When To Sell A Stock - 7 Strategies on my 20% Portfolio Stock Sale Example

When to sell a stock – the hardest part of investing

I've recently sold a stock that made 20% of my portfolio and when it comes to investing, I think the hardest part is not to buy a stock, that is easy and these days most do it with a swipe. Also, the vast majority of discussions around stocks is about what to buy.

Selling is the hard part, the one that makes you think, makes you unsure and uncertain, but also locks in your gains, limits your losses and eliminates your risk.

However, selling a stock also creates high possible opportunity costs. A member of my research platform bought Amazon at $30 in 2003 and sold at $40 a few months later for a wonderful 33% gain. At least, at that moment it seemed so.

Amazon stock price historical chart

I love the Amazon example because it really emphasizes the most difficult part when it comes to investing: selling!

I wish to discuss 7 strategies that might help when it comes to selling stocks. The 7 strategies we will discuss are:

When to sell a stock – 7 strategies

Keep in mind each business is different and consequently each stock is different. The above 7 perspectives will always have different weights in the decision-making process depending on the situation. I'll attach approximate weights to the above reasons as I discuss my recent sale example through the 7 strategies.

Let me just quickly introduce the stock that I recently sold; Scatec Solar.

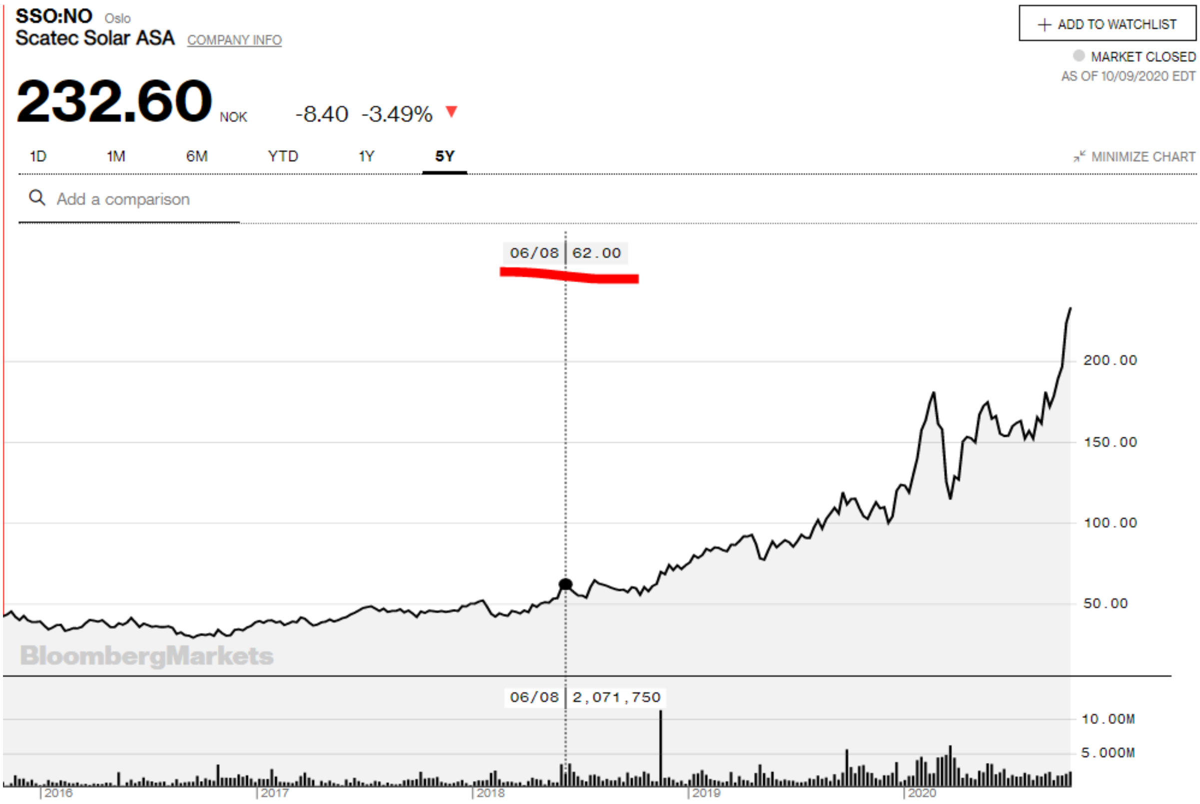
The stock I just sold

Scatec Solar is a company that builds and operates solar plants in emerging markets.

Scatec Solar – Source: Scatec

In 2018, I did a full solar sector analysis and I really liked the business model that got cheap and safe financing from development institutions and deployed it into interesting and value adding solar projects across the world. The company retains part of the ownership of the project and gets paid for the electricity produced with long lasting contracts.

The first time I bought the stock was in 2018 when the price was around 60 SEK as I calculated that the cash flows from the projects built would likely give a return between 10% and 15% which makes me happy. I later bought more at 120 SEK as I really liked the business model, the management and the growth it offered which had been confirmed over time.



