

## **EXIT STRATEGY**

**By Nancy Zingel**

**SELL TO ROTATE OUT OF ONE SECTOR INTO ANOTHER**

Jim Cramer “good things happen to people in the right sector. Sector is everything. People fall in love with a stock & it becomes hard to end the relationship. You must be able to sell.”

Sell **BECAUSE YOU NEED THE MONEY**. You choose your weakest link...or... a stock that is the most expensive.

Selling to cut your losses is more difficult to do & we will look at why that is.

**SELL TO LOWER RISK... CAUSED BY:**

1. Management changes
2. Change in Focus of the business
3. Price to NAV – the stock is too expensive
4. Dilutive Financing. The company has taken on too much debt.

**Article “Protect your Portfolio from Yourself”... 5 key themes**

1. Commit in writing. Investors increase the odds of sticking with their strategy ...if they first ... set out clear investment objectives ....and parameters.... including a portfolio return goal... risk limitations... a target asset mix, and rebalancing requirements... in a written plan.
2. Own your strategy. The most important decision in any investment strategy is the tradeoff between potential return and risk. Avenue Investments ...” Risk Adjusted Return. We’re always trying to lower the risk on our portfolio. We want to sell on weakness and stay on strength.’

3. Have concentration rules. Impose limits on the exposure to any single manager, or position... avoid placing an ever-increasing bet on yesterday`s winners.
4. Think in decades ...not in years. It`s easier to stay the course when your planning horizon dictates that your portfolio will have to endure... numerous bear markets.
5. Be realistic. Diversification can enhance risk-adjusted returns... but it is not a silver bullet... this won`t deliver outstanding returns in sinking stock markets. Example – the ultra rich suffered the same losses in 2008 as did the average investor.
  - a) The average investor generally buys stocks for less than one year... sell too quickly & generally loses money. You won`t hear people talk about their losses; you will only hear the good news... as people like to boast. **Think long-term**... it`s the single best indicator of emotional stability.
  - b) The time to put money to work is when you feel the worst about it. It`s very emotional & hard to do. The biggest obstacle to achieving your goal is emotion. Emotion destroys **self control** ...that is essential to rational decision making. John Templeton believed the best investors are only right 2/3<sup>rd</sup> of the time. It`s prudent to protect yourself... **because you will... make mistakes**. Every investor should lose some money... because it teaches you about yourself.
  - c) People who succeed... accept occasional losses. George Soros welcomes the discovery... that he has been wrong & acts accordingly without fighting it. Do not get frustrated by

- a loss... don't dwell on it ...because it can undermine your self-confidence.
- d) A lot of people don't usually ask questions ...unless there is a crisis. They can go from panic... & depression... to capitulation [I can't take it anymore]. We can move from very negative... to very positive emotions very quickly. Therefore, it's **important to remember that historically markets go up... a lot more than go down.** It's important to understand what you own... good quality businesses.
  - e) Investor's Emotional Response – we experience more pain when we lose money v.s. when we make it. That's one of the drivers of Risk Aversion.
  - f) Decision Regret ie. Sell a stock & then watch it go up or not buying a stock & it performs better than the one you did buy, it's impossible to pick only top performers, -the core to equity investing – buy when you least feel like it.

### **Learning from Mistakes**

“The most instructive moments... are when you are proven wrong...& realize... that you believed you knew more than you did”. One of the costliest traits of human nature is... **overconfidence**. That's true of military & political leaders, it's true of CEOs & it's true of doctors & investors. It's been said that both military commanders & top investors that one of their hallmarks ...is... humility. A constant awareness... that they may be wrong. As a result,... they are always open to new evidence that contradicts preconceptions... and existing views. Successful investors have a well scheduled and planned time to study the markets. They use a plan/strategy a couple of hours/month. Always keep challenging your own assumptions... & keep your eye on the big picture.

## **BOOK - IN DEFENCE OF UNCERTAINTY**

Those who reflect... & hesitate... make far less in bull markets but those who never question themselves... get obliterated when bear markets come. In investing... certainty can be a serious problem, because it causes you not to reassess a flawed conclusion. It's harder psychologically to be unsure... than to be sure. We know we can never be certain... so we diversify. We sell when a security price begins to reflect its full value. Uncertainty prompts us to work harder... & be ... endlessly vigilant.

## **SELL TO REBALANCE**

Shawnessy Investment Counsel-“ It's scary when you do well in the purchase of one stock & you start to believe in your predictive powers. We need to filter out very extreme views. Hold portfolios & rebalance once/yr. Higher interest rates encourage savings. Lower rates encourage speculation. Speculation, Trading, Gambling – they are all the same things.”  
We have been in a low interest rate environment for over 10 years.

TO REDUCE CONCENTRATION in one company or sector.  
Portfolio Managers use this discipline. If a stock doubles, they will sell some & re invest the proceeds. A core position may be 4-5% If it goes beyond 10% this is considered too risky.

## **CONCLUSION:**

Reference the Globe Investor January 2, 2020 article.

## Globe Investor January 2, 2020

### These 2 Forces are why value investing works in the Long Run”

Two forces that interact to provide opportunity for value investors...Human nature & conflicts of interest that portfolio managers have when they manage other people's money.

#### Weakness in human nature

Nobel Prize Winner Daniel Kahneman through experiments demonstrated that humans are not rational in the sense that they tend to become RISK AVERSE when they win & risk takers when they lose. The implication is that they tend to sell their winners too early & hold on to losers for too long.

Investors use past performances as an indicator of future performance and so they naively extrapolate past trends. Humans are momentum traders, buying winning stocks and selling losing stocks. This behavior leads to overpricing of winners and the opposite for losers

Humans tend to be overoptimistic and overconfident about their abilities. We see this in every aspect of human life. It's part of our DNA...but when this behavior manifests itself in investing, people tend to become market timers and day traders.

Investors tend to overreact both on the upside and downside.

**THAT IS WHY BULL MARKETS TEND TO BE STRONGER AND BEAR MARKETS TEND TO BE WEAKER THAN THEY BOTH SHOULD BE.**

Investors interpret accidental success to be the result of skill, and they bet the farm and they lose.

Humans are social animals, and they like to be in groups, so they herd. If the crowd goes in one direction, they think the crowd knows something, & they follow suit.

### **Let's look at Institutional biases.**

Portfolio Managers are the worst offenders when it comes to herding, as very few have lost their jobs because of average performances...meaning...they herd to protect their jobs.

Analysts also herd. The low ability analysts hide in the crowd, while the more reputable analysts who have already made a good name for themselves are hesitant to take chances.

Portfolio managers rebalance their portfolios in a systematic way throughout the year. EVERY JANUARY, THEY TAKE RISKIER POSITIONS, THAN THEIR BENCHMARK IN AN EFFORT TO BEAT IT. Later in the year, as they earn what they think will give them their Christmas bonus, they lock in returns by selling their riskier stocks and load up on safer stocks or go back to benchmark weights.

Portfolio managers also window dress. Towards the end of the year, they sell losing and unglamorous stocks and load their portfolio with winning and glamorous stocks, in an effort to spruce it up so that when they send their clients their annual reports they only see good and winning stocks held by the portfolio manager.

THE interaction of such behaviors causes stock prices to deviate significantly from value not only over the longer term, but also within a year.

PORTFOLIO REBALANCING IS THE CAUSE OF THE “JANUARY EFFECT” AND THE “SELL IN MAY & GO AWAY”

HUMAN NATURE OF BOTH INDIVIDUAL AND INSTITUTIONAL INVESTORS ARE BEHIND THE CAUSES OF BUBBLES IN ASSET PRICES.