

When To Sell To Assure Profits

BY
JAMES P. MORTON

THE MAGAZINE OF WALL STREET
42 BROADWAY
NEW YORK CITY

TABLE OF CONTENTS

CHAPTER I REQUIREMENTS—PERSONAL AND FINANCIAL—FOR SUCCESSFUL INVESTING AND TRADING.	1
CHAPTER II LONG-AND-SHORT-DISTANCE PERSPECTIVES—LAW OF SUPPLY AND DEMAND—FORERUNNERS OF IMPORTANT CHANGES IN TREND.	11
CHAPTER III DETECTING BUYING POINTS IN LONG SWINGS.	23
CHAPTER IV DETECTING BUYING POINTS IN SHORT SWINGS.	37
CHAPTER V WHEN TO SELL TO ASSURE PROFITS.	53
CHAPTER VI CHOOSING THE MOST FAVORABLE INDUSTRY AND ITS MOST ATTRACTIVE SECURITY.	65
CHAPTER VII NEW INDUSTRIES AND PROMOTIONS—HOW TO DETERMINE WHETHER SOUND PROMOTIONS ARE OVERPRICED	79
CHAPTER VIII MECHANICAL MARKET AIDS—THEIR USES AND LIMITATIONS.	91
CHAPTER IX BUSINESS DEVELOPMENTS AND PROSPECTS WHICH FORETELL SECURITY MARKET MOVEMENTS.	105

CHAPTER X	UNCOVERING BONDS THAT OFFER BIG MARKET PROFITS, AS WELL AS INCOME.	117
CHAPTER XI	WHAT TO CHOOSE AND WHAT TO AVOID IN THE UNLISTED MARKET.	129
CHAPTER XII	INTEREST ON INVESTED CAPITAL: AN INVISIBLE LEAK OF PROFITS.	141
CHAPTER XIII	LESSONS OF THE 1924-26 MARKET.	149

When to Sell to Assure Profits

CHAPTER I.

Requirements—Personal and Financial— for Successful Investing and Trading.

THIS book is intended as an auxiliary to THE MAGAZINE OF WALL STREET in its work of guiding and helping the investor; on the positive side, by pointing out opportunities and possibilities in the various financial markets, on the negative side by enabling the investor and the speculator to avoid dangerous and costly pitfalls.

Where the MAGAZINE is timely and specific, describing individual investments and situations, this book aims to lay down the general principles behind the concrete judgments; where the MAGAZINE covers an enormous territory in the course of years, this book tries to be a compact work of reference.

It is clear, of course, that neither book nor MAGAZINE can take the place of careful thought and experience, no more than the incessant reading of a textbook on chess will make a man a chess champion; but, like any instructive text, they can help to build the foundations on which the individual can erect a substantial structure of knowledge and skill.

When to Sell to Assure Profits

First of all, therefore, the individual reader should determine in which direction his own personal aptitudes and financial situation should incline his market activities. There are many different kinds of financial success, depending on different kinds of ability and method, but it is safe to say that none have been achieved without a clear realization of the objective.

Types of Investors.

One type of investor, for instance, whose income is practically entirely dependent on a limited investment fund, tries to make this fund yield as large a return, year in and year out, as possible, and is successful in so far as he can achieve a steady return above the normal income of 5 or 5½% obtainable on good bonds. Another type, having a steady source of income from his business, or salary, or profession, or a trust fund, and accumulating a surplus from which he desires to build up an estate, may be interested in buying securities in bear markets, holding for a period of one or two years, selling, and keeping his funds liquid for another year or two until the next favorable time for buying appears. Still another investor prefers to buy into young, developing industries and holding on for five or ten years until they have achieved wide public recognition through large earnings, paying little attention to market fluctuations or return on capital,

Requirements Personal and Financial

while his equity increases constantly in value. An entirely different type is interested in the factors affecting day-to-day or week-to-week fluctuations, willing to buy or to sell or reverse his position overnight, according to the indications of the market as to its next short swing.

