

Stock Sell Considerations for Investment Clubs

MYICLUB INVESTMENT CLUB WEBINAR SERIES

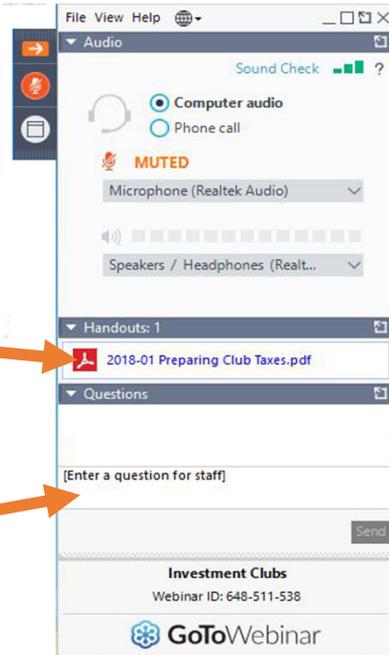
Presented by Doug Gerlach
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Handout & Questions

Handout in PDF
format is available
in Handouts tab.

Type questions in
Questions box.





CLUB STRATEGIES MAY DIFFER FROM INDIVIDUAL STRATEGIES

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Clubs vs. Individuals



- Portfolio decision-making criteria in investment clubs may be **different** than those used by individuals:
 - Capital gains taxes are **not paid by partnerships**, but clubs may still consider tax impact of sells as members ultimately are responsible for gains.
 - Clubs typically need to **raise cash only for member withdrawals**, but individuals could have lots of reasons to generate cash.
 - Clubs can take advantage of **IRS rules in full withdrawals** & transfer shares instead of selling, thus deferring (**not eliminating**) capital gains realization.
 - Monthly meeting format means sell decisions aren't usually done **quickly**.

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WHAT WE BELIEVE AS BETTERINVESTING MEMBERS

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When Is Right Time to Sell?



“Buy low and never sell.”
—Warren Buffett

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When Is Right Time to Sell?



“If the job of buying a stock has been done properly, the time to sell is never.”

— Philip Fisher,
*Common Stocks &
Uncommon Profits*



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Long-Term Real Growth in US Stocks.



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Why We Believe in Long-Term Investing



- Over **long-term**, stock's price grows as company increases profits.
- In **short-term**, many factors (often irrational) affect stock's price.



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Sometimes Stock Picks Don't Work Out



No matter how much research is done, 1 of every 5 stocks (20% of typical portfolio) analyzed on SSG **will underperform expectations** due to undiscovered fundamental issues or newly-arriving problems.



These demand more than “**let's wait and see what happens**” approach to portfolio management.

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Sometimes Stock Picks Perform Too Well



Stock valuations **fluctuate**, & valuations can become stretched, especially in **bull markets** or if company is subject of **irrational exuberance**.



These also present **risks** to total portfolio performance, as **downsides** can be **significant**.

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Strive to Be a Disciplined Seller



Better to have **discipline** than conviction.



SSG provides **discipline** for knowing what stocks to buy.



Selling requires **different skills & mind set**.

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3 Key Reasons to Consider Selling



Company has **problems** that threaten future of business.



Stock price is **hypervalued** when compared to future growth prospects & past valuation trends.



There is need for **cash**.

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DO'S AND DON'TS OF SELLING

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Don't Get in the Way of Your Own Success



Let your **winners** ride.



When pruning your portfolio, **don't** cut your flowers & fertilize your weeds.



Hold top performers through periods of market overvaluation.

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Do Be Disciplined in Sell Decisions



Don't be driven to sell by **fear**.



Disciplined **buying** approach requires disciplined **selling** approach.



Develop club's own pragmatic guidelines for making sell decisions.

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Do Focus on Long-Term (5+ Years)



Strength of fundamentals over time almost always defeats weakness in price.



Strong companies will **survive** — & **thrive** — over time.



As long as fundamentals appear **solid**, & timeline is **adequate**, investment should eventually perform.

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Don't Hold Onto Weakening Companies



Companies with **deteriorating fundamentals** seldom make good investments.



Avoid “waiting for recovery” or “value” or “turnaround” situations in long-term oriented growth portfolios.



After 3 quarters of worsening trends, should be ready to act.

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What Are “Deteriorating Fundamentals”?



Don't ignore factors that put a company's long-term (or short-term) viability in **jeopardy**.



Even professionals are often **not** able to predict.



Objective is prevent **significant** “damage” to portfolio (some “damage” may be unavoidable).

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Warning Signs of Fundamental Problems



EPS or revenue growth is slowing or falling.

Quarterly pre-tax profit growth is slowing.

