

Quality Asset Management

Grow Your Wealth with Peace of Mind

Should you sell your declining stock?

By Gil Hanoach, May 5, 2005

How many times have you asked yourself in the past, "Should I sell my declining stock?" This is one of the toughest questions investors have faced since stocks existed. If you could know that your declining stock will recover soon enough, you would have the potential of becoming rich from stock investments. Not only would you not sell the stock, you would want to buy a lot more of it. The deeper the decline, the more you would want to buy.

Unfortunately, any particular company could declare bankruptcy, resulting in up to 100% loss of your investment. There is no perfect recipe for deciding whether to sell a declining stock, making individual stocks speculative investments.

What if you could own thousands of stocks in many countries all over the world? When this portfolio declines, can you assume it will recover? You can own such a portfolio using index or asset class mutual funds, as in [Long-Term Component](#). In the measured history since 1970¹, this globally diversified portfolio fully recovered from all declines within less than 3 years, as measured since the beginning of the decline.

These statistics are very comforting, but history, no matter how long, may not always repeat itself. Let's try to think about what it takes for a decline to be irreversible. In order to do that, we need to understand what stock investments are and what makes them grow.

The history of companies. Many years ago, individuals and families grew their own food, sewed their own clothes and built their own houses. There were no companies, and people took care of their needs on their own. Over the years, people found out that they could specialize doing different tasks, and do them much more efficiently. Using machinery, it was easier to produce large quantities of goods.

With advanced transportation and communication, people were able to serve large numbers of people. This led to people grouping together to form companies that serve whole countries, continents and even the whole world.

As a company became large, it was usually impossible for a single person to provide money to operate it. The need to raise large amounts of money led to the formation of large groups of people who owned the company. In order to split the company ownership, they divided the company to many small parts – what we call "stocks", and sold different amounts of them to individuals.

By dividing the company into small enough parts, any individual can buy today a part of a company for as little as a few dollars.

Why do companies go up in value? Companies buy materials and, using the work of individuals, create products that have a higher value than the materials and human resources used. Whenever a product is created with higher value than its components, it can be sold for a profit. This profit raises the value of the company. This is the natural state of a company that offers a product or service in need, and does it more efficiently than the individual consumer.

Can all companies decline with no recovery? In order for companies around the world to decline irreversibly, the process of specialization and mass production should reverse. More people would

¹ Returns include simulated data before fund inception. See [Performance Data Disclosure](#).

have to create products for themselves less efficiently. If you believe that a diversified global portfolio can decline irreversibly, you probably believe in people wanting to work harder for their needs.

What if there is a huge catastrophe? This is a question that often comes up when talking about risks of stocks. Any local catastrophe won't affect a globally diversified portfolio significantly. The companies in unaffected regions may keep growing.

What about a global catastrophe? A global catastrophe could have an adverse effect on the portfolio. As before, let's start by looking at history. Humans are amazing at dealing with problems. People dealt with the Great Depression, the World Wars, and extreme oil prices in the 1970's. How did they do that? No matter how few people survive a catastrophe, they have the same human nature of wanting to provide for their needs as easily as possible. The re-creation of infrastructure with knowledge that already exists should stimulate rapid growth and the portfolio should recover more quickly than average.

To summarize

Humans prefer to get things done as easily and efficiently as possible. This preference should lead to the continuing existence and growth of companies. History measures support this preference.

History shows that people are able to recover from large catastrophes. Not only do they recover – they do so at an accelerated pace maintaining the long-term growth of companies and stocks. It happens with the use of existing knowledge, due to their continued preference to get things done as easily as possible.

Closing notes

This article presents good prospects for positive growth of stocks over the long run, assuming a globally diversified portfolio, with low costs across the board, no stock picking and no market timing. Other strategies could lead to different results. It does not imply guaranteed future returns with any strategy.

Past performance may not be indicative of future results. Simulated data was used for periods prior to the inception of mutual funds (see [Performance Data Disclosure](http://www.qualityasset.com/disclosure.htm) at <http://www.qualityasset.com/disclosure.htm>). Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this article, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Note that services are limited to investment advice and do not include financial planning and/or non-investment related consultation services. You should not assume that any discussion or information contained in this article serves as the receipt of, or as a substitute for, personalized investment advice from Quality Asset Management. If you have any questions regarding the applicability of any specific issue discussed above to your individual situation, you are encouraged to consult with the professional advisor of your choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.