis has already been incorporated into the share price. In that case, it might be too late for you to invest. Additionally, an overvalued company may not react as much to positive news since investors are wary of pushing the company's valuation to stratospheric heights.

As mentioned last week, a popular and widely regarded valuation method is using a Discounted Cash Flow (DCF) model. This approach looks at the total value of a company's free cash flow (FCF), discounted to today's value. More detail on DCF can be found here.

When we examine JB Hi-Fi's valuation as an example, we can see that it is currently undervalued according to our model. As such, if we are committed to our thesis and the catalyst is within our investment horizon, the valuation shows that it is a good time to buy the stock right now.





When should I sell?

Whenever you are considering selling a stock, you should always ask yourself the following question: Has my investment thesis been violated?

Remind yourself of your original investment idea

As long as you strongly believe your thesis will materialise in the future, it is generally worthwhile to hold onto the stock and sell at a later date. In JB Hi-Fi's case, imagine that a few weeks have transpired but the iPhone's release date was delayed until next week. If you still believe demand for the new product will exceed expectations, you probably should keep holding onto the stock.

However, once you realise that your thesis has been violated and the share price did not respond to your catalyst as expected, it is advisable to reconsider your investment and consider selling. An example of a violated thesis would be the iPhone failing to meet consumer expectations, resulting in a failed launch and a decline in JB Hi-Fi's share price. While it might be tempting to hold on in hopes of the share price recovering, if you don't have new ideas about the company, it would be unwise not to sell.

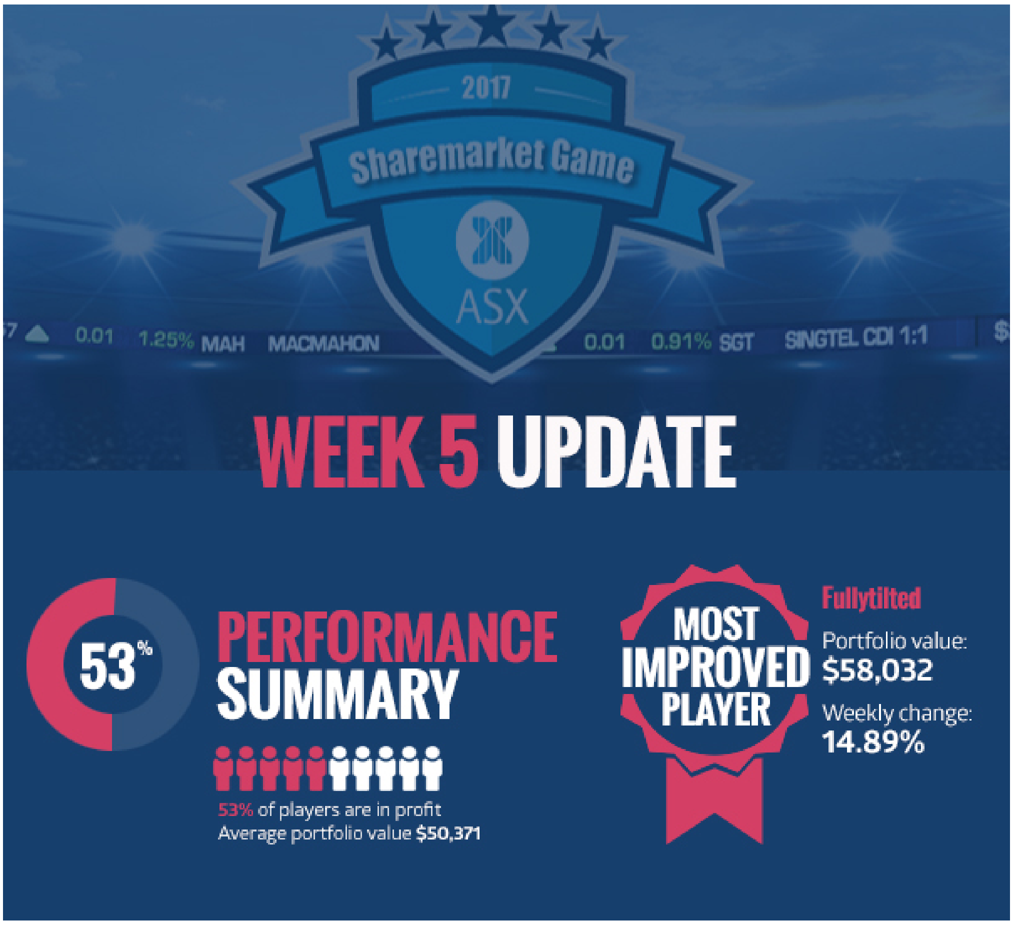
The opposite is also true if your thesis was proven correct and the share price rose strongly in your favour. While it might be similarly tempting to hold on in hopes of the share price improving even more, if you don't have any new ideas about the company, you should consider selling the stock and focusing on other investment opportunities.

Conclusion

By explaining the importance of having a solid thesis to base your investment decisions on, we hope that your motivations to buy or sell shares will be less affected by short-term share price movements and more by rational investment ideas. Whenever you're unsure of your holdings in a certain stock, remind yourself of your thesis and ask yourself if it has been proven correct or wrong yet.

While having a great investment thesis is very important, you should always ensure that the company's fundamentals are equally sound. Click here, if you missed last week's article about fundamental analysis. Alternatively, if this article has sparked an investment idea for JB Hi-Fi, check out the company report here.

Game weekly update



Eighth Wonder
QLD
$60,538

1ST

Purcho
QLD
$59,889

2ND

LePrix
TAS
$59,882

3RD

TOP 3 RANKED PLAYERS

S&P/ASX 200 PERFORMANCE

Up 0.35% for the week

0.35%

Mighty Ducks
$58,630
TOP LEAGUE

5 HOT STOCKS

	ASX Code	Company Name	% Change
1	GXY	Galaxy Resources	23.86% ▲
2	ORE	Orocobre Limited	15.09% ▲
3	IGO	Independence Group	13.45% ▲
4	SDA	Speedcast Limit	9.06% ▲
5	SFR	Sandfire Resources	8.82% ▲

5 COLD STOCKS

	ASX Code	Company Name	% Change
1	HVN	Harvey Norman	-12.47% ▼
2	VRT	Virtus Health Ltd	-7.34% ▼
3	PRY	Primary Health Care	-6.67% ▼
4	ACX	Aconex Limited	-6.65% ▼
5	CAB	Cabcharge Australia	-5.99% ▼

*Stocks are based on price performance: 30 August - 6 September **Please note** - these are not stock recommendations.

The indices and share price list has been updated for the period 3 - 30 August (CSV 13KB).