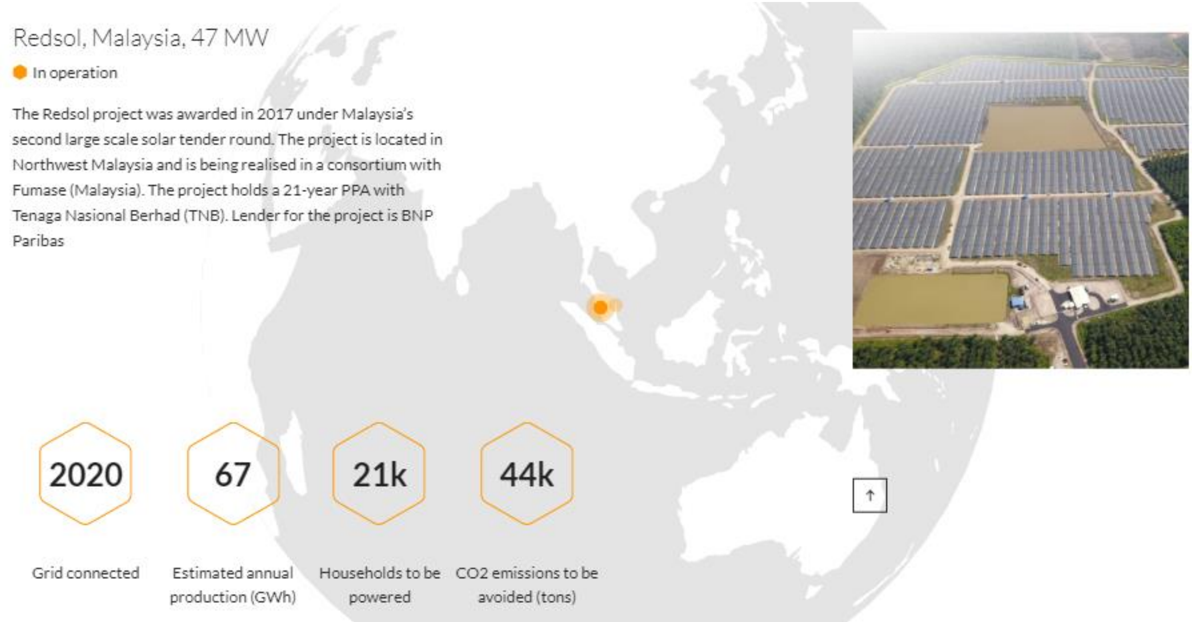
Scatec Solar stock price – Source: [Scatec Quote]

Now the stock has reached a level of 238.2 which is the price I sold it at, let's discuss my stock sale through the 7 strategies.

When to sell a stock #1 – Why Did you Buy it?

People buy stocks for various reasons; some because they think the stock will go up, some for the dividend, some for the fun of owning it. I usually buy a stock when my estimation of the value of future cash flows compared to the price gives me a return that is above 10% or even higher depending on the risk taken.

When I first bought Scatec, the margin of safety return was around 15%, expected from the already existing business through long-term cash flows. At my second buy, the safe return, also confirmed by the growth the company was delivering, was still above 10%. Plus, I really liked the exposure to emerging markets, the solar clean energy and helping people around the world with their electricity needs.



Scatec's Redsol project in Malaysia – Source: [Scatec]

Whenever you think about selling a stock, you have to ask yourself what has changed since you bought it?

For me and Scatec, the only thing that changed was the price of the stock. The business didn't change much at all but the market has been getting crazy about solar stocks and therefore Scatec's stock exploded.

The higher stock price led to a price to cash flow ratio of around 60, from the earlier 30. Even the 30 price to free cash flow seems high, but that was supposed to be covered by the growth of above 25% in the early years and later of at least 10% to 15%. The fast growth years have passed and the company will likely grow at a slower rate in the future. Given that the stock price doubled, the reasons why I owned the stock have changed from a risk, reward and expected return perspective.

In Scatec's case, I would give a 15% weight impact of my decision to sell to the fact that the competition increased a bit in the environment the growth slowed. Also, the valuation went up and consequently the expected return went down but Scatec is still a great business. I'll keep my eye on Scatec in the future, you never know.

Other things that can change, apart from the stock price are:

- The fundamentals,
- The dividend and be cut,
- Fraud,
- Incompetent management,
- Acquisition,
- Increased competition,
- Government intervention etc.

When something changes you have to see how the change impacts your initial reasoning and perhaps the best way to analyse what has changed is to put it into a portfolio risk and reward perspective.