Cash flow is diverging from net income.

Adverse change of management.

Direct or indirect competition.

Uncertain product cycle.

Uncontrolled raw material costs.

Fraud or “accounting irregularities.”

Debt rating has been lowered.

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Spotting Problems on SSG



Company is acting **contrary** to original purchase rationale.

Are factors same as when stock was purchased?



EPS and/or Sales are **falling**.

What is trend on SSG graph?



Pre-tax profit growth or margins **deteriorating**.

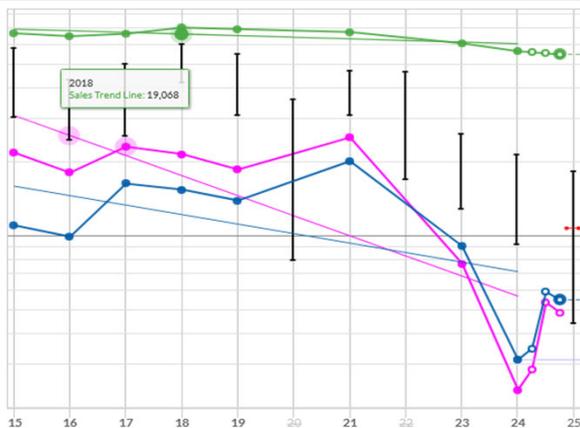
Is PTP on Quarterly Trend (PERT) graph declining?

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Growth Is Disappearing



Company: Kohl's (KSS) Study Name: KSS 10/20/22



- Without growth of sales & EPS, price has no volition to increase.
- Turnaround companies can look “inexpensive” but may still be overvalued.

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Quick Test of Weakening Fundamentals



Evaluate Management

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	4.9%	4.5%	0.7%	3.5%	3.6%	3.6%	1.7%	3.1%	1.6%	0.5%	2.1%	
% Return on Equity	14.5%	18.8%	-2.0%	10.6%	10.4%	10.6%	5.8%	11.2%	6.2%	2.4%	7.2%	

- Review trend of % pre-tax profit on sales.
- Companies struggling with margins are likely facing problems that will inhibit future growth.
- These are key quality indicators, so if they are not strong, best to find another company.

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Watch Quarterly Profit Growth & Margins



3 to 5 quarters of **declining pre-tax profit % growth** are sell signal.

