

## The Ultimate in Contrary Opinion

**Portfolios heavy with under-performing stocks almost never outperform the market.  
Ignat's Law**

**“Manipulation and fraud are part of the investing game. Yes, they increase the risks, but as an investor, you get paid handsomely to take such risks.”**

**James K. Glassman**

[A](#) collection of recent newsletters is available on the web site.

**Market Dynamics**

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Twenty five years ago, when I was teaching college level courses in investments and portfolio management, I followed a more or less traditional approach to the class. Today I would reorganize the course and the first half of the course would be dedicated to teaching the students how to identify stocks that should be sold. The second half of the course could then concentrate on finding stocks to buy.

The first half of the course would be committed to the study of long-term technical analysis to find the stocks that should be eliminated from the portfolio. This would be the most important part of the course, by far. What I now know is that if you know which stocks should be sold, you also know which stocks not to buy. If a stock is OK to hold, it is also OK to buy. The whole process begins with the question, does this stock need to be sold?

Long-term investors need to be able to spot stocks that are being manipulated, stocks that are the focus of Wall Street promotions or fads, stocks that are influenced by aggressive or fraudulent accounting schemes, stocks in the throes of long-term business deterioration or stocks with promotional managements that are prone to puffing their stocks and will often lie about the true state of the business.

Sooner or later, the true aspects of the business will start to affect the performance of the stock and the stock will start to under-perform the market. The onset of a persistent trend of poor performance will signal that the stock should be sold. It will often take some time for the negatives to emerge, but rest assured, they will appear. Bad news leaks into the market for the stock and the performance of the stock will be affected.

It may not be readily apparent what is causing the bad performance of

the stock in the market. The investor is not required to know the causes of the bad performance but he does need to know how the stock is performing. This is where recording and measuring the performance by the stock becomes critical.

Many books have been written about “How to buy stocks” but in my experience very little attention has been given to the sell decision. In my opinion, this is most unfortunate. The sell decision is based on a different methodology than the analysis that goes into the buy decision. A focus on the sell decision is, therefore, almost completely contrary to the conventional wisdom about investing in stocks.

Experience shows that the proportion of stocks that are suitable for purchase at any given time, is only about one third of all stocks. A recent statistical analysis of annual returns showed that about one third of all the stocks were seriously under-performing the market and another third were performing in-line with the market and both groups of stocks were not suitable for purchase. The remaining third of the stocks were persistently outperforming the market and were suitable for purchase. I think the limited number of stocks that are worth buying will be a shock to most investors.

The most effective tool for tracking a stock's performance is a chart of the relative performance of the stock against the market. The charting technique should remove the random and meaningless noise from the data and allow the persistent long-term trend of performance to show through.

Charting in any form is roundly criticized by the academic community because stock price movements are random and unpredictable. The very fact that stock prices are unpredictable, by any means, makes the use of charts indispensable. How else will the investor know that the performance of the stock has become unacceptable if he avoids the use of charts. Charts do not predict future performance but they reveal what the trend of performance has been. When the trend of performance becomes unacceptable, the investor then knows the stock should be sold.  
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