Selling stocks during a crisis

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July 24, 2025 — daae079c

1 Question

Should I sell my stocks during the coronavirus crisis?

2 Answer

Most advise that one should invest for the long term and that they should have a diversified portfolio. They mention that many studies demonstrate that it's not possible to time the market.

However, when a crisis as big as the coronavirus hits, it's important to assess its impact on your portfolio as a whole. What kind of assets are you holding? In what industries? What are the impacts the coronavirus might have on that business? How long have these businesses taken to recover from prior crashes (given more weight to the recent ones)? How likely am I wrong in my assessments of the situation?

I currently hold stocks in airline companies. I would assess that air traveling is likely going to take a large hit for most of March and April. Except if the governments were to step in to reduce the bleeding of those companies, I would press the eject button and save whatever money I have left in those stocks. It took about 5 years for airline companies to recover from the 2007-2009 crash. Some companies almost went bankrupt. They definitely recovered and some went to make 4000% from their lowest value.

If you kept your money in those stocks, you would have spent about 7 years of time returning you nothing (ignoring dividends here). Instead, if you sold at any point during the downward movement and bought the stocks at the same price you sold them when they went back, you would have avoided going further down. Furthermore, if you had decided to purchase those stocks at a lower point, it would have taken you less time to make your money back.

Here's an example:

In January 2007 you buy 10 stocks for 60 CAD each, totaling 600 CAD. One year later the stock is worth only 20 CAD. You sell them all. You now have suffered a loss of (60 - 20) x 10 = 400 CAD and have 200 CAD left. Half a year later the stock is now worth 2 CAD. If you had instead decided to sell then, you would have 2 x 10 = 20 CAD, suffering a loss of 580 CAD.

Now, let's see what happens when the stock starts to go up again. Five years later, the stock went from 2 CAD to 20 CAD. Had you sold the stock at 20 CAD, there would be no difference for you. Had you sold the stock at 2 CAD you would have "suffered" the opportunity cost of (20 - 2) x 10 = 180 CAD. If at any point (having sold the stock at 20 CAD) you had decided to buy back the stock, you would be making money, or should I say, recovering from your loss. As an example, if you had bought 20 shares at 10 CAD (for a total of 200 CAD), you would now have 400 CAD. You would still be 200 CAD down the drain from your initial investment, but you would be on your way to recovery.

Three years later the stock price has recovered back to 60 CAD. If you had never sold, investing in this stock would have been a cost of opportunity in investing in other stocks. If you had sold at 20 CAD and started investing when it reached 20 CAD again, you would have made 10 x (60 - 20) = 400 CAD. You would be back to square 1, without any gain or loss. The benefit you would have had during the period you had sold your stock is that you wouldn't have to check if the stock was going lower. Had you however invested your 200 CAD to buy 20 stocks at 10 CAD, you would now have 20 x 60 = 1200 CAD. You would have doubled your money!

In summary, staying in the market during the crash means that you will not make any money while the market recovers, which can take months if not years. If you instead get out at a loss and wait for it to go down, then buy in (let's say after a 10% drop in the price you sold)

This is obviously the optimistic scenario. In the pessimistic case, as you sold your stocks, the stocks would go on to recover immediately and make enormous gains.

My assessment of the options I have and their associated risks:

- Staying in the market and having to wait for months or years for the stocks I own to return to their original value, which implies years of wasted potential for profits on this original investment while at best receiving dividends from companies that have them.
- Leaving the market, at the cost of a loss (which half of it can be used toward your taxes if you live in Canada), at the risk of the market going up again and potentially reducing my loss, or in the worst case, going above my prior profits.
- Reducing my position in stocks that are highly likely to be very impacted by the coronavirus, being a half-half position, where stocks that are expected to still perform during the downward period are kept and those that are too volatile and negative trending are sold as soon as possible.

Note: This is not actual advice. This is only me trying to reason about the situation.