MOI GLOBAL

Investing Titans on When to Sell

Few numbers matter more to investors than the intrinsic value of the business, the price you pay for it, and the price you sell it for. A significant portion of time in the asset allocation process is devoted to those first two–figuring out what the business is worth, and how much to pay for it. But what about the last number? When, if ever, is the optimal time to sell the stock of a business?

The following conversations and quotes will explore this question thoroughly. Navigating the decisions involved with selling is challenging psychologically and emotionally. Luckily, we've picked the brains of some of the very best. Here's what they have to say.

Philip Fisher's Three Reasons to Sell

Philip A. Fisher is a notable name in the investing community. He founded Fisher & Co. investments in 1931 and later wrote the 1958 classic, *Common Stocks and Uncommon Profits* pioneering his 15-step stock selection process. The entirety of his money managing career spanned 70 years, and he was among the first advocates for seeking out high-quality, growth stocks. Even Warren Buffett took some pages out of Fisher's playbook: "I'm 15% Fisher and 85% Benjamin Graham," said Buffet. And when it came to the subject of selling, Fisher had three very clear rules.

> *"I believe there are three reasons, and three reasons only, for the sale of any common stock which has been originally selected according to the investment principles already discussed. The first of these reasons should be obvious to anyone. This is when a mistake has been made in the original purchase and it becomes increasingly clear that the factual background of the particular company is, by a significant margin, less favorable than originally believed. The proper handling of this type of situation is largely a matter of emotional self-control. To some degree it also depends upon the investor's ability to be honest with himself."*

Obviously, if you realize that you've overlooked some critical component when you initially assessed the business, there's no shame in selling your position. Mistakes happen in every profession, no matter how careful you are. To mitigate mistakes, top investors regularly implement checklists.

Mohnish Pabrai, even goes so far as to not talk about his current holdings publicly, because he knows he'll feel biased to stand behind his statements. By keeping his positions private, there is no psychological commitment to the company, and he can feel free to correct any mistakes he makes at any time.

Philip's second rule, reflects the effects of the passage of time. Circumstances can always change, and when a company no longer would fit your original criteria for an attractive position, it could easily indicate that it's time to sell.

> *"Sales should always be made of the stock of a company, which, because of changes resulting from the passage of time, no longer qualifies in regard to the fifteen points outlined in Chapter Three to about the same degree it qualified at the time of purchase. This is why investors should be constantly on their guard. It explains why it is of such*

> *importance to keep at all times in close contact with the affairs of companies whose shares are held ."*

No matter how long-term your thinking when you initially buy a company, an investment position isn't a set-it-and-forget-it deal. You've got to periodically and consistently go back and evaluate if your initial thought-process still makes sense. Value investors don't "trade", but they do adapt. Which, brings us to Philip's final rule for selling. Sometimes, there's just a more attractive opportunity.

> *"If the evidence is clear-cut and the investor feels quite sure of his ground, it will, even after paying capital gains taxes, probably pay him handsomely to switch into the situation with seemingly better prospects. The company that can show an average annual increase of 12 per cent for a long period of years should be a source of considerable financial satisfaction to its owners. However, the difference between these results and those that could occur from a company showing a 20 per cent average annual gain would be well worth the additional trouble and capital gains taxes that might be involved."*

While rare, compelling opportunities can occur suddenly and for small windows of time. So switching a position with dwindling prospects for another position with much higher long-term potential could easily pay off. Again, the idea isn't to be jumping from one stock to the next like a frog leaping from a sinking lillypad. Rather, it's to remain flexible in your thinking, and allow for new opportunities to bloom out of the old.

François Rochon on the Four Reasons to Sell a Stock

François Rochon, is a Canadian-based Value Investor and the Portfolio Manager of Giverny Capital. We've featured François' creative thoughts before in our post about What to Look for in a CEO. If you want a quick overview of François' thought process and a taste for Giverny Capital's investment philosophy, read this statement from his website:

> *"I often compare the craft of a money manager with that of a gardener: To have a great garden takes decades, not a few months. To successfully grow great trees and flowers, you have to understand your environment and capabilities (you can't grow the same flowers in Quebec than in Florida). You have to know the soil, the temperatures, the orientation of the sun, etc. And to build a garden is a dynamic process: you have to continually take great care of your plants."*

It's obvious François takes his craft very seriously. With a personal passion for art collection, he infuses this artistic flare into his investing style. So, what does he have to say about selling?

> *Well, we don't like to sell. We're not being sellers in general. We'll sell for, we have four reasons that we'll sell a stock. The first reason is that we believe the fundamental is not as good as when we purchased it and that's the life of investment. I mean, things change and sometimes they don't change for the best and when you realize that the best thing is to sell and buy something else.*

Like Fisher, François doesn't like flipping and flopping his positions. And similarly, if the fundamentals of the business change over time, François is willing to cut it from his portfolio. But one idea that François introduces which isn't on Fisher's list, takes management into consideration. Great investors like to say they think of themselves as business owners. So, when the investors don't agree or get along with the management of a company, it can be a source of conflict another signal to sell.

> *The second reason which happened sometime is that we don't agree with a management decision, usually it's a big acquisition, not all the time. But most of the times we sold a stock for that reason because they made a big acquisition that we thought was made at a very high price or we thought that was not very central to their business. I mean, Peter Lynch has this word, diworsification, the reason that so many times, so when one of our company does that then we don't agree with the management, the assessment of the acquisition we won't fight with them. We just sell our investment.*

Buffett can't stress enough the importance of working with great management. If you're intending to hold onto your shares for the long run, it probably makes sense to be on the same page with your managers.

> *The third reason, it's been awhile since it happened, it's when we think the stock is overvalued. I mean, if Visa would go to thirty or 35 times at one point, you have to say it's too high. So, we do sell when we think that the stock is overvalued. Usually, when I think that the price is at a level that I won't be able to earn 10% a year in the next five years, usually we'll sell.*

When the increase in the market price of the business far outpaces the increase in the intrinsic business value, François suggests that it might be time to sell. To be very clear, he's not recommending you sell your winners. What François is getting at is the inverse of value: overvalue. In the same way the market undervalues companies, the market most certainly overpays for businesses, and it's at these attractive prices that a value-seeking investor could be tempted to trim a position.

> *And fourth reason which probably is the most common is when we just find something else that we like better, so we'll sell A to buy B not because A has some kind of big problem, it's just that we like B a little better or a lot better, depending.*

François' last reasons is also a nod to Fisher. Sometimes, there's just a better looking fish. Nothing personal to the original selection, but part of managing money is factoring in opportunity costs. A dollar allocated in one company could be more efficiently used elsewhere, and it's the responsibility of a money manager to make and act on these differences.

Paul Lountzis on the Decision to Sell

To wrap up this post on the optimal time to sell a business, we'll listen to one more outstanding value investor from our community. Paul Lountzis is the founder and portfolio manager of Lountzis Asset Management. One of the unique points that Paul makes, is that it can feel easier or harder to sell your position depending on macro-economic cycles. For example, in a bear market it feels like everybody else is selling, so it doesn't seem as contrarian. But when everyone around you is buying, it takes guts to sell.

> *"Selling, when things are really going well like now, is much more difficult, but we're not averse to selling when we are convicted and even if it continues to rise, if that valuation didn't make sense to us, we'll still sell it. You're never able, really, to get it at the final point, but when the numbers don't make sense to us, we're eager sellers."*

In summary, no matter how optimistic things look, Paul Lountzis falls back on quantitative logic. If things don't look or feel right, there's probably a reason for it. At the end of the day, the books must balance. So when all else fails, go back to the fundamentals, and use them as your guide.