

Making the Most of Your Company Stock Holdings

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ARE YOU WORRIED THAT YOUR NET WORTH IS AT RISK?

As an executive of a publicly traded company, you may feel:

You're risking the derailment of your financial future by concentrating too much of your wealth in one company.

You aren't getting the advice you need for such complex matters.

You're failing to take advantage of strategic opportunities.

As a senior executive of a public company for more than 15 years, 55-year-old Jeff has accumulated a significant amount of company stock as part of his compensation package. In fact, company stock now makes up more than half of his personal wealth. Although he has confidence in the company, he also realizes that the company's fortunes could change based on a number of factors beyond his or the company's control.

As he moves closer to his retirement years, Jeff faces important decisions about whether and how to reduce his company stock holdings. If he does nothing, a significant decline in the company's share price could derail his retirement plans.

To avoid this, Jeff faces important decisions on how much stock to sell, when to sell it and how to manage required blackout periods. For example, as Jeff decides to reduce his exposure to company stock strategically – for example, by using 10b5-1 plans to manage insider trading risk and the constraints of blackout periods –he faces a host of technical and financial decisions that could shape his and his family's financial future for years to come.

DEVELOPING A SMART SELL STRATEGY FOR COMPANY STOCK

Managing concentrated equity holdings is complex. This is especially true when those holdings include the stock of your employer, which raises important legal and regulatory issues. Without a plan to strategically sell company stock at opportune times, you may feel both exposed to excessive

investment and regulatory risk and concerned about missing out on future share price appreciation.

This eBook explains the key steps involved when managing company stock holdings so they can become a key part of a investment portfolio without overwhelming it. This information is designed to help you understand what is required to develop an effective sell strategy for company stock and how to facilitate the process for executing those sales. By relying on a proactive approach guided by technical expertise and financial acumen, you can improve your chances of realizing your financial goals and retirement dreams.

At Blue Chip Partners, we believe your financial future should not depend too heavily on the success of one company's stock. Our experience and expertise in this area can help you maximize the value of company stock holdings as part of an overall wealth management strategy.



Concept 1: Beware of Behavioral Biases

We all strive to make the best investment decisions. While those decisions generally result in an action (buy/hold/sell), investors tend to spend very little time understanding why they make those decisions.

*"The investor's chief problem – and even his worst enemy – is likely to be himself."
– Benjamin Graham*

We are all subject to irrational beliefs that subconsciously influence our decision-making process. The key is to acknowledge these inherent imperfections in our decision making and use them to your advantage.

As a corporate executive, you are not immune to behavioral biases. In fact, these biases can uniquely influence those who receive a large portion of their compensation in the form of company stock. After all, you do not make an active decision to acquire the stock in an equity grant. Your only active decision is whether to hold or sell those shares.

RECOGNIZING YOUR BIASES

There are three potential biases that may subconsciously affect how you perceive and manage your company stock holdings.

1. Status quo bias

Status quo bias occurs when we prefer to keep things as they are by doing nothing or by sticking with a previous decision, even when we have access to new facts.



For example, if you received a cash bonus of \$500,000 in lieu of Restricted Stock Units (RSUs), would you immediately use that money to purchase company stock? The answer is probably, no. In reality, few insiders immediately sell vested RSUs and, instead, embrace the status quo and let those holdings accumulate over time.

The status quo may be the path of least resistance, but it is not a sound long-term strategy for managing equity awards.



2. Recency bias and the fear of missing out

"I can't sell now. The stock is making a move!"

Sound familiar? Many executives avoid selling company stock when it is doing well to avoid losing out of future gains. This kind of recency bias and the fear of missing out (FOMO) on future gains can be overwhelming and reflects a desire to avoid regret caused by selling a stock too early.

3. Anchoring

"Analysts are calling for \$50/share. If the stock hits that price, I'll sell for sure!"

