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Big Bets on Stocks Create Big Losers

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If you're a stock-market investor, the quickest way to get rich is to bet heavily on one stock or one sector. Unfortunately, that's also the quickest way to get poor.

But whether your big bet soars or slumps, you have yourself a problem. What do you do next? The decision can be agonizing, as technology investors can attest.

The Loser's Lot

Since March 2000, the stock market has handed out an alarming amount of financial pain, with tech-stock investors hurt the most.

Consider the fate of some well-known mutual funds. Weighed down by technology stocks, Fidelity Aggressive Growth plunged 74.2% over the 18 months through Sept. 30, Janus Twenty slumped 58.6% and Putnam New Opportunities lost 63.3%, according to Chicago fund researchers Morningstar Inc.

But those losses seem modest compared with the drubbing suffered by some individual technology stocks. Over the same 18-month stretch, the Dow Jones Composite Internet Index tumbled 89.9%. One-time highfliers like Amazon.com, JDS Uniphase and Lucent Technologies are all down roughly 90% from last year's market peak.

"Suppose you're down 75%," says Jerry Tweddell, an investment adviser in Sonora, Calif. "Just to get back to even, it might take two decades of moderate stock-market returns. You'll have to double your money and then double it again."

What to do? For many folks, the temptation is to stick with their battered technology holdings, hoping they will snap back. This isn't an unreasonable hope. Technology shares have high "betas," which means they tend to lose more than most stocks in a market decline, but they should outperform in bull markets.

The problem is, the previous bull market's heroes are often left behind when stock prices revive. Indeed, technology issues took years to recover from the early 1980s tech-stock frenzy. "The next bull market will probably be led by companies you and I have never heard of," Mr. Tweddell predicts.

Technology now accounts for about a fifth of the Standard & Poor's 500-stock index. If you have more than 20% of your stock portfolio in technology, "you've got to cut your weighting," argues Honolulu investment adviser **Harry Kasanow**. "Investors will be disappointed if they wait for tech to come back."

Meir Statman, a finance professor at Santa Clara University in California, notes that there is a big tax incentive to dump losers. If you sell losing investments held in a taxable account, you can use those losses on your tax return to offset capital gains and even ordinary income.



John Pritchett

But what if somebody is convinced that tech will bounce back? "If you think the technology sector has been beaten down beyond reasonable value, you should sell the stocks you have, take the tax loss and buy other tech stocks," Prof. Statman advises.

Yet many investors balk at this strategy. They are loath to realize their losses because that means admitting they made a mistake in picking those stocks.

To overcome such pangs of regret, "do what you have to do, but do it gradually," Prof. Statman suggests. "If you have 5,000 shares of Sun Microsystems, you might sell 500 shares every month for the next 10 months. That way, if the tech sector does revive, you'll capture some of it."

The Winner's Curse

While unloading losers generates a tax windfall, selling a big winner can mean forking over some big bucks to Uncle Sam. That's a tax bill you may avoid if you hold the shares until you die. Still, Prof. Statman thinks many investors use taxes as an excuse not to sell.

What's really holding them back, he reckons, is an aversion to regret. "Every time you sell, whether it's after a gain or a loss, you run the risk of kicking yourself for selling too soon," Prof. Statman notes.

Many people end up with unbalanced portfolios because they accumulate their employer's stock and loyally hang onto every share. "Even loyalty has to stop somewhere," Prof. Statman argues. "You already depend on your company for your job. You don't want to depend on it for your entire financial security."

Yet employees often feel it isn't particularly risky to hold their company's stock. Partly, it is the comfort of familiarity. In addition, if the stock has risen steadily, the shares may have garnered an aura of invincibility. Indeed, in the late 1990s, tech stocks seemed like a sure thing, not a dicey proposition.

Barbara Steinmetz, a financial planner in Burlingame, Calif., works with many employees of Silicon Valley technology companies. Before the stock market tumbled, "I'd have 30- or 31-year-olds come in here and they'd say, 'I want to retire in two or three years'," she recalls.

Anxious to amass a lot of money quickly and sure that tech stocks were headed higher, many refused to sell their company's stock. "They're much more receptive now," Ms. Steinmetz says. "I tell them that this is one step closer to realizing their goals."

As a rule of thumb, you shouldn't have more than 5% of your stock portfolio in any one company. Got a heftier position than that? Selling may trigger a big tax bill. But that, I believe, is a small price to pay for reducing risk.

"You have to diversify," **Mr. Kasanow** says. "This is the perfect year to take gains and offset them with your other losses."

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