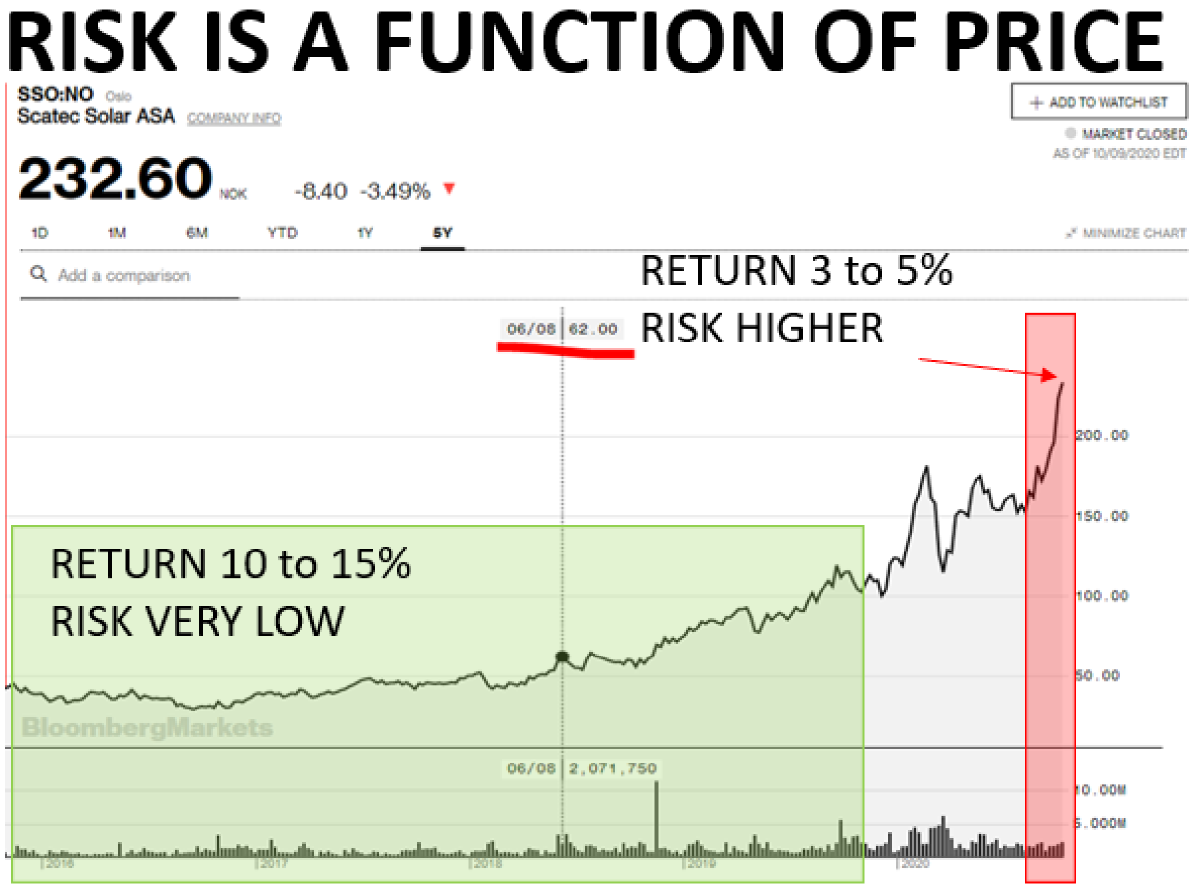
When to sell a stock #2 – Risk and Reward?

Investing is about risk and reward. What kind of risk are you willing to take compared to the potential reward?

Scatec Solar is backed by large financial institutions which means it gets cheap money, the management seems reasonable, there is demand for their service in the world, the cash flows are diversified globally and relatively certain given the 20+ year contracts. Therefore, the risk from a business perspective was and is low.

Today, given the exuberance related to renewable businesses, I feel like the competition has intensified which might lower margins a bit, this might lead to slower or less profitable growth down the line. The business risk didn't change much, but the risk impacting profitability did and the reward too because the higher the stock price is, logically the lower is the reward.

Investing risk is first and foremost a function of price, especially when the business fundamentals remain sound and steady.

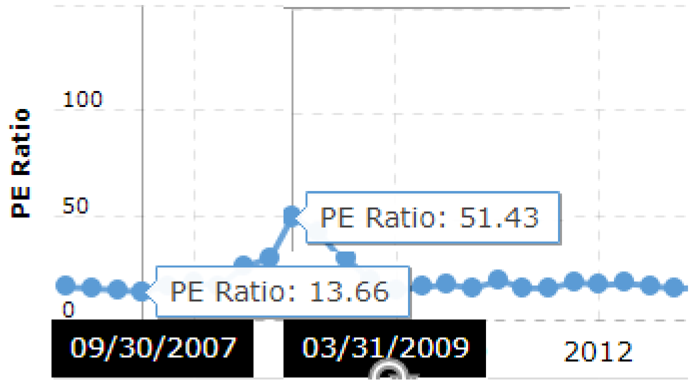


When I first bought Scatec, I saw a low risk investment that could easily double because the fundamentals were strong and the valuation low. Now that the stock actually doubled and the business doesn't look much better, and actually slightly worse than before, the chance that the stock doubles again is much lower while there is the risk that it halves and goes back where it was 12 months ago.

So, the stock has turned into a medium risk/medium reward position from a low risk/high reward one at the beginning.