This is an example of anchoring, a cognitive bias in which an individual depends too heavily on an initial piece of information when making decisions. Anchoring can occur based on information from a variety of sources. In addition to analyst price targets (no matter how arbitrary), anchoring can also stem from recent stock price high-water marks, stock option strike prices, and even round price levels.

AWARENESS IS KEY

Behavioral biases are not caused by intentional acts. Being aware of these biases when managing equity awards can lessen their impact on your decision making.

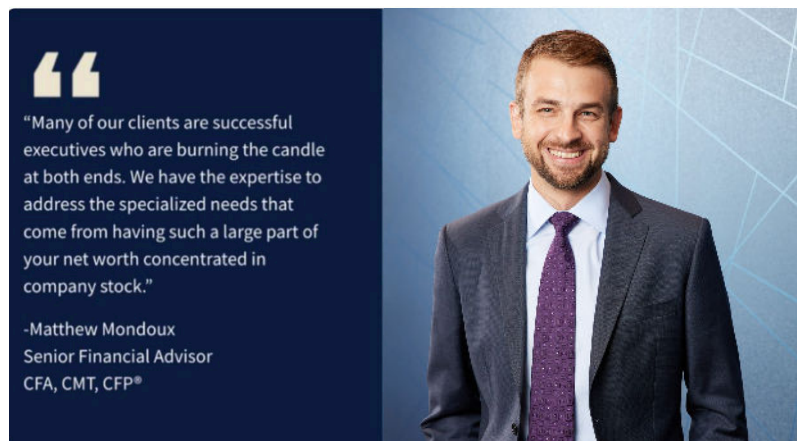
It is a good idea to get an objective perspective before making decisions about equity holdings. A financial advisor can help you recognize what may be driving your decision making and guide you toward a more objective path to success.

THE CASE FOR TECHNICAL ANALYSIS

Complement your company knowledge with a technical analyst's expertise in the financial markets. Technical analysts focus on past market prices and technical indicators in the belief that short-term stock price movements are driven by the supply of and demand for that stock.

Technical analysts believe that the fundamentals of a security are less relevant than the current balance of buyers and sellers of that stock. They interpret past trading patterns to discern this balance to predict future price movements.

Technical analysis can support an objective and disciplined sell strategy for company stock that helps manage risks and allows you to minimize the chance of making regrettable sell decisions.



Concept 2: Leveraging 10(b)5-1 Plans

Without a detailed plan for holding or selling shares over time, you risk accumulating a concentrated position in company stock that can greatly increase the level of risk in your portfolio. Yet, as a company insider with detailed knowledge of company operations and strategy, you must follow insider trading rules set up by the U.S. Securities and Exchange Commission (SEC).

This is the case of a government regulation creating an opportunity to achieve two seemingly opposite goals—a defense against potential insider trading allegations and a disciplined approach for selling company stock and diversifying your assets.

LEVERAGING RULE 10(b)5-1

The SEC's Rule 10(b)5-1 is designed to provide an affirmative defense against allegations of insider trading by allowing you to establish pre-approved advance trading plans for company stock. To create a compliant 10(b)5-1 trading plan, you must enter into the plan in good faith and cannot have access to material nonpublic information (MNPI) when the plan is formalized.

You do have some leeway when structuring 10(b)5-1 trading plans. For example, the plan can identify when to sell specific stock grants at predetermined prices. Once in place, 10b5-1 trading plans automatically trigger stock sales irrespective of future blackout periods or corporate pre-clearance. In other words, the plan will be executed automatically behind the scenes.