From this it will be seen that the prudent investor will make sure of his aim as soon as possible, and as a necessary prerequisite, will estimate his resources and his own personal qualifications for the different kinds of investment activity which are open to him. We shall attempt in the following paragraphs to group together some of the more familiar kinds of investment program, and to indicate the most favorable financial and psychological requirements for each.

Financial Requirements of the Long-Term Investor.

The long-term investor in stocks should have a stable source of income which will leave him free from worry in the event that the market turns temporarily against him, and should not depend to any great extent on the income from his capital. United States Steel common paid no dividends for many years, although it was undoubtedly an excellent purchase in its early years. Before the water was squeezed out of it and sufficient asset values piled up back of the stock to sustain a stable dividend rate, its price was subject to sharp fluctuations which

When to Sell to Assure Profits

might have compelled a weak holder to sell out at a loss when he would ultimately have shown handsome profits by holding on long enough. In 1901, therefore, a shrewd, far-seeing investor would have bought steel as a long-term non-dividend-paying investment.

Similarly, bank stocks return very little in dividends on the investment, but have been very profitable from the standpoint of capital enhancement.

It is clear also that it takes a certain temperament to make money out of this type of security. One must be willing and able to study an investment situation so thoroughly before buying that he will be undisturbed by any subsequent decline, and may even take advantage of lower prices to buy more and lower the average cost of his holidays.

This is what is meant by some shrewd market observers when they say that many people make money only when they stay away from the ticker. Not being concerned with minor fluctuations, they keep in touch with the larger developments only, and are not tempted to sell too early.

This type of investor is characterized by a certain faith in his own judgment amounting almost to obstinacy. When a sound stock declines, there are never wanting people who will say that the fact that it has declined shows that it is not a sound stock after all. A kind of inner deafness is necessary to ward off all these buzzings.

Patience, thoroughness, and even a certain slow-

Requirements Personal and Financial

ness in deciding whether to buy or sell are psychological necessities for this kind of investor.

Long Swings of the Investment Market.

Different methods are followed by the investor who wants to take advantage of the broad swings, lasting one or two years, known as bull or bear markets. His aim is to make as much money as possible out of the periods when markets are active and rising, at the cost of leaving his money unemployed or else employed at relatively low rates of interest, for the sake of liquidity, during the intervening periods.

He, of course, will not ignore day-to-day fluctuations; not that he is interested in them for their own sake, but as giving supporting evidence as to the beginning or end of big market movements. Unlike the previous type of investor, too, he will be likely to confine his purchases to well-established stocks with a long and sound record, as being most responsive to the great swings of the market.

This type of investment method is open to the small as well as to the large investor, provided only that the small return during the period after stocks have been sold out and before a new line has been bought works no hardship.

A different set of mental qualifications is required of this kind of investor. Where the long-pull, long-profit buyer needs to absorb only the comparatively

When to Sell to Assure Profits

limited circle of facts relating to the special industries and companies in which he is interested, the long-swing buyer has to be able to combine a very large number of entirely different facts relating to general business, money rates and the stock market in such a way as to get a clear-cut picture of the stock market situation and its prospects over the next swing.

Necessary Data for Long-Swing Investment.

A man who bought stocks of electrical power companies, say, about 1920 or 1921 to hold until 1926 or beyond, for instance, would need to know the potential market for electricity in the United States, the possibilities of rural, industrial and railroad electrification, the development of electrical appliances for the home to increase power consumption per capita, the reasons for the displacement of gas by electricity for lighting purposes, and a host of similar facts relating to the industry, as well as enough facts about the individual company of which he is a stockholder to warrant him in considering it a worthy representative of that industry. Once he had ascertained these facts, however, and acted on them, he could afford to remain "sold on the idea" and merely keep on the watch for unfavorable developments affecting the electric power and light industry, of which, by the way, no serious ones have appeared as yet.

Requirements Personal and Financial

On the other hand, a long-swing investor, in January, 1925, convinced that the time to buy high-grade stocks had arrived, would search the market for sound, dividend-paying, well-established leaders, with large asset values and a strong financial position, such as United States Steel, Atchison, Consolidated Gas, National Biscuit, and the like; not that he expected any phenomenal development in their respective industries, but that he regarded these stocks as the proper leaders in a long upward movement.

