The Art of Selling

Overcoming the most difficult investment decision.

Walking away from a loss-making trade is very hard to do, but hanging on in hope is perhaps the biggest sin of all. So why is it so hard to take a loss?

One academic study into behavioural finance once put up a theory that, true or not, makes a convincing stab at explaining it.

As the theory goes, losses have three times the emotional impact of a gain. We react more emotionally to losing money than making it. It is why markets fall three times faster than they rise. Because fear is a more powerful trigger for action than greed. When it comes to selling, it's the quick or the dead. When it comes to buying, you can take your time.

Emotion is a problem for all private investors. When you are physically sweating at your loss, concerned that this one is so big you can't tell your spouse, are you in any fit state to be making a rational decision?

No. So, you need rules and mechanisms to eliminate the confusion and make the decision for you. To do what we are all so bad at. Taking a loss.

Brokers live through this "shall I take the loss?" debate with their clients every day, so we have developed arguments to persuade our clients to do the sensible thing (for some reason, the same arguments don't seem to work on ourselves).

If ever you are having trouble taking a loss, not enjoying your trading, are getting emotional, and the stock is still in your possession, read this list. You will have put on a 'sell' order before you finish.

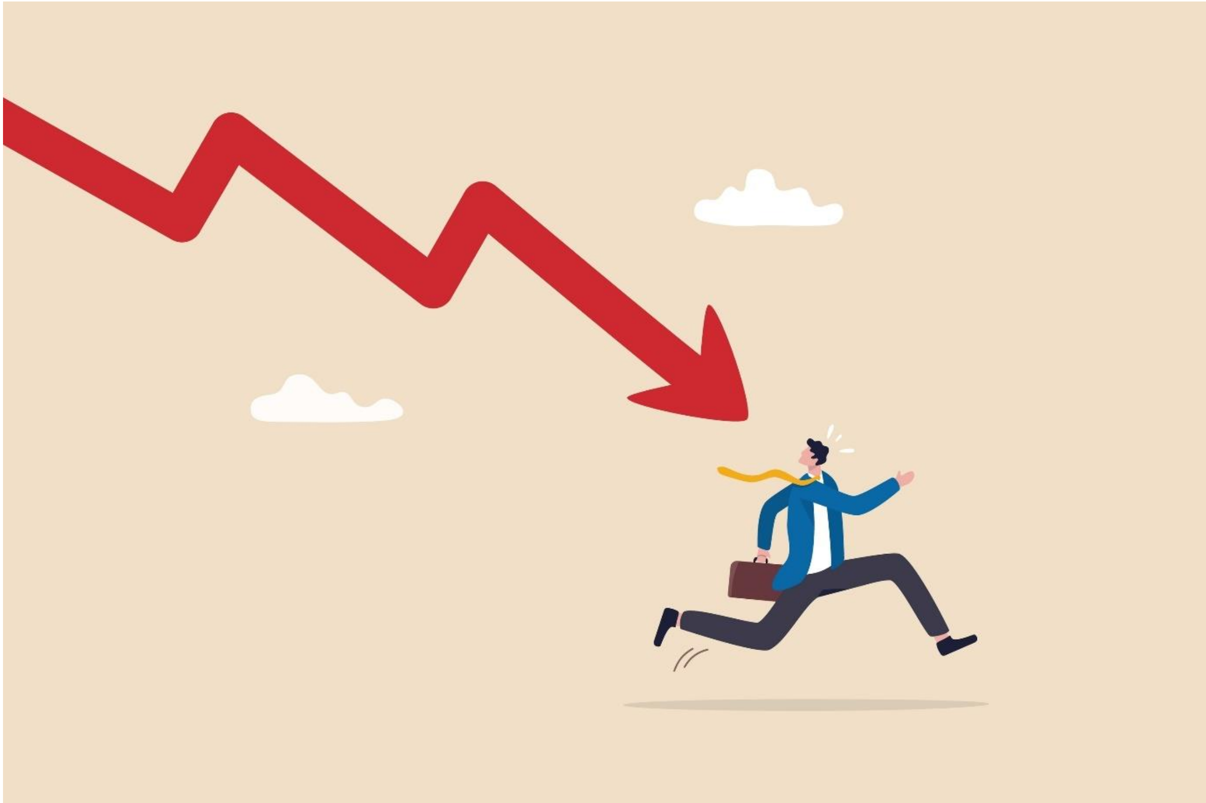
13 Tips for Taking a Loss, by Marcus Padley