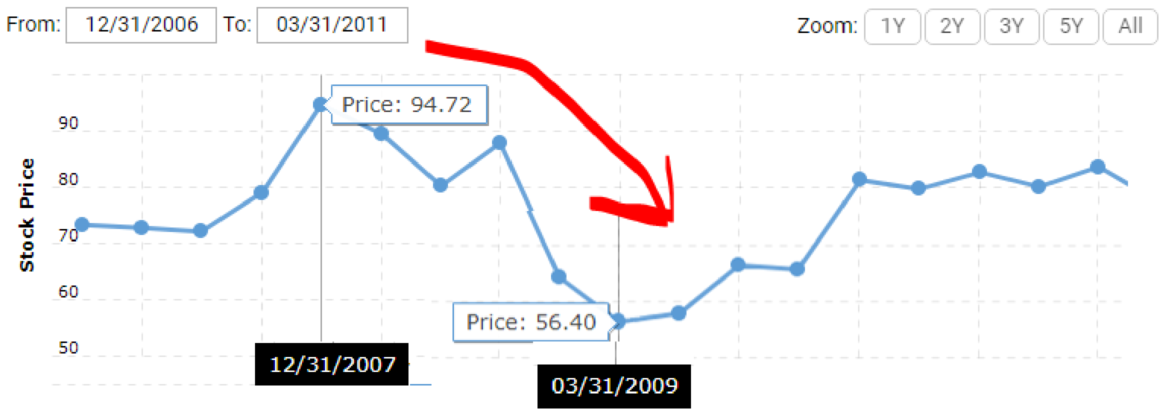
Looking at the risk and reward situation of an investment is extremely important because sometimes a stock can fall 50% or more due short term economic impacts, some news, market fear, scandals, some political situation, legal or environmental issues, for example. This might change the reasoning why you first bought it, but if the risk is actually lower after the stock price dropped and the reward higher, it might not be a reason to sell.

For example, imagine you bought Berkshire stock because you liked the price to earnings ratio of 13 and the exposure it offered to the growing American economy in 2007. By 2009, the price to earnings ratio wasn’t 13 anymore but 50 as due to the bad economic situation, earnings were decimated. Many sold Berkshire because the reason why they bought in the first place changed and the stock dropped. When something changes, also always keep in mind how the risk and reward changes too.



BRK stock price to earnings ratio from 2007 to 2009.

BRK's stock price dropped 40% where it was unlikely that the company will go out of business. Given BRK's business quality and long-term perspective, the actual investing risk declined and the likely long-term returns increased. Unfortunately, most investors don't get that which gives us a huge advantage because they keep the market irrational from an investing perspective.



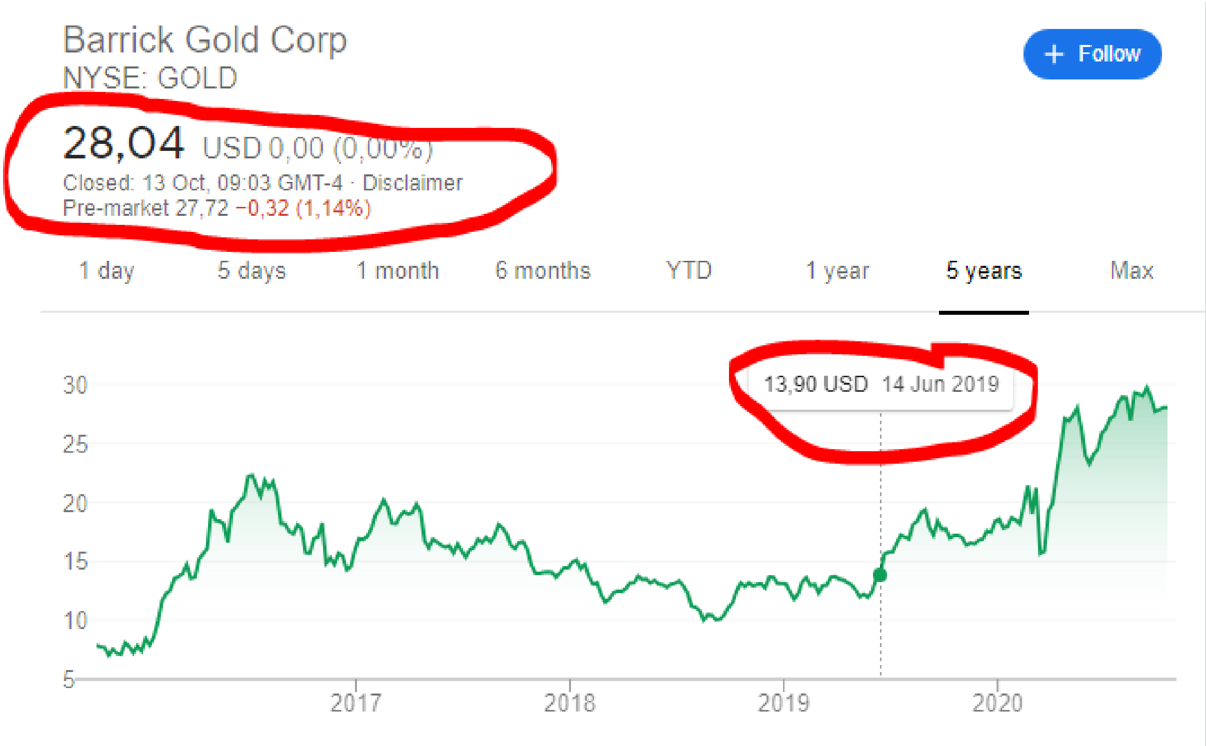
BRK.B stock price from 2007 to 2009 – 40% decline

From a weight perspective I give a 25% decision weight to the change in the risk and reward related to my Scatec sale because I prefer better situations, with lower risk and higher possible returns.

