The Problem With Single Stock Positions - Transcript

Tom Mullooly: In Episode 83, we talked about the risks of holding individual stock positions.

Welcome to the Mullooly Asset Show. I'm your host, Tom Mullooly and this is episode number 83. Normally, we start with a question that we get from our viewers. This topic is something that has come up a lot lately in our calls, emails and our inquiries, so we're just going to call this a compilation of different questions that we've received over the last few weeks, and we talked about, we want to talk about the risk of holding single stock positions.

I'll start with a quick story. In the late 90s, we had a client who called on multiple occasions and begged us. He wanted to put his entire account into America Online. Remember AOL? He wanted to put the whole account into America Online.

As he said, all it does is go up every single day and millions of people are signing up for AOL. I get as he was saying, I get those floppy disks in the mail every week. If you go to look up the chart for AOL today, what are you going to find? You're going to find the chart of Verizon. Here's why.

AOL went public in 1992. They were extremely popular through the 90s. They split. They went over $100 a share. Then they announced they're doing this deal with Time Warner.

When they announced that deal by the way, the company was valued at $224 billion. 15 years later, company is drastically different. They wound up doing a deal with Verizon. The company was worth $4.4 billion. They lost almost the entire value of the company in the next 15 years.

We know that it can be very rewarding to hold single stock positions in an investment account. We've been doing it for years, but it has to be in the right proportion.

Now we have a friend of our firm, a gentleman by the name of Michael Batnick. He is the Director of Research at Ritholtz Wealth Management and he recently had two quotes that I want to share with you because they're excellent. The first thing that he said was that you're not buying yesterday's Amazon. Think about this.

Yesterday's Amazon was a bookseller and a company that started selling a lot of things online. What does today's Amazon look like? Because really when you're investing in Amazon today in 2018, you're buying a completely different company. Think about that.

You're buying a company that's into a grocery store chain. They're talking about getting into healthcare. They, in addition to being the biggest retailer around, they also own Amazon Web Services,. That could be a gigantic standalone company all on its own.

The second thing that he said, which I thought was great and kind of puts things into perspective is that he said hey Netflix can fall 40% from its recent highs and just made it a couple of weeks ago, it can fall 40% and still be up for the year.

While it can still be up, are you going to be standing up if you hold a stock that drops 40%? That we don't know. We have a lot of folks I get nervous when the market drops 10%. What do we do? What do you do when a single stock position falls 20%, 30%, 40% or more?

Here's some of the problems that we see with holding single stock positions. The first thing is you don't know what the company is going to look like in 5, 10, 20 years. I mean just using AOL as an example, they were the biggest dial up company. There were 23 million people that used AOL for dial up connections. I think my uncle and aunt still use that as a dial up but think about where they went.

Now they're are a small piece of Verizon and along the way, they morphed into buying the Huffington Post and they even started something called Patch. Remember Patch? Okay, so the second problem we see with single stock positions is that with the success that comes with these things, you got to be ready for some really severe drawdowns and sometimes we're talking about 60%, 70%, 80%.

Netflix is a perfect example of that. They've had huge draw downs, it takes a lot of guts and a lot of intestinal fortitude to just stay with these names throughout some really serious drawdowns and we get calls from folks that really start flipping out when their stock is down 15%. You have to be able to look long term and say I'm going to ride this no matter what.

The third problem that we see is oftentimes, selling these single stock positions unleashes a tax bill that is often unnecessary. It's hilarious to see or hear client reactions when I tell them okay, we're going to sell this stock. We're going to close out this position. You're going to have a $10,000 tax bill next year when all's said and done, whoa, whoa, whoa, it changes their opinion, it changes their perspective.

It's not really the way you want to do it, but it does put things in a different light, knowing that you're going to be unleashing a big tax bill. The biggest takeaway that we see is that these single stock positions, while great, it puts you at times on an emotional rollercoaster. You're taking that rollercoaster ride without putting that safety bar down. I just don't know if everybody's cut out for that.

That's the big message from Episode 83. We got to keep everything in proportion. Thanks for watching. We'll see you on the next video.