

# YOU GOTTA KNOW WHEN TO HOLD 'EM —AND WHEN TO FOLD 'EM

## Playing the Stock Market Is a Lot Like Playing Poker

By Archana Sahay

**T**iming is everything—in poker and in the stock market. No one knows that better than Martha Stewart, who sold her shares of ImClone at an average price of \$58 just a day before the Food and Drug Administration (FDA) denied approval of its cancer drug, Erbitux. That news sent the stock plummeting, and soon Stewart was fending off allegations of insider trading. Eventually found guilty of lying about the sale, she went to prison for five months.

Today, Martha Stewart is out of jail (though under house arrest until late August) and, with an *Apprentice*-style TV series in the works, she's staging a major comeback. ImClone stock isn't doing so badly, either. It rebounded after the FDA reversed its decision and approved Erbitux last July, rising to a five-year high of \$87.24 per share. It's fallen considerably since then, but, seeing an upside, investors consider it an attractive buy. If Stewart had hung on for the ride and sold when the drug peaked, she'd not only have come out ahead financially but she



would have spared herself the agony of an embarrassing trial and imprisonment.

What's the lesson to be learned here? You have to know when to hold and when to sell. The previous statement begs the question: *How do I know when to hold and when to sell?* Glad you asked. There is a great deal of literature out there advising investors when to buy a stock, but very little telling them when to sell. Buying and selling are two sides of the same investing coin, yet selling does not get nearly as much attention as buying does. So how do you know when to hold 'em and when to fold 'em?

A lot depends on your investing style and your appetite for risk. The short answer: At the same time that you create your portfolio, it's wise to also decide how low—and how high—you will let any individual stock go before you

sell your shares. The limits you set may be realized in a week or it may take a year. As soon as those limits are met, sell the stock and don't look back. Of course, it's not as easy as that. There are many factors, emotional and otherwise, that come into play, complicating matters, along the way to profit or loss.

Following are a list of pointers to guide you when you review your portfolio. Many people hold mutual funds along with, or instead of, individual stocks. The pointers below apply to both types of investments.

### Love Isn't Forever

Stocks are fickle. When the glow begins to fade on a promising stock, consider why you bought it to begin with. If the results of the fundamental analysis you conducted in the beginning no longer apply, it may be time to sell. There's a quantitative and a qualitative element to your analysis. The numbers may be telling you to sell, but you may feel that the

business model of the company is good, or it sells a product that the world cannot do without. The stock is performing poorly, but you have faith it will pull through in the long run. Your relationship has simply hit a rough patch, and it hasn't hit your low limit yet. So you hold on. Conversely, let's say your investment has done really well, and you are determined to part ways on a happy note. The stock has reached the upper limit that you set as your target, so you sell. When it's time to move on, the analysis you performed when you first purchased the stock, as well as the limits and goals you set, should be your guides in your decision-making.

Call it women's intuition—or perhaps women are less afraid to admit a mistake, or we do better research and get out when all the signs (competition, market changes, etc.)

point to a quick exit. Whatever the reason, according to a recent Merrill Lynch survey, women are less likely (35 percent) than men (47 percent) to hold onto a losing stock too long.

### Out with the Old—In with the New

The portfolio manager of one of your mutual funds has jumped ship, and a new one has stepped in. Or the hunt for a new CEO has begun at XYZ Company, of which you are a shareholder. Sirens should be going off in your head. Loudly. First and foremost, get the skinny on the new kids on the block. If you're lucky, it's all good news, and you can let down your guard—slightly.

If the mutual fund in your portfolio is an index-tracking fund (ITF), you needn't worry about a change in managers. An ITF mimics whichever index it follows. As long as this remains the same, and so long as the index is doing well, you're fine. It gets a bit tricky if you hold individual stocks.

Was the change in management prompted by a corporate scandal? Was the CEO not living up to his or her expectations?

A changing of the guard may help the company's stock immediately. Take Hewlett-Packard: Carly Fiorina resigned, and shares of HP jumped 10 percent. In general, however, expect a bumpy ride for at least the first quarter, especially if the company is in bad shape. Pay very close attention to the changes the new CEO is making. Redo your analysis, look at your limits, and see what the numbers tell you now.

### Nerves of Steel—Not!

You're holding on tight as that stock price climbs higher and higher. You're the best gosh darn investor in the world. Watch out, Warren Buffet, because here you come. →

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Suddenly, you get a nagging feeling that you've been here before. And then it hits you. The last time you felt this way was during the tech-stock boom of the '90s. Your stocks were on fire during that period—until the bubble burst. There were so many sleepless nights that your nerves were shot, and you never want to experience that anxious feeling again.

Here's a strategy for nervous investors who've been burned by the market. Let's say your initial investment of \$50 in ABC Corp. has now ballooned to \$100. You've made back your initial investment. Consider cashing out that portion—\$50—and leaving the rest in the market.

