

Eliminate "Sell" from Your Vocabulary

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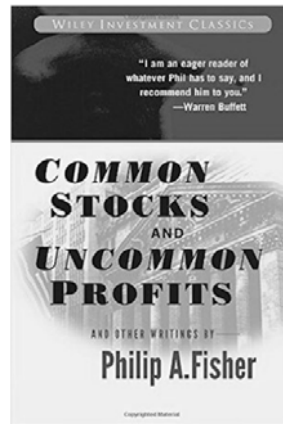
Disciplined Investing

- It's better to have discipline than conviction.
- SSG provides discipline for knowing what stocks to buy & how much to pay.
- Selling requires different skills & way of thinking.
- However, SSG can inform our sell decisions.

When Is Right Time to Sell?

"If the job of buying a stock has been done properly, the time to sell is never."

-- Philip Fisher,
Common Stocks & Uncommon Profits



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Warren Buffett Says...



"Buy low & never sell."

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Why Never Sell?



Wall Street Myths

- Individual investors aren't smart enough to invest on their own.
 - Brokers say we must have "professional" help.
- Wall Street's "rules" of investing generate commissions, not improve client portfolios.
 - "Lock in profits" = generate commissions.
 - Trade frequently according to analyst recommendations.
 - Buy brokerage firm products that serve the broker, not the customer.

Individual Investors Good at Buying

- Research shows that individual investors do good job of knowing when to buy individual stocks.
- BI approach makes it straightforward to identify high-quality businesses selling at reasonable prices.

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Investors Are Terrible at Selling Winners

- We sell winners too soon.
 - Wall Street preaches we should "lock in profits."
 - We should sell enough of winning commission to recoup our basis & "let the rest ride."
 - Good for generating commissions, bad for investor returns.
 - Selling winners is locking out future profits.

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Peter Lynch Says...

- "You won't improve your results by pulling out the flowers and watering the weeds."
- If you sell all your winners, what's left? Portfolio of losers!



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We Hold Losers Too Long

- "Long-term" & "buy and hold" don't mean forever.
- Uncertainty drives paralysis, & we hold on until it's too late.



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Acknowledge Mistakes & Move On

- We negotiate with ourselves & make promises to sell if we can get 80% of our money back (or 60%, or half, or 40%) until we have so little of our investment left that we say "why bother selling now?"
- Waiting to get even is self-defeating strategy.

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The Myth of Memory

- Because we can remember, we assume markets have memory.
- We therefore wait to "get our money back."
- However, market has no idea what you paid for stock.
- Waiting until it returns to original cost before selling is usually futile.

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Cognitive Biases Affect Sells

- Blame it on the brain.
 - Karl Pilkington: "Do I control my brain or does my brain control me?"



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Don't Avoid Problem

"Trading brings pride when decisions turn out well, but it brings regret when decisions do not turn out well. Investors try to avoid pain of regret by avoiding realization of losses."

- Meir Statman, Professor at Santa Clara University, "Investor Psychology and Market Inefficiencies"

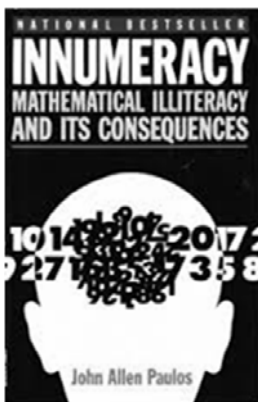
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Holding On...and On...and On...

- Moment we sell, we "lock in" loss & validate our "bad" decision.
- As long as we hold underperforming stock, it might recover!
- We hold on to slim strands of hope
- Easier to ignore than face up to problems.

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Don't Forget Your Failures



- "There is a strong general tendency to filter out the bad and the failed and to focus on the good and the successful."
- John Allen Paulos,
Innumeracy

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Know "Rule of Five"

For every five stocks that you purchase:

- 3 stocks will perform just about as you expected.
- 1 stock will be a superstar, performing well above your expectations.
- 1 will be a dog, an underperformer.
 - Underperformers consume inordinate amount of energy & thought.
 - Will cause paralysis & indecision.

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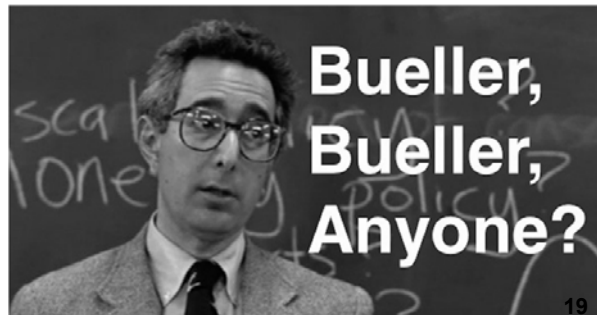
Identifying Underperformers

- Underperforming companies are not hard to identify.
- Any company with:
 - Poor growth trends.
 - Adverse management changes.
 - Competitive pressures.
 - Uncertain product cycle.
 - Unchecked raw material costs.
 - Margin deterioration.
 - Accounting irregularities.
 - Uncertain future prospects.

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Coping with Uncertainty

- If you are not confident about company's future prospects, why continue holding?



"Sell" Is a 4-Letter Word

- But "sell" is loaded term.
 - Wreaks havoc with our emotions.
 - Hurts feelings of club member who recommended stock.
 - Stimulates second guessing.
 - Adds to cash of portfolio, which may be undesirable.
 - May skew portfolio diversification.

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Banish "Sell" from Vocabulary in 3 Steps

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1. "Replace" Stocks

Think of "replacing" underperformer with better performer.

- You can always find better companies than those you own, in any market or economy.
- Added advantage of keeping portfolio fully invested.

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2. Challenge Current Holdings

Constantly "challeng" your current stocks to find better companies.

- At every club meeting or portfolio review, ask "what can we do to improve our portfolio today?"
- "How can we improve quality & total return of portfolio?"
- Weaker companies become obvious targets.

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3. Downgrade Underperformers

Mark underperformers as AFC ("Available for Cash") on valuation statement or portfolio summary report.

- Reminds that stock is candidate for replacement.
- Serves as incentive to find suitable replacement.

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Purpose of Portfolio Management

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3 Goals of Portfolio Management

1. Maintain optimal levels of risk and reward.
2. Help to replace stocks of companies with declining fundamentals.
 - Protect portfolio from damage done by poorly performing companies (defense).
3. Help to replace stocks that are overvalued or that don't provide necessary returns.
 - Pro-actively remove companies with limited upside (offense).

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Constantly Challenge Your Holdings

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Maintain Watch List

- Constantly be on lookout for new opportunities & add to Watch List.
- Use watch list to find candidates to replace uncertain companies in portfolio.
- Feed portfolio from bottom up.

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Challenge Holdings

- Use Challenge Tree or TK6 Challenger to compare candidates.
- When likely opportunities to replace one stock with another with higher projected total return exists, grab it!
- (Be mindful of tax situation, but don't be governed by it.)

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Use BI Challenge Tree

- Challenge Tree is paper form, not computerized.
- Available in members section of BI website.
- Useful in talking through impact of replacing one stock with another.

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QUESTIONS?

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For More Information

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