- If a stock is going down, it is far more likely to continue going down than it is to turn on a sixpence to suit your wishes.
- The further a stock falls, the more intense the selling becomes, as higher losses cause more selling decisions. So, sell early. An early loss is the smallest loss.
- As any technical trader will tell you, if you sell ten falling stocks, it will be the right thing to do in nine cases – but you will only remember the tenth.
- If you sell now, you are no longer exposed. All you must do is come to terms with the loss.
- If you sell now, you can always buy the stock back. And who knows, you might buy it back for lower than you sold it.
- If you sell now, you enter the eye of the storm. All becomes calm. You can watch from a distance and take a moment to think. You can always choose to enter the storm again, and if you do, you will be thinking more clearly, and be armed with a plan.
- If you are making a loss on a stock, think to yourself – "If I had cash, would I buy the stock at the current price?" Is the answer no? Then why are you holding it? Sell. (Most people begin to 'hate' the stocks they lose money in, so this argument generally works).

- Your state of mind has value. What would your spouse pay (or you) to have you carefree at the weekend, instead of ripping the heads off the kids? Look after yourself. There are not that many weekends in the year, or your life. Don't ruin too many of them by keeping risky loss-making positions until Monday, because you didn't have the guts to sell them on Friday.
- Averaging down is what brokers advise you to do, to distract you from the fact that they have put you into something that has lost money. Do you really want to turn a short-term trade into a long-term loss? You see it every day in your portfolio. Every day, it will be flashing – "You idiot". There is value in avoiding that.
- Averaging down is a mug's game. If you have money to invest, you should be putting it into the best investment in the world. Do you really think that's going to be the very same stock you have already bought at a higher price and is falling now? Very, very unlikely. You already have exposure as well. Why do you need more of something that has already proved itself to be a dog?
- The quickest way to become a long-term investor is to make a short-term trade and get it wrong.
- There is no logic in being emotional about losses. Do what most brokers do with their own shareholdings. They have an Excel spreadsheet linked to live prices, monitoring all their holdings and what they are worth. At the bottom of the page is a total of what all holdings are worth now. That clicks over every second, all day. Up $500, down $500. This figure is the only truth. This is what the shares are worth. What you paid for the shares is irrelevant. So why care about whether the bottom line is a profit or a loss? It is an amount of money. If it's gone, it's gone… period. It is no more likely to come back because you paid a higher price. (There are still clients who will tell you they have $50,000 in ABC, when the holding is worth $25,000. You do not have $50,000 in ABC, you have $25,000).

- Most clients who have loss-making stocks will tell you that they "hate XYZ". So why hold it? Far better to put the cash into something that you want to wake up to in the morning, than something that depresses you. If in doubt, sell.

You will find that loss-taking can be a rather cleansing experience.



Now, let's delve into the realm of fear with Marcus Padley, and examine its profound impact in the finance world.

No doubt a lot of you, scarred by the GFC, by the 2020 pandemic-inspired drop in the market, or by the next potential sell-off, are constantly worried about a significant market correction. It's no fun investing in 'fear', and if that's you, then let me tell you about fear, and in so doing, rid yourself of the constant worry that the stock market is about to fall over and destroy your financial expectations.

Sidenote: Anyone who is wealthy, inactive, or incapable of selling can stop reading here.

First, You Need to Understand Fear

There is always, always, always something to fear when it comes to the stock market, and fear is good, because it's the fear that creates opportunities. *Rather than avoid fear, you should welcome it.* It is in the grip of stock market fear and exuberance that the most money is made in the shortest timeframe.

You should also understand that when fear starts, we will perpetuate it. Fear is great for us, for the financial media, the brokers, the financial planners, the fund managers, the financial advisers. In fact, it's great for the whole finance industry. Some commentators make a living out of fear, like Nouriel Roubini, or Marc Faber with his 'Doom and Gloom' report. Why? Because fear triggers insecurity which drives investors to us. Fear is the sheep dog of financial services. It rounds up the sheep so we can shear them. Yes, the sheep, that's you.

Fear is also a powerful magnet when it comes to attracting eyeballs, and in a competition for clicks, when investors are at their most fearful, the clicks and eyeball numbers explode. Everyone wants advice, and we will provide. Advice is the 'Trojan Horse' of our commercial purpose. Fear achieves that for us. It is so much more effective than common cheerfulness.

Fear and Clickbait

Clickbait, in its natural form, starts with the words “5 Things…”. To capitalise on that, we chuck in some of the top clickbait keywords, and then, if the glorious moment (as now) presents, we throw in some fear. “5 Things”, the keywords “Warren” and “Buffett”, and a small sprinkling of fear, and you have the most commercial headline in finance.