Once he had bought, the factors that would occupy his attention would be, not so much steel production, railway traffic, gas sendout or the consumption of biscuits as a variety of indices of general character: commodity prices, interest rates, cotton-mill production, crop forecasts, foreign trade, Federal Reserve ratios, and the like.

The type of mind suited for this kind of program should therefore be more alert, able to cover a wide territory without necessarily going into too technical detail, yet capable of sticking to its convictions when once formed.

Taking Advantage of the Minor Fluctuations.

A third kind of investment activity merges gradually into speculation. It is primarily concerned with market fluctuations measured by days, weeks or months. Some of the most spectacular

When to Sell to Assure Profits

successes, and far many more unspectacular losses, of Wall Street history have been recorded in this type of trading. Financially, the man who undertakes it should be long of purse, and able to stand a series of losses if necessary.

Expert knowledge is required no less than in any other type of securities operation, but this knowledge should be centered on the market rather than on the company and the industry behind the stock, or even on general business conditions. The things that matter here are correct judgment as to actual and potential buying or selling strength behind the particular stocks in which the trader is interested; the element of intuition, of individual judgment, has freer play in view of the scarcity of definitely ascertainable facts.

In this field comparatively little things, rumors, news that So-and-So is buying, that such-and-such a house is in bad financial condition, that an election is going to turn out unfavorably to sound business interests, are all of importance, and the trader must have the rare ability to interpret them quickly, and in the main correctly, if he is to be a success at his business. For a business it certainly is, and not a "flyer" or a thrilling amusement. It requires also a certain calm, which will not permit the trader to be worried out of his position by trifles which his mind rejects as irrelevant; and a great adaptability, which will allow him to act quickly when he has made up his mind, no matter if he has to reverse opinions every hour.

Requirements Personal and Financial

The above classifications include the majority of people who are financially interested in stocks. There are other and more special types, such as the phlegmatic and analytical bond “speculator,” the rapidly calculating arbitrageur, and the shrewd manipulator, but these do not concern the average speculator or investor.

It will be seen from the above that while investing methods and mental requirements vary with the objects sought, certain qualities are needed by all who make securities their concern: patience, ability to keep one's head, willingness to learn, but above all, Common Sense.

CHAPTER II.

Long-and-Short-Distance Perspectives— Law of Supply and Demand—Fore- runners of Important Changes in Trend.

ONCE the investor has made up his mind as to which type of investment activity he is most suited for, financially and psychologically, his next step should be to make a certain internal adjustment in his financial vision which will enable him to keep clearly in view at all times those factors which are of importance to him, and which will keep in the background, more or less out of sight, such factors as would only disturb and confuse him. It is like setting the focus of a telescope for near, middle-distance or long-distance observations.

Not that every investor can necessarily engage in only one kind of activity. Many prudent buyers of securities have a backlog of investment bonds and preferred stocks on hand at all times, irrespective of the state of the market, not because they need the income from it, but as a measure of precaution; to that extent they are long-time investors, and need to consider long-time factors, no matter whether they trade in and out of the market or wait for the long swings,

When to Sell to Assure Profits

with the rest of their investment capital, thus occupying a double rôle.

It is also possible, at least in theory, for the same man to take advantage of the long one- and two-year swings of the market, and at the same time trade in and out, to take advantage of weekly or monthly fluctuations, which would of course involve at times his being long of certain stocks for the long pull and short of others for a short swing. In general, however, such combinations do not work out well; in the first place because the different types of market operation demand different psychological qualities, which may be found together but usually are not; and in the second, because of the necessity of focusing which we have mentioned, and the difficulty of shifting back and forth from short- to long-distance observations.

Length of Swings and Profits.