When to sell #3 – Portfolio rebalancing

When I first bought Scatec, it was 10% of my portfolio. As the stock doubled, it became 20% of my portfolio. I could have lowered the exposure to 10% and simply remained long. I personally don't have fixed portfolio exposures but such a strategy can be great for many. One example of such strategy is the All-Weather portfolio strategy often discussed by Ray Dalio and on my channel.

For example, you decide that you want your portfolio to have 10% exposure to gold because of its hedge properties to what goes on with monetary policies these days. A way to get exposure is through gold miners and I'll take Barrick Gold as example. You can read my Barrick Gold stock analysis here.



Barrick stock price

If you bought Barrick in 2019 and allocated 10% of your portfolio to it, by now it should be approximately 20% of your portfolio. You lower than exposure by half and bring it down to 10% and perhaps you increase your portfolio exposure to [oil stocks] because those are in a pickle at the moment.

RDS stock price – RDS stock analysis

Selling a stock to do portfolio rebalancing depends on your portfolio strategy. It forces you to do what you might not want to do instinctively, which is buy low and sell high, which is one of the reasons why Dalio's all-weather strategy works well.

As we discussed earlier, higher prices increase investing risks, which we could say is the case for gold stocks like Barrick now, while prices are low for oil stocks and the investing risk today is actually lower than it was 6 months ago.

As I don't personally do portfolio rebalancing based on exposure, but based on cash flows alongside the risk and reward that we discussed above, portfolio rebalancing has a 0% impact on my decision to sell Scatec.

#4 Why to sell a stock – Found something better

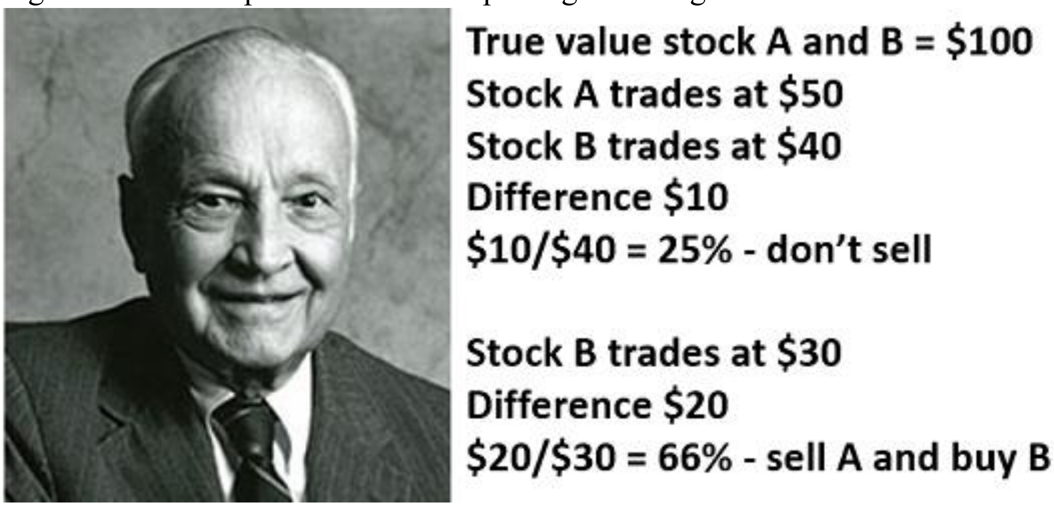
It seems logical to sell something and buy something that is better, but what would be stupid is to trade on a daily basis on every percentage point change. I've often looked for a strategy and actually found the best explanation given by the legendary John Templeton.

Joh Templeton would replace one stock in his portfolio only when another stock would represent a 50% better investment than the first one and he also offered a simple mathematical calculation that determines when a stock is 50% better than the other.

For example, if there are two equal businesses with a true stock value of $100 each based on your fundamental analysis and long-term cash flow expectations. Let's say that stock A trades at $50 while stock B trades at $40. The difference is $10 which is a 25% upside potential the cheaper stock offers and not really something to sell and trade on - $10/$40 = 25%.

Now, if stock B drops to $30, the difference becomes $20, which is now 66% upside and something worth to replace one with the other - $20/$30 = 66%.

Figure 5 John Templeton's rule for replacing a holding



John Templeton when to sell - Source: The Great Investors, Glenn Arnold

A simple rule like Templeton's trading rule helps to keep a cool mind and the discipline necessary to be a successful investor. Investing is about comparing opportunities and buying when the risk is low and the rewards high.

The fact that I have better investing options at the moment, that are low risk and higher reward than Scatec, is 50% of why I sold Scatec. I simply feel that the compounding potential offered other options is 50% better than the compounding Scatec offers at this moment.

When to sell a stock #5 – Stop loss

I personally don't use stop losses but it is a strategy used by many so we can't avoid mentioning it.

A stop-loss order to sell a stock is an order placed to sell a specific stock once the respective stock falls to a certain price. A stop-loss is designed to limit a loss on a position or to take as much advantage as possible of the upside.

Momentum investors or traders, those that look at charts and stock price movements, use stop losses in order to limit their losses if their trading idea goes the wrong way. For example, if the stock price moves 10% against them, it is automatically sold. This way you can limit your loss to 10% and leave all the upside open.