Ultimately, you must have a firm understanding of your expectations from your investments, whether they are stocks or mutual funds. Once these expectations have been met—and especially if they haven't after a reasonable amount of time—consider selling your shares. All good things must come to an end, so take your money and run.

### They're Shaking Things Up

Change will do you good. Or will it? Your fund has moved from environmentally friendly firms to nuclear power plants. It is investing in cats, instead of dogs. The investments have gone from low risk to high risk. Mutual funds change names, change investing styles and move away from their original objectives.



WHEN SELLING SHARES OF A HIGH-PERFORMING STOCK, CONSIDER ALSO SELLING SHARES OF ONE THAT'S NOT DOING ANYTHING FOR YOU. COME TAX TIME, THE LOSSES YOU INCUR ON THE LACKLUSTER STOCK WILL OFFSET SOME OF THE GAINS FROM THE STELLAR PERFORMER.

Companies go through changes, too, that affect their stock price and long-term outlook.

One of the most common changes to occur is a stock split. Take, for instance, the 2-for-1 split, where the share price is cut in half and the investor gets two shares of ABC Corp. for every one share she holds. At the end of the day, nothing has really changed. Let's say you have one share of ABC Corp. and it is selling for \$100 before the split. After the 2-for-1 split, you will own two shares, and each share will be worth \$50. Now, you have two shares instead of 1, but your investment in ABC Corp. has not changed its value. But consider the rationale behind a stock split: The company feels its stock price is too expensive. In order

to attract more investors, it needs to lower the price, so it implements the split. If you happen to find yourself with a stock that is splitting, hold on tight to your investment. It's usually a sign of good things to come, as more investors join the party.

Another change to impact stock prices is consolidation. Consider Bank of America's recent \$35 billion dollar deal with MBNA. The announcement alone sent MBNA shares soaring, while Bank of America saw its shares dip slightly.

In general, the firm that does the acquiring will see a drop in share price, while the company being acquired sees its shares

jump. If you own shares of the one being acquired, you may decide to hold on and cash out at a later date. If, on the other hand, you hold shares of the firm doing the acquiring, look back to previous mergers and see how the company fared after the merger went through. If this is the first merger for the firm, you should research other mergers in the industry to see how the acquiring firms performed post-merger. Regardless of which side of the fence you are on, it's back to square one for you.

### The Tax Man Cometh

You never know where your stocks will be from month to month, but you can definitely count on taxes come April every year. It's good to get in the habit of reviewing your portfolio every spring. Are some nearing your upper or lower limits? Here's another strategy you can try: If you decide to sell shares of one of your high-performing stocks, consider also selling shares of one that's not doing anything for you. That way, come tax time, the losses you incur on the lackluster stock will offset some of the gains from the stellar performer.

Timing is everything: when you sell an investment will determine the tax rate applied to the gain on the sale. Short-term capital-gains tax is applied to investments held for less than a year; long-term capital-gains tax is applied to investments held for more than a year. There are significant differences between the two. To complicate matters further, there is a \$3,000 limit to how much you can claim as a loss in a given year. Anything over that amount can be carried over to the following year. Long story short: be sure to consult a tax adviser before you make your moves.

LET'S SAY YOUR INITIAL INVESTMENT OF \$50 IN ABC CORP. HAS NOW BALLOONED TO \$100. YOU'VE MADE BACK YOUR INITIAL INVESTMENT. CONSIDER CASHING OUT THAT PORTION—\$50—AND LEAVING THE REST IN THE MARKET.

### You've Outgrown Your Portfolio

You've taken on more financial responsibility. Your life situation has changed. Whatever the reason, your heart is just not in your current investments anymore. In addition to reassessing your portfolio from time to time, you should take a good, long look inwards. Where are you headed in the next few years?

If you are just starting out, go ahead and pile on that risk. But if you are close to retirement, preservation of income and assets is key. Your financial needs will change throughout your life, and rebalancing your portfolio to reflect these changes is important. Letting go is hard to do, but let go you must, especially

when the conditions you started out investing under have changed.

In poker, you are dealt a hand consisting of a number of cards. In order to create the best hand, you can discard some cards and redraw new ones. Think of your portfolio as your hand and your investments as the cards. In order to create the best portfolio, you may have to sell some of what you have and buy into new investments. Always evaluate the impact of transaction fees and factor them into your gains and losses. But don't be afraid to let go of a loser—or admit that you were wrong—if a stock isn't performing. Conversely, don't get too greedy and hang onto a rising star until it begins to slide. Hanging onto a stock too long is one of the biggest mistakes any investor can make.

In short, you gotta know when to hold 'em and when to fold 'em. Otherwise, you can kiss that royal flush goodbye. □

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