

*This is an original article written by Philip Loh; the edited version appeared in the Business Times 6<sup>th</sup> July 2005.*

## **Why can't you bring yourself to sell your money losing investment?**

Deciding to buy a stock or fund is always easier than deciding to sell. This is particularly true if the investment is a loser. But selling at the right time is the best way to free up cash to pursue more promising opportunities. Most people know that in theory but few have the discipline to put that in practice.

Looking at the portfolio of a client recently, I was shocked to see that it consists mainly of technology funds which he bought at the peak of the market cycle in 2000, and still waiting for them to breakeven. The fact is if he had sold of his technology funds one and the half year ago and move the money to catch the Asia recovery after SARS, his portfolio would be 30% higher now.

The issue of “seller remorse” is a complex one and much research had been conducted to examine the investor’s mindset in such situations. Some psychologists suggest that it is due to the investors’ reluctance to admit an error. Others suggest that it is because of our tendency to place a greater worth to what we “own”.

But perhaps the most compelling reason that we stick with the losers is that human beings will do anything to avoid regret. Contrary to most popular belief, the investor greatest fear is not about losing money. In fact, their greatest apprehension is to see their investment climb in value after they have sold them. This is why people are much more likely to sell winners instead of their losers.

To illustrate our mortal fear of regret, let’s look at the landmark research paper published in 1983 by psychologist David Bell. In his study, Bell gave his subjects a choice between entering a lottery that paid \$10,000 if they won and nothing if they lost – or skipping the lottery altogether and receiving a sure \$4,000. Those who played the game and lost tended to think they are greedy and were punished. But those who took the \$4,000 and found out that their forfeited chance paid off would take it quite hard and kick themselves for not taking the risk. Those who gambled and lost were disappointed but they did not suffer the same sharp self recrimination – even though they wound up with nothing. The conclusion is that most investors cannot endure the realisation that they did something which kept them from winning.

As a result, investors typically choose to hang on to their losers and sit on “dead” money, rather than redeploy them to better opportunities. They choose to avoid regret at all costs. The pain of finally unloading an investment and seeing its price rise is much more intense than the pain of holding on and watching a bad investment sink further.

In the local context, the most obvious manifestation of the “hanging on” mindset is illustrated by Singaporeans’ love affair with the property market. For the past two generations, Singaporeans had viewed it as the most “solid” way to preserve their wealth. Given the many technical indicators that suggest the property markets would remain in the doldrums for the next several years, property investors continue to hold

on to their investment properties they bought at higher prices. Many owners who bought their properties much earlier and sitting on pretty good capital gain are also hanging on, believing that they can sell at peak prices if they wait “long enough”. Despite the huge financing and opportunity cost, coupled with depreciation losses from the run down of their properties and low rental yield, cutting loss is simply not an option, fearing that the property market would start surging once they liquidate their holdings. I had personally witness many multi-millionaires living their retirement years well below their means, choosing instead to hold on to their private property until they can sell them at a “good profit”. Property prices would definitely recover if we wait long enough. But as the saying goes, “in the long run, we’re all dead.”

Examining another client’s stock holdings illustrates the same problem. The stocks he is holding consist mainly of his loss making trades, many the darlings of the 1990s bull market, like Goldtron, IPC, Creative, Chartered, MediaRing, Telemedia etc. When I asked him why is he is still holding on to them, his reply is a succinct “since it is not worth much, no point selling them now”. The ones which had made him money had already been liquidated. And believe me, this is the twentieth time I have heard the same story. I suppose that why the average stock investors earn 5% lower than what the markets make in any given year.

The “hanging on” mind set has continued to puzzle me. And yet, as a financial consultant who helps to manage ten of millions of my clients’ life savings, I can fully appreciate the mental hurdles that most investors have to overcome to swap their money losing investment for more profitable ones. Ironically, in the world of investment, the thin line that often separates the successful investor and a mediocre one is the discipline to act against our own natural instincts.