Using stop losses might be a good strategy on highly volatile stocks and stocks that move a lot on sentiment, like Tesla. As long as the trend for the stock is positive you enjoy the upside, when the trend turns, your stock is sold, especially if you use trailing stop losses.

Tesla stock price – using stock losses might increase your upside and limit the downside

If a stock price continues to go up, you can set up a trailing stop-loss where the stop loss price levels goes up as the stock price increases. When the trend reverts and the stock declines 10% from the peak, it is automatically sold. A trailing stop loss, in theory, allows to take more advantage of the upside with momentum stocks.

I am a value investor, so I don't use stop losses because when a stock price declines, I usually like the stock even more and I am inclined to buy more, not sell. Fundamental investors base their selling decision on fundamentals and the risk reward situation, not on short-term stock price movements.

Anyway, a proper discussion on when to sell a stock must include stop losses. If the strategy is something for you, you might want to investigate further and I foun a good academic article that confirms my intuitive elaboration above. Kaminski and Andrew W. Lo, the second one of the most quoted researchers in my Ph.D thesis, make an analysis on When Do Stop-Loss Rules Stop Losses? They found that in a normal environment stop losses actually reduce returns, but in a momentum environment they add value.

When Do Stop-Loss Rules Stop Losses?

EFA 2007 Ljubljana Meetings Paper

51 Pages • Posted: 5 Mar 2007

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Date Written: January 3, 2007

Abstract

Stop-loss rules - predetermined policies that reduce a portfolio's exposure after reaching a certain threshold of cumulative losses - are commonly used by retail and institutional investors to manage the risks of their

Do Stop-Loss sales actually Stop Losses? – Source: SSRN – Ljubljana meeting, close to where I live, fun.

Conclusion – use stop losses if you have momentum plays in your portfolio. As for me, 0% weight on Scatec Solar sale as I don't use them.

When to sell a stock #6 – When you have reached your goal

The best reason to sell a stock, when you have reached your goals. I don't want to be like Buffett and be in the top 5 richest in the world, I would be happy to be like Munger, a few billions will be enough.

This means that in 5 or 10 years, when my personal portfolio does really well, I might sell to materialize some goal of mine. It might be the beach house that I have dreamed of since I was a kid or a nice boat as you can't really move a house and enjoy the islands.

At such a point in life, it is not about financial goals anymore, it is about life. As Steve Jobs said, the last thing you want is to be the richest person in the cemetery.

On Scatec, as I think I can compound better with something else in order to reach my goals, let's say this factor has a 5% weight on my decision making.

When to sell a stock #7 – NEVER by Warren Buffett

Warren loves to say how his preferred holding period is forever. He invested $1 billion in Coca-Cola in 1988 and gets approximately $600 million in dividends from that and he will keep reinvesting those into new businesses and compounding into eternity with his [Berkshire Hathaway](). But, always be very careful with what Buffett says and what Buffett does.

09

12/31/09

Shares	Company	Percentage of Company Owned	Cost *	Market
			(in millions)	
151,610,700	American Express Company	12.7	$ 1,287	$ 6,143
225,000,000	BYD Company, Ltd.	9.9	232	1,986
200,000,000	The Coca-Cola Company	8.6	1,299	11,400
37,711,330	ConocoPhillips	2.5	2,741	1,926
28,530,467	Johnson & Johnson	1.0	1,724	1,838
130,272,500	Kraft Foods Inc.	8.8	4,330	3,541
3,947,554	POSCO	5.2	768	2,092
83,128,411	The Procter & Gamble Company	2.9	533	5,040
25,108,967	Sanofi-Aventis	1.9	2,027	1,979
234,247,373	Tesco plc	3.0	1,367	1,620
76,633,426	U.S. Bancorp	4.0	2,371	1,725
39,037,142	Wal-Mart Stores, Inc.	1.0	1,893	2,087
334,235,585	Wells Fargo & Company	6.5	7,394	9,021
	Others		6,680	8,636
	Total Common Stocks Carried at Market		$34,646	$59,034

