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Forced Sellers

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One of our analysts recently tried to buy a house plant for the office. These however don't come cheap if bought new from a garden centre or plant shop. Being a value investor on the hunt for a quality bargain, searching for forced sellers comes naturally. People moving houses or offices often sell their plants for pennies on the pound or even for free if they are desperate enough.

In the markets, a similar phenomenon occurs that can create opportunities for investors. Stocks that have recently been been spun off from their parent company can often suffer a large decline in share price. This usually happens because investors who originally bought shares in the larger company now own shares in an unknown and much smaller spun off company and may not want to own it. A stock recently removed from a widely followed index can also suffer price declines because ETFs and index trackers that were previously forced buyers of the stock are now forced sellers.

In both of these examples, this supposed bargain caused by forced sellers is only a true bargain if the share price falls for non-economic factors. The market cap or popularity of a stock are examples of non-economic factors – they are irrelevant to the underlying value of the investment.

Being a forced seller is the worst position to be in because if you are desperate enough, other market participants take notice and use this to their advantage. The now gated Woodford Equity Income fund is in such a position. Some of the fund's unlisted holdings have seen up to 50% declines in value as the manager tries to unload positions to meet redemptions and satisfy the regulator.

Avoiding unforced investment errors can be achieved by simply avoiding potential forced sellers. For us, this means avoiding absolute return funds (hedge funds) and property funds which can become forced sellers at the moments investors actually need the opposite. This has been and continues to be one of our guiding principles since Tacit was launched almost 9 years ago and we believe will become more important in the future. A liquidity mismatch can more than offset any potential gains you could make from an investment but if you can't sell it, its value is worthless.