There is a very close connection between the length of time for which a security is held, and the profit, in dollars per share, which may reasonably be expected by the investor who uses sound methods and sound judgment. At one extreme is the ticker trader, or tape reader, who may buy and sell within the same hour, and is doing well when he averages a point of profit on each transaction; at the other extreme, the investor who buys a stock to hold a lifetime and transmit it to his heirs, with the expectation of

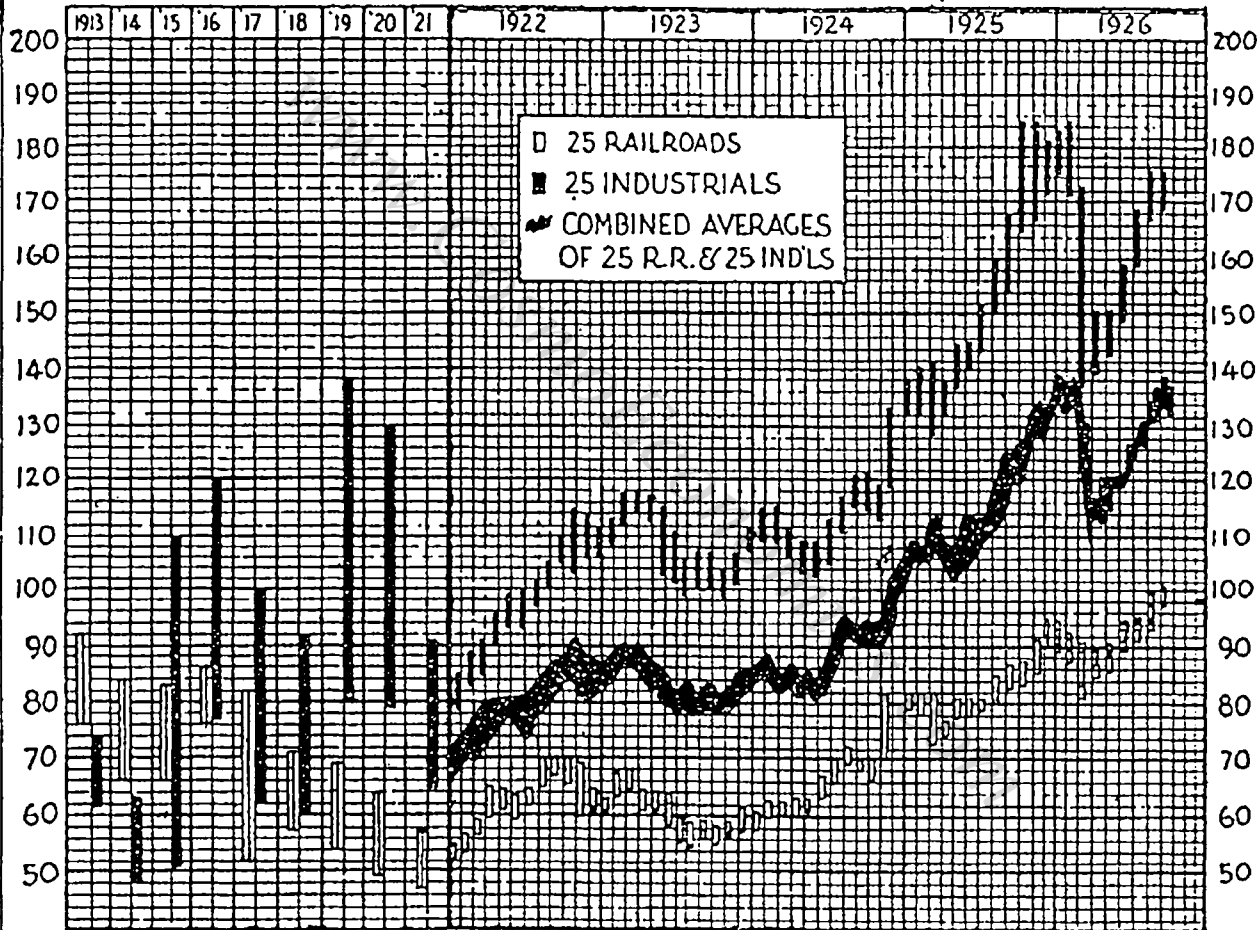
Long-and-Short-Distance Perspectives

multiplying his original capital ten or twenty times over in the course of a half century. In between is the man who tries to make a ten-point profit by holding his stock a month, or a fifty-point profit in the course of a complete swing of the market.