19

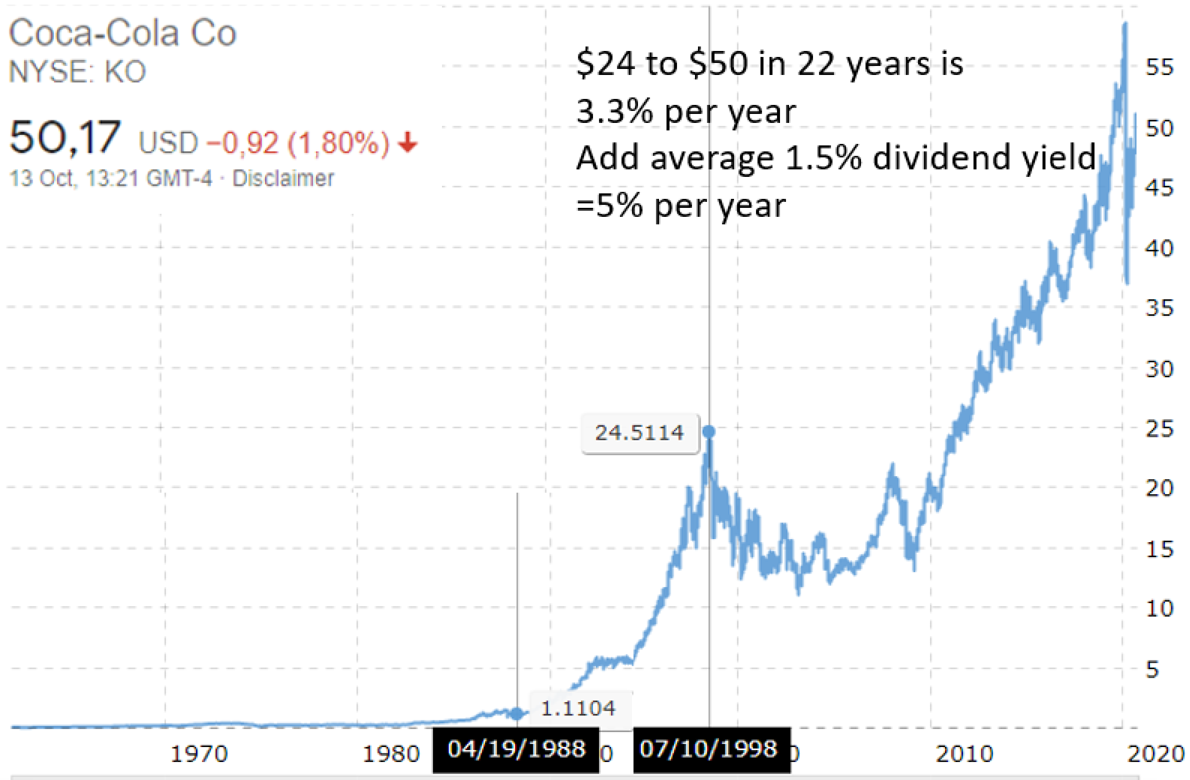
12/31/19

Shares*	Company	Percentage of Company Owned	Cost**	Market
			(in millions)	
151,610,700	American Express Company	18.7	$ 1,287	$ 18,874
250,866,566	Apple Inc.	5.7	35,287	73,667
947,760,000	Bank of America Corp.	10.7	12,560	33,380
81,488,751	The Bank of New York Mellon Corp.	9.0	3,696	4,101
5,426,609	Charter Communications, Inc.	2.6	944	2,632
400,000,000	The Coca-Cola Company	9.3	1,299	22,140
70,910,456	Delta Air Lines, Inc.	11.0	3,125	4,147
12,435,814	The Goldman Sachs Group, Inc.	3.5	890	2,859
60,059,932	JPMorgan Chase & Co.	1.9	6,556	8,372
24,669,778	Moody's Corporation	13.1	248	5,857
46,692,713	Southwest Airlines Co.	9.0	1,940	2,520
21,938,642	United Continental Holdings Inc.	8.7	1,195	1,933
149,497,786	U.S. Bancorp	9.7	5,709	8,864
10,239,160	Visa Inc.	0.6	349	1,924
345,688,918	Wells Fargo & Company	8.4	7,040	18,598
	Others***		28,215	38,159
	Total Equity Investments Carried at Market		$110,340	$248,027

Berkshire's 2009 vs 2019 portfolio – 50% of positions are gone

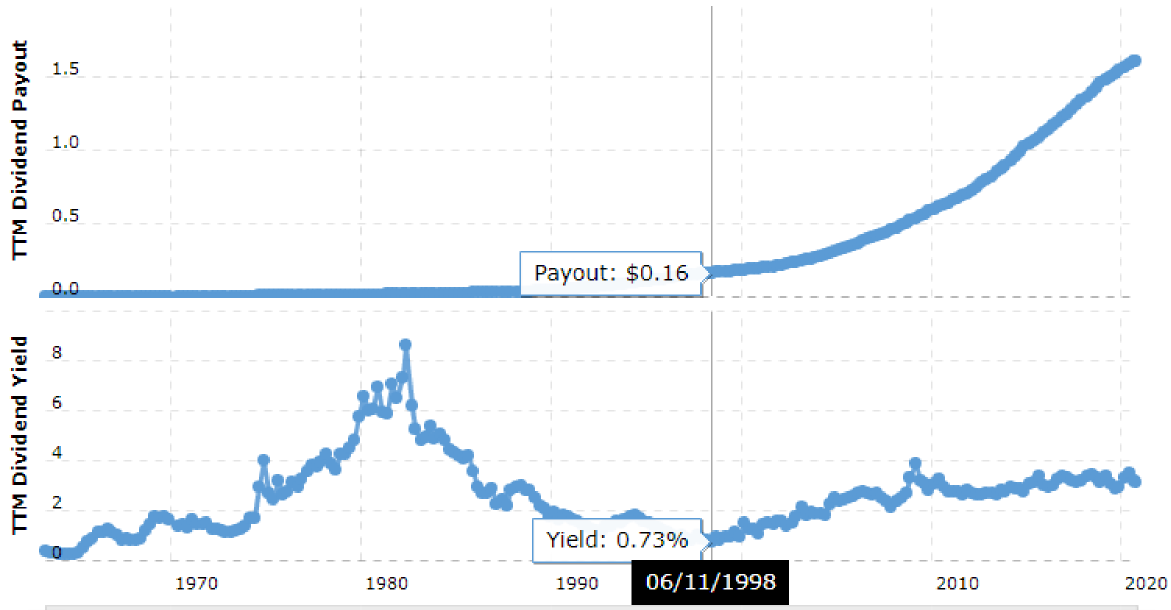
Buffett sold 50% of his portfolio positions over the last 10 years. So, yes, the preferred holding period is forever where the dividends keep growing and compounding for eternity.