It goes like this:

"5 Reasons Warren Buffett Thinks the Stock Market Will Crash"

Publish and wait.

The bottom line is that fear is just part of the great game that is the stock market (any market). It creates the lows, it creates the best opportunities to make money, and for the finance industry, it is gold.

Whether it is a broker looking for an order, a media person looking for attention, or a financial planner looking to convince a client that they need them, fear gets more traction than optimism, fear gets attention, and fear gets clicks.

So, when the stock market drops 5% in a day, there are a few things you don't do. You don't join in! Fear makes you vulnerable as an investor. It distorts your normally objective state of mind. If you get fearful when the market loses its head, you become part of the herd. Far better you recognise it for what it is, an emotional 'moment' in other people's minds, and think about how you can exploit it. It will vary depending on the sort of investor you are, and the sort of risk appetite you have.

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A 5-Step Simple Plan of Action for You

When the market loses its head in fear.

- *Stay cold, objective, and logical. Be 'Spock'.* Look down on the fear, don't join in. Being emotional will not help you, it will cost you.
- *Accept what your shares are worth now.* Don't dwell for a moment on the highs, and how much you *were* worth. The highs are gone and there's nothing you can do about it. Anchor yourself to yesterday's prices and it will deliver nothing but regret and a feeling of stupidity.

- *Get excited.* The market only presents great opportunities occasionally. One is coming. It is from moments like these that quick money is made.

- *Take an informed guess at what you think is going to happen next.* The only thing that matters is what's *going* to happen, not what has happened. Read the Marcus Today newsletter and decide for yourself if the sell-off is a blip or a trend.

- *Decide what to do, if anything.* Understand that no one knows. Do your best. Just decide. And live with it. Accept the outcome, right or wrong. The only crime is deciding nothing and letting it all happen to you.

So, My Thought Process in Preparing for the Next Sell Off Goes Like This:

- *Take ten seconds* - For a few moments of weakness, I thought about how I could have called this earlier in the newsletter, before each fall in the market. Tiger Woods says you are allowed ten seconds to express your emotion after a golf shot. But that's all. Take ten seconds. It's good for you. But there's nothing to be done about that now. It is what it is. Time to move on and decide what to do next.

- *Identify the core issues* - I read a lot (as always), and quickly (it's pretty obvious) identified the core of the issues for the last correction. Macro stuff. In this case, inflation, interest rates and the fear of a US recession, with a sprinkling of China lockdowns and Russian risk.

- *Decide if it's a 'blip' or a 'trend'* - I made an assessment of whether the main issues were likely to persist, or turn on a sixpence. I decided they were more likely to persist.

- *Do something, or decide to do nothing* - I sold the three market-related ETFs in our 'Strategy Portfolio', and almost every stock in our 'Ideas Portfolio'. I'm good at selling, it's a thing I do well. You should learn to do it. It's cathartic. You wake up the next day hoping the market collapses, rather than fearing it will. It's empowering to have cash and be "ready to go".

- *Take it day by day, until the bottom* - Now the game is to watch and wait for 'peak fear'. The market will bottom one day. It could be tomorrow, or it could be in a year. You must take it one day at a time. Wake up every morning and react. There's no predicting it. I know I'll make more money in the recovery from the bottom, and more than I lost in the last few days of any correction. If I can get it right, and if I can time it right for our subscribers, it will be fabulous.

And that's how you approach this moment when it comes again. With the intention to exploit everyone else's fear.

By the way. *You can time the bottom.* Don't listen to those feeble commentators that say you can't. They want it to be impossible, so they don't have to do it. For financial professionals, it's a lot more effort handling active clients than it is handling docile 'buy and hold' sheep, and the more clients they can convince that timing can't be done, the less activity they incur for the same amount of fees. Just saying.

The Bottom Line

You should welcome corrections and other people's fear. The most exploitable moments of the market are the fabulous, exponential, irrational, exuberant bits at the top, and the most fearful, despondent, capitulations at the bottom. They are the bits, the extremes, the opportunities, that make the market worthwhile. Those extremes, those moments of stupidity, absurdity, farce, ridiculousness, and nonsense are brought on by other people's irrational fear and exuberance. You should expect them, look forward to them, and use them, not avoid them.

A good investor watches and exploits the herd. They don't join the herd. Let that be you.

Finally, we analyse Henry Jennings' 'selling mindset' and explore the three key factors that drive a 'sell'. These are:

- Cut losses, make the pain go away.
- Take profits.
- Better opportunities elsewhere.

It is one of the hardest things to do, and one of the most neglected.

It recently came up as a question at the course I do for kids from one of the mothers.