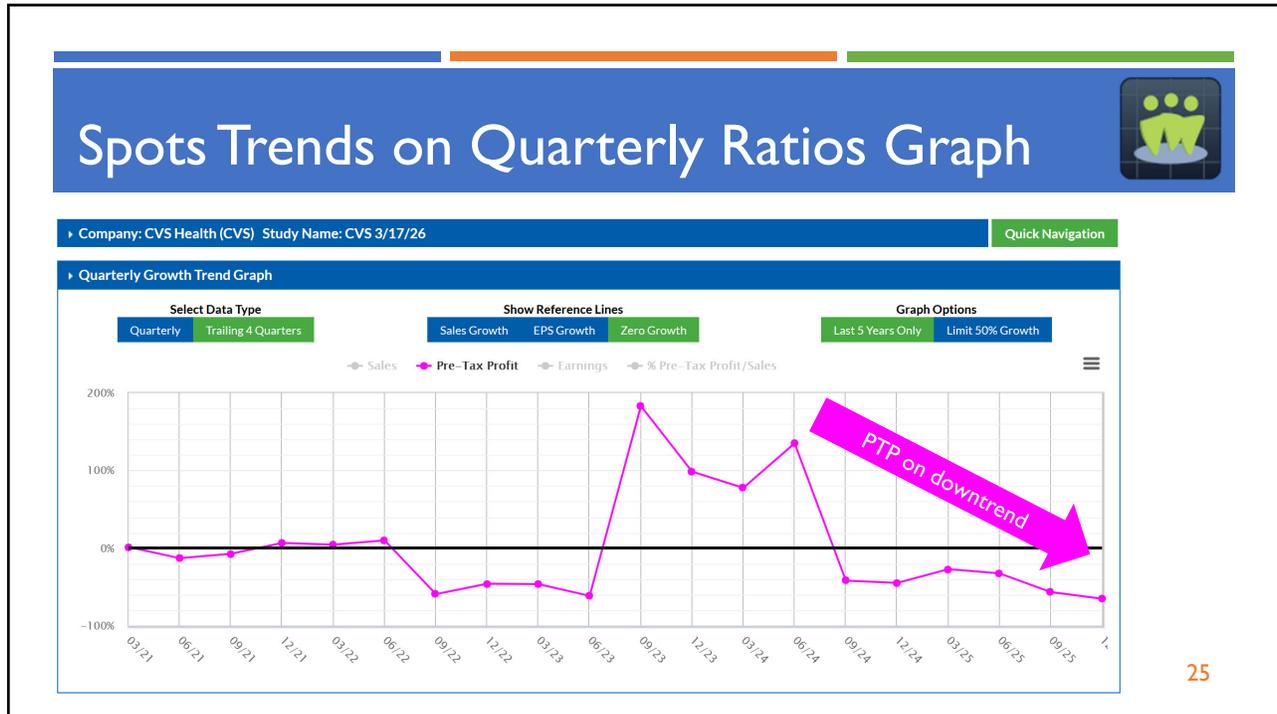


Companies that “**stumble**” for 3 to 5 quarters can take several **years** to recover.



Compare to **competitors** to determine if trend is industry-wide.

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Remember: 4 Strikes, You're Out!

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1. Upside/Downside Ratio < 1:1. If upside equals downside, why invest?
- 
2. Projected Relative Value > 150%. Projected RV=Current P/E ÷ Average Future P/E.
- 
3. Proj. Return < Long-term Bond or Savings Yield. Stock returning 4%-5% right now is likely not good use of cash.
- 
4. Stock is in Sell Zone. Rarely happens for consistent performers.

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Review Projected Relative for Hypervaluation



RELATIVE VALUE ?

Current P/E: 46.9 / Average 5 Year P/E: 21.5 X 100 = 218.3%

PROJECTED RELATIVE VALUE ?

Projected P/E: 39.1 / Forecast Average P/E: 22.4 X 100 = 174.4%

PEG RATIO ?

Projected P/E: 39.1 / Forecast EPS Growth Rate: 20.0% = 2.0

- Projected Relative Value > 150% is sign of potential hypervaluation.
- As P/E ratios regress to mean, stock price liable to take big hit.

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Wrong Price-Related Reasons to Sell



To “**lock in a profit.**”

May be **locking out** future potential returns.



Stock has reached pre-determined **target price.**

Has grown to reach that price, so may well **continue.**



“Stock hasn’t **done anything.**”

Prices don’t rise linearly – it takes **time** for performance to drive price.

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More Inadequate Reasons to Sell



Company announces **temporary** bad news.

Short-term setbacks may be **buying** opportunity.



Company has **missed** earnings estimates.

Is variance large? What is long-term **impact**?



Analyst has **downgraded** stock.

Analyst may have set target price or have **short-term perspective**.

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Other Common Selling Mistakes



Don't **automatically** buy when price falls.

Re-evaluate as if new.



Don't "**wait to get your money back**" from stock.

It doesn't **know** you own it.



Don't always consider selling all shares **all at once**.

Sell **partial** holdings & pare down positions over time.

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Coping with Uncertainty



Don't be paralyzed by **uncertainty**.

Acknowledge what **isn't known**.



Single problem may not be enough to warrant selling.

As other concerns mount, decision becomes **clearer**.



Do sell stocks with **uncertain** prospects, especially if:

Need **cash**, to **upgrade** quality or returns, or **trigger loss** to offset gains.

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SMARTER SELLING STRATEGIES

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Don't Sell to Pay off Full Withdrawal



Only **sell** depressed shares to pay departing member.

Never sell appreciated shares if possible.

Instead of selling appreciated shares, **transfer** them.

Capital gains are **deferred** for remaining members.

Transfer has no **negative tax impact** on withdrawing member.

Member **controls** when to sell & generate capital gains.

Note: Transferring appreciated shares only has benefits as part of full member withdrawal. See **myICLUB Withdrawal Scenario Report** for detailed recommendations on partial & full withdrawals.

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Smart Tax Selling



IRS allows capital gains to be **offset** by losses.

Allows additional \$3K loss per taxpayer to **offset** ordinary income.



Review portfolio at **year-end**, preferably before Thanksgiving.

Good time to **remove problem holdings & trim hypervalued** stocks.



Review sold stocks in **January** to see if **repurchasing** is justified.

Takes advantage of potential **January effect**.

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Challenge Weak Companies



Portfolios can be **upgraded**.

Why cling to **uncertainty**?



Use **BI Challenge Tree**
(available free in BI Forms
Library) to compare stocks.

Swap weakness for **strength**,
low return for **high return**.



Use “**replace**” strategy instead
of selling outright.

Tricks mind into not feeling
regretful.

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Use These Stock Selling Concepts



Mark uncertain stocks “**AFC**” –
“**Available for Cash**.”

Then seek **replacement**
candidates.



Instead of selling, **replace**
uncertain stocks.

Removes much of **emotion**
from decision.

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QUESTIONS?

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Thank You!

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