# The One Strategy Warren Buffett Will Never Use

## Description

With the economic crisis still fresh in people's minds, many investors are still jittery when it comes to investing in the stock market. As a result, there is a tendency to sell a position as soon as it starts doing poorly. And there is a way to do this automatically: stop-loss orders.



Stop-loss orders are designed to limit an investor's loss on a particular security by automatically selling when the shares decrease by a certain amount. And it sounds like a great idea at first – after all, isn't this a great way to avoid a catastrophic loss? With every stock you buy, you know going in you can only lose a certain amount.

But this is the wrong way to approach investing. Rather, you should only sell a stock when one of four situations arises. One is the share price rises to the point where the stock is no longer undervalued. Another is if something fundamental changes at the company level. The third is if you find better opportunities elsewhere. Finally, you may need to sell some stock if you need the money.

It makes no sense to sell a position just based on past price movements. Rather, for successful long-term investors like Warren Buffett, price drops usually lead to opportunities to buy more shares at a discount. Below are three perfect examples.

**1. Home Capital Group**

**Home Capital Group** (TSX: HCG) has been one of the TSX's best performers over the past 15 years. During this time, the shares have returned over 28% per year. But it hasn't all been smooth. In early 2009, the shares traded below $10 (split-adjusted), after dropping more than 50% in few months. More recently, the shares dropped from $30 to $25 just last year.

A stop-loss order would have forced an automatic sell in either of those situations. But there was never anything fundamentally wrong with the company; the shares were just cheaper. Today, Home Capital trades north of $45 per share.

**2. Magna**

In early 2011, auto parts manufacturer **Magna International Inc** (TSX: MG)(NYSE: MGA) was trading at about $60 per share. Then the company encountered some problems, mainly in Europe, sending the shares down into the low $30s by September. These problems were fixable, and actually created a great buying opportunity. But a stop-loss order would have sold the shares.

These problems have now mostly been rectified, and the shares today trade at $107. The success of North America's big three automakers, as well as Frank Stronach's departure, hasn't hurt.

**3. Moody's**

Bond rating company **Moody's** (NYSE: MCO) is a great example from south of the border. In early 2013, the shares dropped instantly from $55 to $43 when investors became worried about future litigation expenses. As it turns out, it was actually the perfect time to buy; Moody's now trades in the mid-$70s. Warren Buffett's **Berkshire Hathaway** actually owns a $1.9 billion stake Moody's, and fortunately he did not have a stop-loss order.

**Foolish bottom line**

It is easy to cherry pick examples from the past where stop-loss orders would have been costly. There are certainly plenty of occasions where they would have been life-saving too. But the point is that one should never have a quick trigger finger when investing in stocks, and it's an even worse idea to automatically sell a stock when it goes down. The companies above are great reminders.



**CATEGORY**

1. Investing

**TICKERS GLOBAL**

1. NYSE:MCO (Moody's Corporation)
2. NYSE:MGA (Magna International Inc.)
3. TSX:HCG (Home Capital Group)
4. TSX:MG (Magna International Inc.)

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