Not only the profit per share, but in a certain sense also the average risk, depends on the expected length of the transaction. For most men, the immediate future of the market is much harder to grasp or forecast than its long swings, and, correspondingly, the percentage of losses may be expected to be greater. On the other hand, when one buys securities for an extremely long pull, extending possibly over decades, the proportion of losses in a carefully chosen list should be small.

This is because the factors that may affect short swings are small, numerous, often of an unexpected and temporary nature, and often of a kind where the basic facts are difficult to obtain,—a statement by a banker, a speech in Congress, the action of the Federal Reserve Board, a momentary shift in the supply and demand of a stock, may cause sharp temporary changes in stock prices. On the other hand, long-pull investment need consider only very general facts concerning the earning power of a particular company and industry. For instance, a cautious buyer, noting the trend of the American people toward the purchase of canned goods, might have bought American Can in 1921 at less than 40, basing his action on a very simple and easily as-

STOCK MARKET AVERAGES



Institute of Cosmological Economics

www.cosmoeconomics.com

Long-and-Short-Distance Perspectives

certainable fact, and his risk would have been minimal.

Both the long-pull and the long-swing investor, therefore, are interested in only those factors which have a bearing on earning power; the short-swing trader, on the other hand, is mainly concerned with the supply and the demand for stocks, and the innumerable factors which may tip the balance to one side or the other.

Putting it in a different way, the long-pull investor buys General Motors at 120 because he believes he sees indications of increased earnings in the companies in which he invests, and sells when these indications have been verified and the general public, recognizing the increased earning power, is willing to bid the price of the stock up to 225 in order to obtain it. The short-swing buyer is interested neither in earning power nor in public recognition or neglect; he is concerned with the immediate future course of prices in the market, and would sell Motors short at 225 to cover at 215 the next day, no matter how highly he thought of the stock as an investment.

General Features of the Market.

All markets, whether for securities, cottonseed oil, wheat, or any other commodity, have certain features in common, and it is on these that the trader fixes his attention. In the first place, in order for a market

When to Sell to Assure Profit

to exist, there must be some people who want to buy, and who therefore bid; others who want to sell, and who therefore offer, and there is, in all speculative markets, a certain discrepancy between the bid and the offered prices, otherwise all the business that could possibly be done would be done at once, and the function of the market would cease.

Whenever a particular bid and a particular offer coincide, a sale results. If sellers are more numerous, prospective buyers will gradually lower their bids, so that whatever sales are consummated are made at lower and lower prices; when buyers are in the majority, and sellers scarce, the bids will have to be put high and higher to attract actual sales. For instance, in a recent market Atchison may have acted as follows: 500 shares bid @ $137\frac{1}{8}$, 200 offered @ $137\frac{3}{8}$, 200 sold at $137\frac{1}{4}$; 1000 bid $137\frac{1}{4}$, 200 offered $137\frac{5}{8}$, 500 sold $137\frac{1}{2}$; 1000 bid $137\frac{3}{8}$, 300 bid $137\frac{7}{8}$, 1000 sold $137\frac{3}{8}$; 1200 bid 138, 200 offered $138\frac{1}{2}$, 600 sold $138\frac{1}{4}$. This illustrates the effect of active bidding and low supply in putting up prices.

The immediate trend of the market therefore depends on how much stock is offered for sale and how much is wanted at any given time. This is not necessarily the amount for which real bids and offers are in the hands of brokers, as there may be mental reservations by buyers or sellers, "If the price gets down to so-and-so, I'll buy a hundred shares," which from a practical point of view have all the

Long-and-Short-Distance Perspectives

effectiveness of actual orders. At the same time, there may be actual orders in the market, more or less distant from prevailing levels, which may alter the entire market position, but which are not revealed until those levels are reached. For instance, if Steel is selling around 150, it may encounter a volume of orders to sell, which will drive the price down, until at 145, let us say, a large numbers of orders are reached to buy, which will prevent the stock from going further down until those orders are filled. Should these orders all be met, and no further substantial orders, mental or actual, to buy Steel at any price above 140 be met with, then any additional Steel stock which is offered for sale in quantity would find no takers until it had reached 140.

