## What Your Holding Period SHOULD Be

Human behavior is a remarkable science. The way we allow our emotions to get the best of our logic when constructing, and ultimately breaking, an investment plan. For this, we see studies such as technical analysis, which is strongly devoted to analyzing the interactions between buyers and sellers in moving stock prices. In the short-term, this certainly has its merit.

Here's an example:

You analyze a small-cap pharmaceutical company with a great pipeline of products, consistently proven track record of impeccable financial performance andcontrolled research and development expenses. You have a belief that the company is headed in a great direction, so you buy at $100 a share. Three months in, the company gives you what seems to be a great return on your investment; it rose to $130.

(I'm ignoring the effects of short-term capital gains taxes and transaction costs for simplicity purposes).

Suddenly,  a pharmaceutical giant puts a bid for the rights to use the generic copy of their drug. Boom, stock price tumbles back down to $100, and in the fear of capital loss, sellers overwhelm buyers, and the price falls further. Clearly, this is not an ideal situation.

You're in a tough spot. Should you cash out to minimize your losses, wait until the stock price goes back to a suitable level so you break-even from your original investment, or stick with your gut and stay through the tough times?

There is great debate about this topic among proponents of technical (i.e. charting methods) analysis and fundamental (i.e. analyzing a company and industry's qualities) analysis. Technicians would argue that you should've gotten out on the downtrend before you reached your peak to minimize losses. A fundamentalist, who hopefully would have considered the consequences of such an instance occurring, would say that their investment horizon has not been reached.

So, what should you, the novice investor, do?

Firstly, you should definitely consider all the risks of an investment before you decide to pledge your capital to it. In a company 10-K filing, there is a section that outlines *Risks* as well and *Business*. You absolutely should understand all the risks inherent in an industry and specific to a certain company. Moreover, you need to understand how the company generates revenue, and how those risks, if triggered, will impact the company's ability to make money.

Just because a company discloses a set of potential risk factors does not mean those are everything that will effect a business. There are more triggers; do some thinking and figure them out!

Secondly, you should always recall that although history does not repeat, it rhymes. Look as far back as you can and when a similar depreciation in stock price occurred, why it occurred, and how the company bounced back from it. If it was significant, the company's management could have discussed it in an earnings call. Figure out how they responded, and if it was a similar instance, how they intend to respond. If the next earnings call is a couple months away, call investor relations and ask to speak to management!

Now, there is something worth mentioning. As I've seen, markets have the ability to adjust for new information rather quickly. That being said, there are several analysts covering stocks making it difficult to find your "secret sauce" that allows your investment thesis to be different from the status quo. But, we've seen acclaimed hedge fund managers such as Bill Ackman refute this idea with major companies such as MBIA.

But, can we recall what happened? In sum, it took the market 5 years to accept Ackman's investment thesis about how a AAA-rated company was highly levered and had transferred all the risk onto taxpayers. In those five years, Mr. Ackman received a lot of backlash, including several accusations of being a market manipulator and someone using his acclaim to drive down a stock price (although, the majority of his short position was in credit-default swaps).

Now, am I saying every investment thesis you will have is something like Ackman's on MBIA? I don't know, but I will say, the amount of reading that goes into discovering a gem like that as well as having the market's overlook something so significant is not easy to come by. You may very well have both strong and weak investment ideas; no one is perfect.

But, this brings me back to my original point: is this setback temporary, and was it projected in your original due diligence of the company? If it was, and you believe management has the ability to turn things around as they've done in the past, then that is worth thinking about before you sell. It is also beneficial to take a step back before you sell the stock and determine whether the action you are making is driven by emotions or logic. There are countless times where individuals sell stocks that have a momentary backdrop and continue upward, and it drives them crazy.

That is irrationality. Simply put, you should not be irrational with you money.

I've heard investing is both an art and a science, but personally, I believe it is a test of mental fortitude. This is not to be confused with stubbornness; if new data is released taht inviolate your investment thesis and sends the company on a downtrend, you should definitely think about the long-term prospects. But what I mean is that you can't let the little obstacles deter you from your long-term goal. You need to be strong in your belief and not let your emotions get the best of you.

Here's why:

If you purchase a stock, and it does well, you will probably be happy and tell your friends. They will purchase the stock too, and the cycle will perpetuate until demand, not fundamentals, drives price up. Suddenly, a bad piece of news is released, you worry, sell, and tell your friends, who tell their friends. The stock price falls again. The cycle repeats, and you find yourself losing money due to all the transactions costs associated with vicious cycle of buying and selling.

You need to be smarter. You should not let your emotions, friends, and outside influences (except relevant information to the stock) influence your decision to exit a position.

Stay strong and smart.

To your success,

**Bryan Baratian**