Should You Sell Overpriced Stocks for Gains?

Description

We invest to earn more money. Theoretically, we want to buy when a business is priced at a discount and potentially sell it when it reaches your fair-value range or becomes overvalued. The reason some investors might sell at fair value is because there's little margin of safety left for the stock, and any news or macro factors might bring the shares lower.

Should we sell overpriced stocks for gains?

If you're a true investor, you're building a portfolio of stocks. Your portfolio might consist of companies from the sectors of consumer discretionary, healthcare, technology, telecommunications services, industrials, energy, materials, financials, and consumer staples.

The Coca-Cola Co (NYSE:KO), of the consumer discretionary sector, is at US$45 and overvalued by about 13% based on its normal 10-year multiple. Does this mean shareholders should sell it for gains?

Investors should decide what to do with overvalued shares by considering their situations. Did they buy Coca-Cola for gains or for its dividend? If they bought it for its dividend, then they should hold it. And if they don't have much exposure to consumer staples in their portfolios, they might wish to hold on to the shares.

If they sell, it could be a long time before Coca-Cola is priced attractively enough to buy again, and they'll need to decide where to invest the money instead to get the same yield of the same quality (if not better quality).

Procter & Gamble Co (NYSE:PG) is another consumer staples company that's overvalued. At about US$81, Procter & Gamble is overvalued by (coincidentally) 13% based on its normal 10-year multiple.

It is undergoing a transformation by cutting out its non-core brands. So, its earnings could actually continue to fall this year. Last year, its earnings per share fell by 5%.

If shareholders sell it, they should know what to replace it with that’s of the same quality and has ayield of at least 3.3%.

In summary

Investors should consider the alternative investments to the proceeds of the sales before selling. If the alternatives are of the same quality but priced at a cheaper valuation, it might make sense to sell. Other considerations include the sector and company allocations of your portfolio. For example, if you only have 5% of your portfolio in consumer staples, you might wish to hold on to your Coca-Cola and Procter & Gamble shares.

Investors should revisit their goals of investing in each stock before deciding whether to sell or not. Selling may be warranted if their original goal was to sell Coca-Cola at, say, US$45.

Instead of selling quality companies such as Coca-Cola and Procter & Gamble, I think it makes more sense to hold them and look for other companies to add. This way, a solid diversified portfolio can be built.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:KO (The Coca-Cola Company)
2. NYSE:PG (The Procter & Gamble Company)

Category

1. Dividend Stocks
2. Investing

Date
2025/07/02
Date Created
2016/03/17
Author
kayng