The Market Structure or "Technical Position."

We thus see that for any stock for which there is an open market, a sort of imaginary "market structure" exists, composed of bids and offers at varying price levels, crowded at certain levels, bare at others, which determines the immediate future of the price of that stock. Stock prices therefore do not merely "go" down or up; they are put down or up by certain definite forces, acting in certain definite ways. In the case of stocks of which there are large amounts outstanding, and which have been on the market for many years, certain regularities in this constantly fluctuating market structure have been set

When to Sell to Assure Profits

up. A certain amount is held by investors and institutions in their strong boxes, and barring exceptional fluctuations at the extreme ends, up or down, of the price structure, is out of the market. Another part is held by powerful individuals, banks or brokerage houses, who are active in the market and whose actions may be traced by the shrewd trader. Still another part, usually varying widely with the degree of activity of the market, is held by the "public," consisting of smaller investors and traders of every degree of market intelligence, tenacity, and financial strength.

The short-swing trader focuses his mental telescope on this market structure, often referred to as the "technical position," and is guided by only those factors which affect that position. Because of the short time which his operations involve, those factors do not usually include changes in the general earning power of the company concerned. But if, let us say, a given stock, of which a large proportion is in the hands of the speculatively inclined public, has gone up ten or fifteen points in a few weeks' time, and then hesitates at the higher price level while the volume of sales diminishes, he will reason, "All the near-by bids, representing buying power, have been filled; on the other hand, it is probable that a considerable amount of stock is potentially on sale by those who have bought at lower prices and are willing to cash in their profit, in addition to those who have bought at the high prices and who, being pre-

Long-and-Short-Distance Perspectives

sumably financially weak or inexperienced, may be scared out if signs of weakness develop, so that the market structure must be full of potential selling orders further down; I shall therefore sell.”

This reasoning would be sound, if no other factors intervened, and would be legitimate no matter how strong the company was, or how good its earnings, or how brilliant the future of its industry. To fix his attention on the latter factors would merely distract the trader from the real points at issue, namely, the expected preponderance of selling over buying orders. This illustrates what we mean by the short-swing focus.

Disregarding the Technical Position.

On the other hand, consider the case of an investor who buys a stock which sells at 100, earns \$10 a share, and pays \$6, because he has reason to believe that it will, in the course of a year or two, and in harmony with generally improving business conditions, earn about \$18 or \$20 a share, in which case it might raise its dividend or declare an extra, and eventually sell at 150 or better. Assuming that he has bought at the right time, more and more investors will buy into the stock, and prices will rise until they reach, let us say, 120. At this level some of those who have bought earlier will want to cash in their profits, and some speculators, figuring in the manner of the short-swing trader whose reasoning

When to Sell to Assure Profits

was described some paragraphs back, will sell short, while few new buyers will care to come in at 120; as a result, the price will fall to 110, perhaps.

Should our investor say, "I could have had a twenty-point profit; the stock is now off ten points from the high, I had better sell out and get what I can before my profits are wiped out altogether"? Obviously not. He made his original purchase on the basis of certain calculations as to the future earning power and dividend policy of the corporation. Not enough time has elapsed to give him any reason to change his opinion as to these factors, or his judgment might even have been confirmed by preliminary indications. He therefore has no real reason to sell, and should not, if he is right in other respects. Unless he focuses his attention sharply on the factors which concern his investment policy, he runs the risk of being sidetracked by considerations which should appeal only to a different type of trader entirely.

As a matter of fact, this kind of confusion happens only too often, and is a fertile source of market losses. Four times out of five, our investor would have sold at 110, found that the market did not go any lower, but on the contrary, all of the stock for sale having been absorbed at that level, was free to move up sharply to 125 at which price the thoroughly bewildered buyer would not have the courage to buy it again.

Long-and-Short-Distance Perspectives

And the worst of it would have been, he had picked a good stock, bought it at the right time, but was deprived of the fruits of his good judgment and initiative—merely by a distortion of his market focus.

www.CosmoEconomics.com