When to Sell Your Investments

A reader asks:

I wanted your advice about when do you recommend one sells holdings that have appreciated? I understand the concept of buying low but would appreciate your advice on when to sell. I understand reversion to the mean and have been guilty in the past of holding on too long, only to see all the gains melt away as the market corrected.

This is a topic that probably doesn't get enough time share for investors. All of investing is more of an art than a science but there are plenty of books and research papers written about what to buy but very few about when to sell.

Sure, there are plenty of aphorisms about when to sell. Buffett says his favorite holding period is forever. Then you have phrases like the following:

We sell the rips and buy the dips.

Let your winners run but cut your losers short.

No one ever went broke taking a profit.

It's one thing to be wrong, it's another thing to stay wrong.

We're taking some gains off the table.

These are fun things to say but they don't provide much help in the moment when you see an investment rising or falling.

The true determinants of when to sell an investment can be boiled down to the following questions:

- What kind of investor are you?
- What's your time horizon?
- Why did you buy in the first place?

The wonderful and terrifying thing about investing is that you have two opportunities to be right and two opportunities to be wrong on every trade or investment -- when you buy and when you sell.

An intelligent investor spends some time up front before the buy occurs to consider when or why they would sell a holding. If you don't have some pre-established rules, guidelines or systems in place to understand what your sell trigger will be you're really just guessing.

There's no right or wrong answer on when to sell because investing is personal. There are plenty of terrible reasons to sell -- I'm nervous; someone on financial television scared me out of the market; I saw some guy on Twitter post a GIF about the how reckless the Fed is; I feel like the market is due for a correction.

Here are what I consider to be some legitimate reasons to sell an investment:

Rebalancing. Rebalancing back to target allocation weights is the simplest way to sell a little of what's been working and buy a little of what hasn't. Rebalancing is a systematic form of value investing. You can never time these things perfectly but this is one of the simplest forms of risk management available to investors who have a defined risk profile for their portfolio. How or when you do it probably doesn't matter nearly as much as following through with whatever your pre-established guideline are.

There are better opportunities available. Some investors are constantly searching the investable landscape for new opportunities in comparison to their current holdings. I find it can be a useful exercise to think through whether you would buy your current holdings all over again if you started from scratch (taking into account things like transaction costs and taxes).

Targets have been met. Other investors have price or valuation targets. Figuring out the intrinsic value of a security or asset class is never easy but coming up with estimates for where you will buy and where you will sell is a good way to place constraints on yourself from allowing investments to get away from you.

Your rules tell you to sell. Quantitative investment strategies continue to gain in popularity. I'm a huge proponent of a rules-based approach but have witnessed far too many people who profess to invest this way change their process when things aren't going their way. It requires discipline to follow your rules even when it doesn't feel right (and most of the time the right move won't feel right at the time).

Circumstances have changed. This one is a little more squishy, but there are times when your original investment thesis doesn't play out. Or your risk profile has changed because of a life or work event. Many investors de-risk as they approach retirement age. Others need to sell because they actually need to spend the money they've been investing. The whole reason we invest is to delay current consumption for future consumption. You risk profile can and should change as you approach your future consumption date(s).

Regret also plays a huge role in any investment decision so it can be helpful to determine which would make you more miserable -- holding and seeing your investment crater or selling and seeing it go much higher.

Further Reading:

When Holding is the Hardest Part

Now here's what I've been reading lately:

- The unsolvable puzzle (Collaborative Fund)
- What's easier to change - the portfolio or the investor? (Dan Egan)
- It's not you, it's me (Above the Market)
- Following good investing advice is not always easy (Of Dollars and Data)
- Meet the financial advisor who works with NFL players (The Ringer)
- Our inner investing world doesn't reflect reality (Bloomberg)
- Behavioral bond bucketing (Abnormal Returns)
- 10 of the best photos of the solar eclipse (Bored Panda)