When establishing a 10(b)5-1 trading plan, you must make four key decisions:

**Which Stock
Grants to Sell**

**The Limit Price
for Each Grant
included in the
Plan**

**How Long the
Plan Will be in
Place**

**Whether to Change
the Chosen Criteria
that Trigger Stock
Sales**

- 1. Which stock grants to sell.** Once a specific stock grant vests, you can exercise options or sell directly held shares from that grant at any time following a 30-day “cooling off period” that starts on the date the 10b5-1 plan is initiated. For executive officers and directors, trading may not begin until the later of 90-days and two business days following the disclosure of the issuer’s financial results.
- 2. The limit price for each grant included in the plan.** You do not have to accept the prevailing market price when you sell stock. You can divide shares into blocks with set limit prices for each block. A technical analyst can help you to determine these limit prices.
- 3. How long the plan will be in place.** Regulations stipulate that a 10(b)5-1 plan can last anywhere from six months to two years. Striking a balance between two extremes, the most common approach is to establish a one-year plan.
- 4. Whether to change the chosen criteria that trigger stock sales.** It is important to review 10(b)5-1 trading plans during open trading windows to determine whether the original price targets continue to be relevant and appropriate. While changing the criteria on some or all blocks of stock may be necessary as circumstances change, it is important to keep in mind that doing so may weaken your good faith defense against insider trading accusations.



WEALTH MANAGEMENT AND 10(b)5-1 TRADING PLANS

10(b)5-1 trading plans allow you to trade company stock without regard to corporate blackout periods, to customize your diversification at predetermined price levels, and ensure a predictable and consistent outcome on transactions that trigger automatically. Without this structure, you may find it difficult to maintain the discipline necessary to sell shares periodically to maintain a prudent level of asset diversification.



Know Your Blackout Periods

Gain a full understanding of
your blackout schedule



Implement A 10b5-1 Plan

Sell stock at predetermined
price levels



Diversify The Proceeds

Reinvest into a portfolio that
aligns with your financial
plan

[Click here for more information about how to leverage a 10\(b\)5-1 trading plan!](#)

Concept 3: Managing Stock Option Grants

Although both stock options and restricted stock vest over time, only stock options give you the discretion to act as you see fit. The only limitation is the window for exercising your stock options, which opens once the grant vests and closes ten years after the grant was awarded.

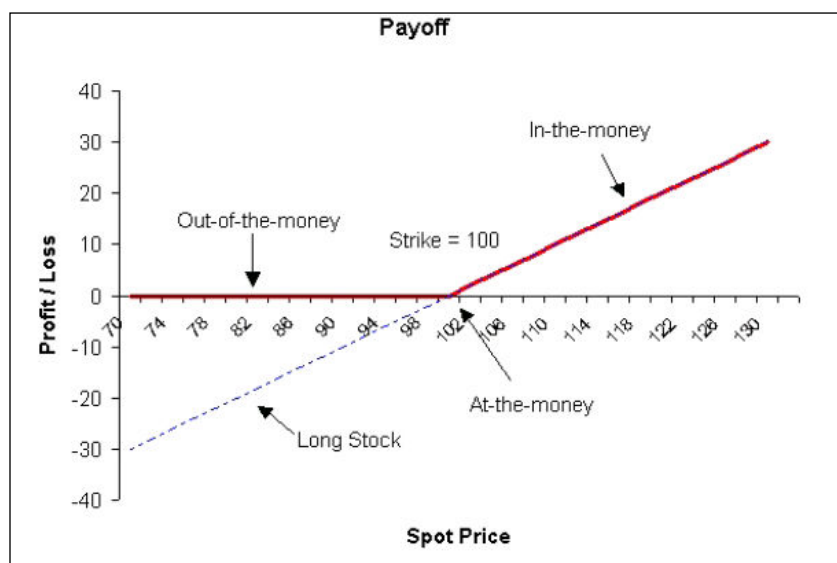
It can be too easy to exercise options in reaction to an immediate financial need, such as funding a large purchase (house, car, or college tuition), or to postpone the decision until the stock option grant is about to mature and you face a use-it-or-lose-it deadline.

Exercising stock options reactively often causes you to miss an important financial planning opportunity. Taking full advantage of this flexibility and control requires deliberate decisions about exercising stock options.

