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Investing

Stocks to sell before it's too late – tactics & tips

Mark Story - August 14, 2008

The S&P/ASX 200 Index may have lost 16.9% for the year ending 30 June, but with the oil price moving south and all indictors suggesting an imminent interest rate cut, there's a glimmer of hope shares may soon regain lost ground. But don't punt the rent money on it. If the 200 day trailing moving average of share prices is any guide, further falls are in-store before things improve.

So if last year's falls remain a dead weight within a share portfolio, what's the best way to take the sting out of investment losses? The first question investors must ask themselves, according to John Pritchett of Patersons Securities is – given where a stock is now trading, and based on its future upside – do I still want to own it, and over what time-frame?

He says how losses are treated should be determined partly on whether investors are 'buy and hold' or more active traders. "If you're ready to take a 5% loss, you're probably ready to sell on a 5% gain – in which case you're a trader," says Pritchett. "But if you're taking a five year view, you're unlikely to bail just because a stock falls 5%."

But even within a buy and hold strategy, Belinda Von Knoll financial adviser with Keysbrook Financial Services says investors still need to rebalance their portfolio, depending on where each stock sits within the current cycle. She says while cutting losses doesn't really work for long-term investors, there are times when they'll need to exit a stock, be it big or small.

Given the difficulty Tabcorp's share price will have recovering from regulatory changes that left it without a duopoly, she recently told clients to get out. "Whereas on non-performing managed funds it might be a case of 'managing-out' in a tax-effective manner, which is always a little more difficult if there are gains instead of losses."

When long-term investors start tweaking stocks within their portfolio, Pritchett recommends separating the larger-caps, typically the first movers within any sharemarket bounce, from the more speculative stocks they might be holding.

He says long-term investors are less likely to loose sleep over a large-cap like Westpac falling 20% in 12 months – especially following revelations it's on track to deliver earnings growth of up to 8%. However, he says they probably need to focus initially on any small-caps - which having fallen twice as much (as large-caps) - may struggle to reach former highs, especially if there's no V-shape recovery. "Take the dogs out first," advises Pritchett. "If having concluded that due to earnings erosion a

stock won't make the sorry road back - don't just sit on it."

It's cold-comfort now, but investors would have been infinitely better off taking a first loss when the market started its decent a year ago than watching it bounce progressively lower. And for those stocks now at rock bottom, Simon Rees financial adviser with William Buck says there's often more sense maintaining exposure to a sector rebound than selling out for peanuts.

But if the rebound is too far into the future, as is his view on ABC Learning (ABS) then he'd recommend selling out. "You need to review the opportunity cost of holding or folding on a stock," says Rees. "If there are tax issues we might recommend selling half and putting the money into super to offset any capital gains."

According to Pritchett taking a loss and reinvesting in something that's more likely to take off gives investors the option of reinvesting in asset classes displaying a better environment for earnings upside. He says locking-in gains from these investments can then be used to re-enter more speculative stocks.

But with so many branded large-caps looking decidedly beaten-up by the market, Pritchett warns against booking losses too early. He says it's especially tricky for investors to decide what to offload when so many stocks have been oversold, despite sound underlying fundamentals. Even though biotech stock, QRxPharma (QRX) is trading at 30% of the $2 a share Pritchett paid for it, he believes the stock's long-term upside is valid reason not to sell.

According to Justin O'Brien of Citi Smith Barney, a successful sell-down strategy can depend as much on timing as it does on the vehicle within which these investments are held. "You might choose to offset gains in BHP by realizing a loss in ANZ and buy-back into (better stocks within) the banking sector at a later date," says O'Brien.

It's also possible, by adopting an averaging-down strategy, advises O'Brien to turn an existing (paper) loss into a future profit. He says this strategy often works when having done their homework investors conclude that fundamentally good stocks have been oversold due to negative short-term sentiment.

He cites, Asciano Group (AIO) as a prime candidate for an averaging-down strategy. Since falling off a cliff from around $11 to $3 in the year to 30 June, the troubled port and rail operator's share price has soared 80% (to around $4.82) since early July.

Buying more stock at a lower price can successfully reduce the average entry cost. But he says the last thing investors want to end up doing is doubling-up on a dog. "Only buy more stock at a cheaper price if the long-term earnings, plus other fundamental criteria like quality management, and debt levels still stack up."