But, Buffett manages a big business where size prevents a lot of what he can do. For example, his Coca-Cola holding did great from 1988 to 1998, but since then it hasn't really met his investing standards and the dividend yield now is just 3%. Plus, the dividend has been much lower over the last 20 years.



Coca cola stock chart – nowhere since 1998

The problem is that it would be hard for Buffett to unload such a big stake in a simple way, something that we as retail owners could had easily done as the dividend yield in 1998 was a meagre 0.73%.



Coca Cola dividend and dividend yield – Source: Macrotrends

All in all, I agree with Buffett, the best is to never sell a good investment, but given the volatility and irrationality of the stock market, that sometimes creates amazing bargains while at other times is exuberantly crazy about the same stock, makes it very difficult to hold forever. I recently analysed Apple stock on which I was long and very bullish in 2016; not much has changed in 4 years except for the stock price.

Apple stock price increased 338% in 5 years on almost equal earnings – Source: Apple Quote

I believe Scatec has the potential to compound for a very very long time thanks to its business model and management. However, to hold a business forever, you need to get good dividends like Buffett does from the businesses he owns like See's Candy or like the float he gets from Geico. Higher and higher stock prices on increasing valuations where fundamentals don't follow, increase the risk and lower long-term returns but at the same time give you a great reward in a shorter period of time which is beautiful when it comes to investing.

5% weigh in my decision making on not holding Scatec forever in this case.

Don't sell every stock in your portfolio now

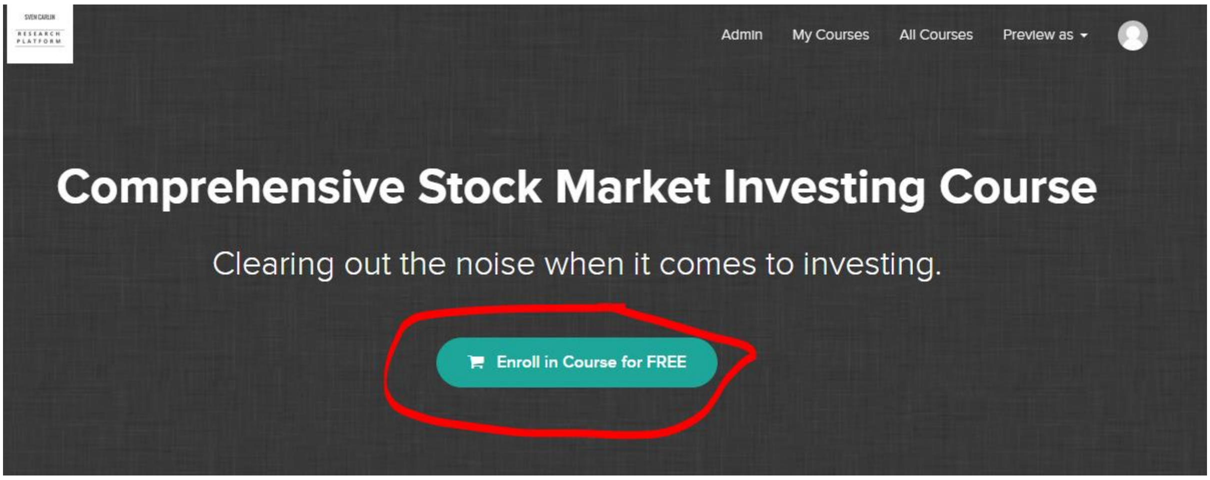
My thinking is that investing in stocks is one vehicle that should lead to something and it should be done according to the criteria that make you feel comfortable and sleep well with your portfolio.

I personally like safe long-term cash flows that give an above average yield, a busines with competitive advantage and exposed to a structural trend with a strong tailwind like electrification or the growth of the global middle class. When something changes, I look at the risk and reward, compare to other portfolio opportunities and sell at some point in time. Sometimes I make mistakes like when I sold Alacer Gold in 2019 where soon afterwards the stock doubled.

You can never be smart about selling because you never know what is going to happen with the stock price next. Don’t beat yourself up if you sold at the wrong time, it was the right decision to make at that point in time so always look from that perspective. Looking back is ok, but don’t dwell too much on it, life goes on.

Therefore, as with buying, I’ll keep focusing on fundamentals for my investment decisions in a value investing form. Has worked for me over the past 20 years. I hope this little discussion on when to sell a stock helps you in finding the strategy that best works for you and the one that will surely bring you towards your goal. Because the key of investing is not to make money, the key is to SURELY and CERTAINLY reach your financial goals, there rest is less important.

This article is part of my [Free Stock Market Investing Course](), check it for more content on long-term investing.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All Courses
Preview as
Comprehensive Stock Market Investing Course
Clearing out the noise when it comes to investing.
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