EXERCISING PROACTIVELY

Proactive planning makes it possible to identify the minimum threshold at which an option grant has realized a fair value for you—that is, the most “juice in the squeeze.” Maximizing that “juice” means identifying the best time to exercise stock options based on their intrinsic value.

Here is how it works. Stock options have a unique contingency feature called a strike price or grant price, which is generally the market price of the stock on the day the stock options are granted.



The strike price acts like a line in the sand when calculating the intrinsic value of each grant. When the underlying stock is trading below an option's strike price, the option has zero intrinsic value and is deemed worthless on paper.

However, if the shares are trading above the strike price, the grant's intrinsic value is based on the magnitude of the spread differential, which is calculated as the current market price minus the strike price. Time value is a second, and less transparent, component of option valuation.

Source: <https://financetrain.com/option-payoff-diagrams>

FINDING THE SWEET SPOT

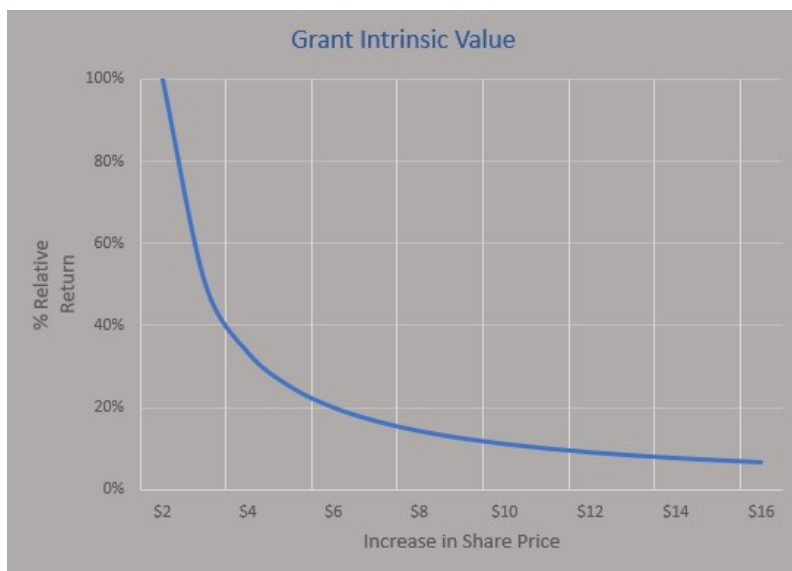
One of the key attributes of stock options is the leverage they offer as the underlying stock initially ascends above the strike price. However, just like an accelerating car that eventually reaches maximum speed, the effects of leverage diminish as the stock price goes up. The further an option travels from its strike price, the more it performs like the underlying stock.

Using this information can help you identify the sweet spot for exercising stock options.

Let's say XYZ Inc. recently granted stock options to its executive team with a strike price of \$100/share. The stock has increased \$1/share and is now trading at \$101/share. This grant is "in the money" with \$1/share of intrinsic value. If the price of XYZ stock increases to \$102/share, the option would then have \$2/share of intrinsic value.

While the second \$1 increase in price from \$101 to \$102 barely translates into a 1% increase in value for the underlying stock, it represents a 100% increase in value for the option (from \$1 to \$2 of intrinsic value).

The following chart calculates the intrinsic value of these stock options if XYZ stock increased to \$115/share. As you can see, each incremental \$1/share increase in market price dilutes the relative return for the option.



Click the chart for a detailed discussion on time vs. intrinsic value

MAKING THE SELL DECISION

As a general rule, we recommend exercising stock options and selling the resulting shares once the intrinsic value of your option grant exceeds 180% of the option's strike price. We believe this milestone represents the point at which most of the juice is squeezed.

It is important to combine stock option trading plans with both fundamental and technical analysis to ensure you are evaluating the decision from all angles. Whether exercising options or trading in your portfolio, the best outcomes generally arise when multiple forms of analysis point toward the same trade recommendation.

