

Sell Into Strength - Investment Rule #2

Over the course of the coming weeks and months I will be laying out the investment rules that I live and die by. These are rules that I have developed over the last ten years as both a retail and professional investor and trader:

[Rule # 1: Buy into weakness.](#)

Rule #2: Sell into strength.

Rule #3: Reduce cost basis.

Rule #4: Keep investments small.

Rule #5: Keep 80% of total invested capital in ETF's and up to 20% in individual names.

Rule #6: Choose duration over direction.

Rule #7: Manage your winners.

Rule #8: Manage risk at order entry.

Rule #9: Increase your # of occurrences.

Rule #10: Make investments with a probability of profit > than 50%.

Selling into Strength

In rule #1 I covered what it means to "[buy into weakness](#)," whereby you get long on down days and lean into a corrective move to the downside. This is one method that will ensure you don't ever buy the top tick in the market. Down days and corrective moves in price are typically accompanied by an increase in volatility.

This becomes very important as we get further into [investing with options](#), specifically selling put options. But for now just take note that it is advantageous to

sell options when the markets are down and volatility is up.

As you have probably guessed by now, *“selling into strength”* is the inverse or opposite of *“buying into weakness.”* This one is a little harder to grasp for most folks because we have all been taught to buy and hold and never sell. And for the passive investor that is sound advice. However, as an opportunist and advocate of a more active investing approach, I believe you have to become comfortable exiting positions.

It's best to have a mechanical approach to selling, thus *“selling into strength.”* You sell into strength by closing long positions on up days and into extended moves to the upside. This is also a great opportunity to sell [covered calls](#) against your long stock. But again, we won't get too deep into the options stuff just yet as future posts will detail this further.

Before we move on, let me point out that most people practice the complete opposite of this rule. When the markets or a particular stock is crashing they end up selling into weakness, typically locking in losses. Fear sets in and investors imagine the stock or market is going to zero and decide to cut their losses before they have nothing left.

This action lets guys like me pick up their positions for 10-40% discounts (and happily I might add).

Let's take a look at an example:

We will use AAPL again, since it is a stock that most people can identify and relate with. Let's also assume that you bought AAPL post reverse-split. You were able to pick up 100 shares of AAPL stock at \$99/share.

Month after month you watch AAPL stock make new highs. You love looking at your brokerage account statements. It's been a little over a year and the stock is now trading at \$130/share and you now have a 31% return.

There are three ways you can *“sell into strength”*:

1) You can place an order to sell the stock out-right, closing your position and locking in your gains at \$130/share. Obviously this would mean you would no longer participate in further upside that AAPL may or may not have. Nor will you collect any future dividends.

2) You could lighten up on your position by selling only a portion of your position. If you sell 76% or 76 shares at the current \$130/share price, you would take your original capital off the table, and it would only leave your profits left invested in AAPL.

OR

3) You could sell a [covered call](#) against your position. This will allow you to reduce cost basis, continue holding the position for “**some**” additional upside. Depending on the strike and duration of the call you also may continue collecting the dividend.

In scenario 3, let's say you were able to sell a 9-month call that expires in January of 2016 at the \$140 strike price for \$7 (\$700 in total premium collected for every 100 shares). This gives you an effective selling price of \$147/share (strike price + premium received). This gives you an additional 17.5% of upside, putting your total gain around 48% if you get called away.

It also allows you to reduce your cost basis by \$7/share, because you get to keep the premium collected no matter what happens. Or put another way, you now have \$7 of downside protection (not including any dividends collected).

Conclusion

Selling into strength is a strategic way to manage your investments. And it doesn't always mean you have to liquidate your position. Remember that no one has ever gone poor taking a profit. At some point even the most dedicated buy-and-hold investors will need to sell positions. You might as well be strategic about selling your stock (or any investment).

I think that if more dividend/buy-and-hold folks understood options a bit more, they would come to love incorporating them into their long-term investment strategy. In this rule I am specifically talking about the covered call in scenario three above. It's a great way to reduce cost basis and enhance long-term returns.

- Gen Y Finance Guy

[TD Ameritrade](#) - They are hands down the best broker for the retail investor. TD Ameritrade provides a number of investing platforms that are more robust than any

other platform I have ever used. My particular favorite is the “Think or Swim” platform. Oh and did I mention that they have over 100 ETFs that you can trade commission free?

They also provide a ton of educational resources that are again all free to you. You will also have access to stocks, options, futures, and forex all on a single platform. And if that wasn't enough, they will let you invest commission free for 60 days while you test drive the platform and they will give you up to \$600 for rolling over your other accounts.

My special offer to you: If you sign up for an account using the links I provided on this post, I will send you a video that gives you an over view of the Think or Swim investing platform and I will even show you how easy it is to execute your first covered call. All you need to do is sign up using the banner below or the TD Ameritrade link above, then send me an email at mrgenyfinanceguy@gmail.com

p.s. once your account is open if you tell them that Tasty Trade sent you and reference promo code #233 you can secure exclusive commission rates: \$1.50/option contract & no ticket charge, and \$7.00 flat rate stock trades



Gen Y Finance Guy

Hey, I'm Dom - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own [financial stats](#). I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a beacon of hope, motivation, and inspiration for *you*, the reader, by living life by

example and sharing it **all** here on the blog. My sincere hope is that you will be able to learn from me - both from my successes and my failures! [Read More](#)