This article is authored by MOI Global instructor Viraj Mehta, Fund Manager of Equirus Long Horizon Fund, based in Mumbai, India.

Investing includes many aspects, such as scouting for ideas, screening them, research (which calls for scuttlebutt, or speaking to various stakeholders of a company), valuation, portfolio allocation, and efficient execution of trades (buying and selling). Most investment-related writing is devoted to screening, research, and the valuation part of investing — aspects that are much more objective and scientific in nature. On the other hand, portfolio allocation and execution, especially selling, involve more subjectivity. Lesser material is available on the art of selling. Even media discussions focus more on research and buying. Experts offer buying tips but rarely speak about the stocks they have sold.

The idea of holding on to investments for the long term, especially when a company's operational performance meets or exceeds expectations, is very attractive. But as most experienced investors know, not all companies perform as expected for extended periods of time. Real businesses are affected by domestic as well as global economic cycles, government policy actions, commodity and currency volatility, trade wars, corporate actions, and a lot more. While most businesses most are susceptible and some are resilient to adverse climates, a very few are antifragile (those that become stronger during bad times). In such times, it is important for the investor to have a framework that enables them to take calibrated actions.

Selling is as important, if not more, than research and buying. (Please note this is not about short selling, which is a completely different ballgame.) Apart from personal exigencies, there are many reasons for an investor to sell stocks in a portfolio.

1) Front-ended returns: Sometimes, the investment thesis plays out faster than expected, leading to stocks running up much faster than expected. Especially during bull markets, some stocks take off as soon as one buys them. Price starts running far ahead of fundamentals and within a matter of a weeks, months or quarters, the stock is up 50% or 100% or even more in some cases resulting in significant overvaluation. The risk-reward ratio at that price might become unfavourable leading to price or time corrections. Selling and deploying in a better alternative makes a lot of sense at these junctures.

2) Wrong investment thesis: Even though an investor has put in serious amount of work for researching an idea, the initial thesis sometimes turns out to be wrong. Any investment decision involves making a few assumptions about the company's future performance and/or assigning probabilities to an event/trigger. An investment thesis should be thought of as a three-legged stool. If any one of the legs is broken, the stool cannot stand. Investors should carefully evaluate the new circumstances and rationally decide the fate of that investment. Often, it saves lot of money to humbly accept a mistake and sell rather than rationalize and hold.

3) Adverse changes to business economics: Businesses keep changing and evolving due to many dynamic factors. These factors can be changes in general business environment,

technological disruptions, political actions or regulatory changes. These changes sometimes lead to deterioration of business economics and the ability of a business the earn decent returns on capital goes for a toss. When such developments occur, investors should revisit their original thesis and evaluate it critically, without being influenced by various psychological biases (especially sunk cost fallacy and price anchoring). Selling might be the best option (even at a loss) in most of these cases.

4) Adverse corporate actions: Importance of management actions cannot be emphasized enough during an investment journey. Management decisions can make or break an investment thesis. Bad capital allocation decisions, unfair treatment of minority shareholders, aggressive accounting practices, etc. are very clear signals pointing towards exit.

5) A turn in business cycle: Many businesses are cyclical. When these businesses do well over a period of 3-5 years, the investor should become very vigilant. Good economics attracts capital. As capital comes to the industry, the supply increases much faster than the demand which leads to deterioration of the business economics. Often, market reacts quickly in such cases and prices slide down very fast. An investor should always keep an eye on which leg of the cycle business is in. Holding a business through a downcycle can be very painful.

6) A better opportunity arises: Capital is limited for most of us and so, it must be used very judiciously. Capital must always be allocated to the best opportunities available. Whenever one is fully invested, and a better opportunity comes along, it is logical to replace the least attractive idea in the portfolio with the new one. Having said that, one should be careful before letting in any new idea. An investor is (ideally) much more familiar with his present investments than with a newer one. A new idea should only be included in the portfolio when it presents a significantly better risk-reward proposition than an existing stock in the portfolio.

Investments are like motion pictures rather than still photographs. Business dynamics keep evolving for better or for worse over time. An investor’s job is to keep a tab on these developments. They should remove the stocks with deteriorating fundamentals and hold on to or add to the ones that are on course or improving. In other words, the investor should water the flowers and cut the weeds.

At the same time, investors should remember that business fundamentals do not change as fast as share prices. There will be long periods of time when there will be no actionable insights. Such periods may last for a few quarters or even for a few years. These are the times when one needs to stay patient, confident, alert, and wait for the market to correct the mispricing.

Investors should also bear in mind that stocks may sometimes go up, for the right or wrong reasons, after you have sold them, especially in bull markets. It should not bother them. Mistakes will be made on both sides of the trade. There will be pain as well as learnings. But rather than being bogged down, investors should stick to a sound investment process which over the long run will produce satisfactory results.