This approach also helps to ensure that stock option grants do not "outstay their welcome" in your portfolio. By using an objective framework to decide when to exercise option grants, you can execute any resulting trades with confidence. You can also avoid the opportunity cost of diminishing leverage and reduce the risk from what is probably an already concentrated position in company stock.

Concept 4: Negotiating Stock Options During a Job Change

Receiving stock option grants as part of an employment compensation package is an important rite of passage in any career. These grants not only indicate that you now have a certain level of professional value, they also provide an opportunity to benefit directly and significantly from the growth of your company.

Equity compensation has another benefit. When considering a job opportunity, the value of any equity you would have to surrender to accept a role with a new company should factor heavily in compensation negotiations. Entering negotiations armed with clear valuations of surrendered equity can increase the chances that you walk away with a more lucrative compensation package.

TIME VALUE VS. INTRINSIC VALUE

The goal when exercising stock options is to capture a spread value as the market price ascends above the strike price. This spread, referred to as intrinsic value, is the first component needed when calculating the value of stock options. However, if the market price is below the strike price at any point during the lifespan of the option, it is considered “underwater” and holds zero intrinsic value.

No executive worth their salt would ever give away an underwater option during its ten-year lifespan. Why? Because they know that this option still carries a second but much less transparent component of option valuation: time value.

Time value represents the future opportunity for stock price appreciation during the life of the option. At grant, an option primarily consists of time value and possibly a small amount of intrinsic value. This balance generally flips over time as the stock price appreciates and time value continues to decay. At the end of ten years, the time value eventually drops to zero.



Understanding both the time value and intrinsic value in option valuation can help you unlock the full replacement value of your stock options. If you are able to negotiate a replacement for the surrendered time value of underwater options with a prospective employer, you stand a much better chance of maximizing the value of any resulting employment offer.

NEGOTIATING TIME VALUE

Let's look at the impact of time value on a real-world executive compensation package. Sonoco Products (ticker: SON) was trading at around \$56 per share in May 2022. The company awarded executive stock options in February 2019 with a strike price of \$60.77. Since the market price of SON was below the strike price in May 2022, these stock options were underwater and the grants were deemed worthless on paper.

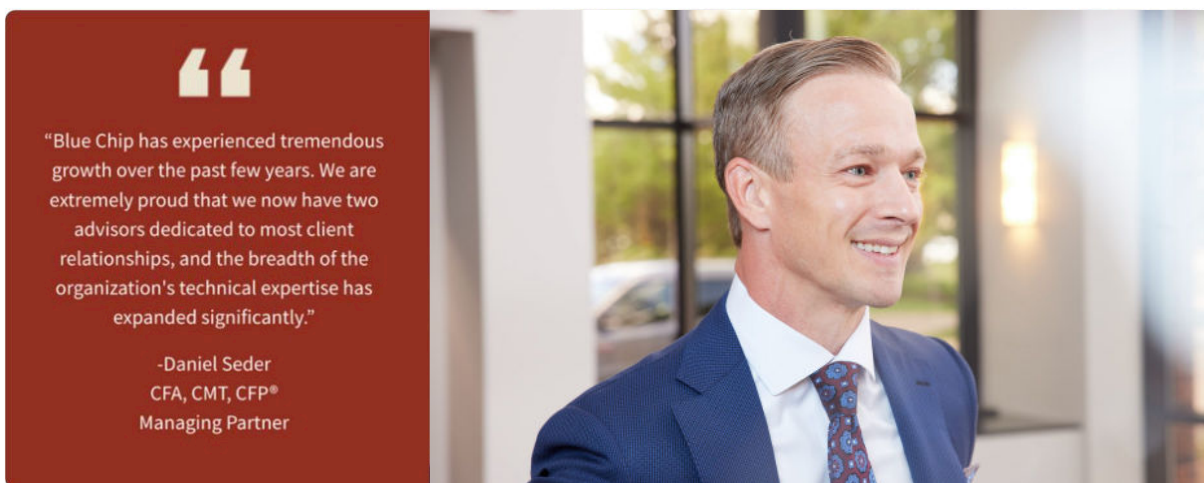
However, because these grants will not expire until February 2029, they still had meaningful time value. For example, the CEO's 2019 option grant of 30,121 shares had zero intrinsic value in May 2022, but they had roughly \$13.67 per share in time value using Black-Scholes, an established options pricing model. That's more than \$400,000 in equity replacement value that should be considered if the CEO was negotiating a compensation package for a role with a new company.

