When to push the sell button on a stock

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On March 23, 2010, the investment team at Toronto-based GlobeInvest Capital Management determined shares in the offshore oil driller Transocean Ltd. were priced well below their true value – and it was time to buy.

Less than a month later, a blowout at Transocean's Deepwater Horizon rig in the Gulf of Mexico caused a massive explosion that killed 11 crew members. An uncontrollable fire burned for two days until the rig eventually sank.

As plumes of oil gushed from the underlying seabed, the GlobeInvest team scrambled for the latest information.

"The stock actually held up relatively well for a few days after the explosion because it was thought it could be contained and they could stop the oil flowing out," says Christine Poole, GlobeInvest's chief executive officer and managing director.

As bad news turned worse, they made the decision to sell Transocean on April 30 – five weeks after buying it, taking a 13-per-cent loss. "We thought it was prudent to take the loss and wait for it to evolve," Ms. Poole says.

Oil continued to gush from the site for 11 more weeks while Transocean shares bottomed out at 49 per cent below GlobeInvest's original purchase price.

Selling is probably harder than buying, Ms. Poole says. Knowing when to push the button can make all the difference in investing.

As a general rule, GlobeInvest re-evaluates any stock that falls 15 to 20 per cent below its purchase price, she says. "It could be a one-time event, or something that the company can work through and you're willing to stick through it."

Equally challenging, she says, is determining when to sell a stock that has gone up in value.

"Sometimes a stock reaches our target price and we don't see further upside. It could be reflecting all the good news, or if it's a resource-based stock we think the underlying commodity price has risen to the point that we don't see any additional upside going forward," she says.

The key, she adds, is to set an exit strategy before buying a stock, taking into account earnings and cash flow projections, and setting target prices. "You want to see at least 15 per cent capital upside, 12 months out. Over time, as the company reports and things happen, that target price can be adjusted upward or downward."

In some cases Ms. Poole will sell a portion of a rising stock to rebalance a broader portfolio. "When we buy a name, it's typically anywhere from 2 to 4 per cent of the portfolio. If it does really well and starts encroaching beyond 5 or 6 per cent, we take some profits off the table," she says.

Technical sell signals

Determining when to sell is less arbitrary for technical investors. Technical analysis is a method of valuing securities by analyzing past activity to determine trends. In other words, analysts look at the past to determine what will happen in the future.

CIBC World Markets technical analyst Sid Mokhtari determines trends through a variety of technical tools that track data such as price and volume. If a stock price is rising and the trend is breaking, it's time to sell.

"We say continue owning your stock until a trigger kicks in to push you off," says Mr. Mokhtari. It may also be time to sell, he says, if a stock is falling and there is no indication the trend is breaking.

One way he determines whether a trend is breaking is to track it side by side with its benchmark. "If it's in a flat to rising mode [compared to its benchmark] it's the kind of stock we want to own. If it's declining against the benchmark index, that's a stock we typically don't want to own until there is clear evidence of a reversal," he says.

Choosing the time period to determine a trend depends on how long the investor is prepared to hold the stock. "We look at rebalancing on a monthly and quarterly basis, and we want to be sure all variables of a trend are assessed within one to three months," he says.

His advice to investors is to combine technical analysis with the more common fundamental indicators such as earnings and product demand.

"It's the fundamentals that drive the trend, and technicians can get on that trend," he says.

Selling to buy

Selling isn't always as simple as taking gains or limiting losses.

Jerome Hass of Lightwater Partners Ltd. manages a hedge portfolio that holds long and short positions. That means he not only attempts to make money on stocks he feels will go up (long), but stocks he feels will go down (short) by borrowing the stocks, selling them on the market at a high price, returning them at the lower price and pocketing the difference.

Lightwater also invests based on an overriding investment thesis. When the thesis breaks, they sell.

For example, earlier this year Mr. Hass took a long position in U.S.-based Allegiant Air because its older fleet benefited from plunging jet fuel prices. When the company announced part of its profit would be used to purchase a more fuel efficient fleet, he sold.

"They announced they were going to start using more modern planes, and that made them a lot less attractive to us as an investment," he says.

One example of a short sale involved Valeant Pharmaceuticals International Inc., which had more than doubled in the first half of 2015 on a dizzying acquisition spree involving huge amounts of borrowed money.

Under the weight of Valeant's massive debt and intense regulatory scrutiny, the stock eventually plunged. On March 15, 2016, alone it lost half of its value – and that's when Mr. Hass sold. "You don't get better days than that for a short position," he says.

Mr. Hass admits he's had to close long and short positions at losses, but he stresses the importance of being honest with yourself before they become big losses.

"If you don't admit you're wrong you start accumulating losers in your portfolio, and they become a larger percentage," he says. "If you're right two-thirds of the time in this business, you're doing very well."