She had bought a stock that had tanked, and wanted to know when to sell. It was a horrible chart and she had lost money. What do you say?

First off, there is the easy answer; stop losses. It takes away the emotion. There are whole books devoted to how to set a stop loss. Marcus has his Average True Range (ATR) to try to gauge the volatility of a stock, taking out the noise and ensuring you do not get stopped out.

But it is not a science, at least in my opinion. Instead, it's a bit of an art, and the ATR will be dependent on how much risk appetite you have. You should probably overlay that in your trading plan. Trailing stops are also a great way to take out the emotion and lock in profits.

From my own experience trading CFDs (Marcus may banish me for even mentioning the products, Voldemort to some), I know that the market makers can just about see where the stop losses are. Frequently, I found that there was a push on some stocks to trigger those stops, take everyone out, and then once the pressure was relieved, the stock bounces. It was uncanny. The provider does not even need access to the stocks, you can probably work it out from a chart. And if the traders are all using the charts provided, then they are all coming to the same conclusions, and setting the same stops. Just a theory (untested) of mine, but one to be concerned about.

How Do You Stay Strong, and Stay Long?

I have said this before when talking about the '$12 Million Dollar Man'. The hard bit is not doing the research, getting close, and understanding the potential, but *not selling too early*. I know that if it were me, I would have sold out way too early. Small fish are sweet. But if you keep taking the small ones, you will never find 'Moby Dick'. The whale.

So, how do you stay strong, and stay long? Part of the answer is setting targets and a valuation in your trading plan. The whole point of investment analysis is to compare something with something else. When you value your lithium stock, for example, there are guidelines as to what it is worth. You can compare it to a company further down the track. You can see what the market values a miner, rather than an explorer, or a project builder. You can observe the timeline, and work on the catalysts for the rerating along the way, constructing your trading plan on that basis.

Of course, it is not easy. If I have something that doubles, selling half means that the rest of it is free. I love being in that position. Something for nothing. A position running that owes you absolutely nothing. Then you can sit back, wait and watch.

I am also a fan of feeding the turkeys whilst they gobble. You can only sell a stock when there are buyers. So, selling into strength works for me. Others may go with momentum and try to time the market, using those trailing stops to lock it in. It's a great discipline.

Anything that can take the emotion out of the decision is good. Fear and greed are big human emotions and can cloud our judgement. How many times have you ended up making a bad decision based on a tax issue, for instance?

When All Things Turn to Custard

How do you cut a losing position that has gone so bad, you cannot even bear to look at it. There is the bottom drawer of course. We all have those. Dodgy mining companies, or the like, where they have stalled, dived, and only just survived. It can be a long road back, if it makes it. What do you do? Just cut and move on? Do you bottom drawer it? It could be a lottery ticket without an expiry date. Frequently not.

Or do you average down? Let's call it 'dollar cost averaging', as it sounds better and well thought out. Many will tell you that you should never average down. Never compound a bad position. Move on. But there are times when the market gets it wrong. The market is not as efficient as it should be. It does not always value things properly, so maybe, just maybe, the investment case still adds up. But don't be stubborn and so chock full of hubris that you think you are right, no matter what. The market is bigger than you are. Always was, always is.

When I have a position that is going wrong, I occasionally use a soft stop loss. To check if all the reasons I bought it for still hold. Sometimes I decide that I should sell some. It makes me feel that I am doing something, and if it keeps going down, then I can buy back more at lower levels. If 'Sod's Law' comes into play and it bounces, I still have some. It works for me. It may not work for you. My risk appetite is probably greater than others. I screen watch all day, every day. *You need to have a plan that suits you.*

Summing It Up

- Actually have a plan. Stick to the plan, but be flexible if new information will affect it.
- Take the emotion out of it, if you can.
- Sell when you can, not when you have to.
- Set stop losses if you need discipline. Hard or soft
- Use strength to ease out of positions. Nothing lasts forever.
- Don't believe you are invincible. You do not know better than the market.
- Put as much work into the sell strategy as you put into the buy strategy.
- Being able to 'sell' is as important as the 'buy'. Anyone can buy. Not always easy to sell, or manage a position.
- If you need to clear your mind, you can always sell and get back in again at another time. You are not barred for life from a stock.
- It is called 'making money'. And to make something requires effort, energy, and experience.

By adopting some of these strategies, you can potentially avoid future losses, and most certainly reduce stress. At Marcus Today, we strive to build a 'Community of Better Investors'.

Taking control of your selling decisions and overcoming fear will put you ahead of those without a plan. As the saying goes – "If you fail to plan, you plan to fail."

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