CONCLUSION

A well thought-out approach to managing equity compensation and the resulting company stock holdings can help you maximize the positive impact of these assets on your long-term wealth. By recognizing the need to diversify and setting up an automated process for selling shares, you stand a better chance of keeping emotion and bias out of these decisions.

Using this approach has other benefits that go well beyond the actual transactions. It allows you to make decisions that are removed from day-to-day stock market movements and less stressful as a result. A calmer decision-making mindset also allows you to tie portfolio management decisions directly to your financial goals so that you can use these assets to address any gaps in your financial plan.

Having a plan that is working behind the scenes for you leaves you with the time and mental freedom to enjoy what matters most to you—your family, your business or career and your leisure time.



About the Author, Dan Seder

Dan Seder, CFA®, CMT, CFP® joined Blue Chip Partners in 2005 and became a shareholder in 2010. Dan specializes in addressing the unique needs of corporate executives. This includes demystifying complex compensation packages, maximizing executive benefit platforms, and integrating equity grants (i.e., stock options, restricted stock, performance shares) into a financial plan. In addition, Dan leverages technical analysis when structuring 10b5-1 trading plans for executives interested in reducing their concentration in company stock.



Dan graduated with a B.A. from the University of Michigan, where he was a four-year member of the varsity wrestling team. Dan is the former president of the CFA Society of Detroit, a member of the CFA Institute, and has served as an instructor for the Stalla CFA Exam review program. Dan enjoys golfing, bowling, bird hunting, and working out. He has completed five full marathons. Dan is the proud father of Joey and Olivia and is blessed to be married to his lovely wife Veronica.

About Blue Chip Partners

Blue Chip Partners, LLC (Blue Chip) is an independent, fee-only Registered Investment Advisor and comprehensive wealth management firm located in Farmington Hills, MI (a suburban area of Detroit). Blue Chip provides personalized wealth management and asset management services, serving as a fiduciary to over 800 client relationships with over \$1.1 Billion in assets under management.



At Blue Chip Partners, wealth management is much more than managing a portfolio of investments. As fiduciaries, our financial advisors have the knowledge and experience necessary to create a customized financial plan that meets your unique needs. Our team of professionals is dedicated to your continued success. We strive to help you get the most life out of your wealth.

Each of our professionals is focused on helping you reach your financial goals. We provide services in five key areas: Retirement Planning, Investment Management, Tax Planning, Estate Planning, and Executive Compensation.

The advisors at Blue Chip have extensive experience and credentials that provide the foundation for providing comprehensive wealth management and holistic advice to a select clientele. Blue Chip has multiple Certified Financial Planner™ licensees (CFPs), Chartered Financial Analysts (CFAs), Certified Public Accountants (CPAs), Chartered Market Technicians (CMTs), and licensed attorneys (Michigan). To learn more, visit www.BlueChipPartners.com.

HOW TO WORK WITH US



BLUE CHIP
PARTNERS, LLC

DELEGATE CONFIDENTLY™

STEP 1: Schedule an introductory meeting.

STEP 2: Review your company stock awards.

STEP 3: Engage us to design your 10(b)5-1 plan according to your overall financial goals

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Disclosures:

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