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6 WAYS TO DIVERSIFY YOUR PORTFOLIO

Portfolio diversification can be achieved at every dollar level. Here's how to diversify your portfolio.

By: Coryanne Hicks - September 24, 2019

Portfolio diversification is the seat belt for your investment portfolio. It's the giant bar across your lap on a roller coaster that keeps you from flying off the ride. Investors diversify their portfolios to reduce risk and minimize the bumps in their investment journey.

"The broader the diversification of the portfolio, the more stable the returns will generally be and therefore will diffuse the overall risk to the investor," says Daniel R. Hill, president of Richmond, Virginia-based D.R. Hill Wealth Strategies.

While portfolio diversification can make investing smoother and your chances of long term success greater, it is not a cure all.

"Diversification does not guarantee better returns or fewer losses," says Scott Cohen, founder and CEO of CD Wealth Management in Dallas. "It's simply a technique that can help you reach your long term financial goals."

There are two key elements to portfolio diversification, he says: time and correlation.

"To make sure you're truly diversified among the right funds, you must first understand when each dollar is meant to be used," he says.

Money invested for short term goals should be invested differently than funds reserved for long term goals. In general, the longer your time frame, the more risk you can afford to take with your investments.

Jeff Klauenberg, founder of Klauenberg Retirement Solutions in Laurel, Maryland, says to start building a portfolio by defining your investment policy statement. This should include your goal, timeframe and risk tolerance, or "fear of loss." From there, you can build your portfolio in accordance with the second element of diversification: correlation.

Correlation is the degree to which your investments move in tandem. If your entire portfolio moves together, you aren't diversified.

"Make sure you're spreading money to areas that don't go up and down at the same time," Cohen says. "The most basic form of this is allocation between stocks and bonds."

While owning a mix of stocks and bonds is a good start toward portfolio diversification, there are other strategies to consider, too. Here's how to diversify your portfolio:

- Use asset allocation or target date funds.
- Invest in a mix of mutual funds or ETFs.
- Customize with individual stocks and bonds.
- Vary company size and type.
- Invest abroad.
- Add complexity.

Use Asset Allocation or Target Date Funds

The easiest way to diversify your portfolio is with asset allocation funds. These are funds with a predetermined mix of stocks and bonds. A 60/40 fund, for instance, will maintain a 60% socks to 40% bonds or cash allocation.

For a fund that alters its risk profile over time, Klauenberg suggests target date funds.

"You choose the timeframe and the fund managers will do the diversifying and future adjustments and rebalancing for you."

The downside to target date funds is that they're built with the average investor in mind and thus don't account for your individual needs or preferences.

Invest in a Mix of Mutual Funds or ETFs

For a more tailored investment portfolio, try a mix of mutual funds or exchange traded funds (ETFs). There's no one size fits all method of building a diversified portfolio with funds, but Cohen suggests using the 5/25 rule as a guide: "Stick to five different asset classes and don't have more than 25% of your money in one of them.

He says to diversify your equity funds globally and between capitalization size.

The trick to making sure your fund portfolio is truly diversified is to look at what's inside each fund. Check the top 10 or 25 holdings to determine your overall portfolio concentrations and make sure you don't have too much overlap, Klauenberg says.

Customize With Individual Stocks and Bonds

If you have the money and wherewithal to take portfolio management a step further, you could build an even more customized portfolio with individual stocks and bonds. The ratio of stocks to bonds and cash you use will depend on your goal, timeframe and risk tolerance, says Dan Egan, director of behavioral finance and investing at Betterment. " For long term goals, those with time horizons over 20 years or more, we recommend setting your portfolio to 90% stocks and 10% bonds."

He also says to diversify your portfolio with a mixture of stocks and bonds that behave differently: "Diversification isn't just a matter of holding numerous investments, but holding investments that move independently or opposite from one another."

You want to own enough companies to diversify away company specific risk, says Lacey Cobb, director of portfolio management at Personal Capital. "A good rule of thumb is to own at least 30 stocks," she says. "We also generally suggest people avoid allocating more than 4% of their portfolio to any single stock."

She says to aim for a mix of growth, value and core stocks and economic sectors because each sector tends to "behave differently throughout the economic cycle."

Vary Company Size and Type

"A portfolio should be diversified at two levels, between asset categories and, then, within asset categories," Klauenberg says.

Between asset categories is your mix of stocks, bonds, commodities, real estate and cash. You should also diversify within each of these categories by investing in companies and bonds of varying types and sizes.

"A portfolio should include large companies and small ones, government bonds and corporate bonds," Egan says.

It should also include companies in different industries. "For example, holding investments in both Ford (ticker: F) and GM (GM) wouldn't be a very diversified strategy," he says.

Owning individual bonds can help eliminate the liquidity risk often associated with bond funds and ETFs, but individual bondholders should take care to diversify among maturity and credit risk, Cohen says. "Remember high yield bonds have the greatest potential for return, but come with higher risk."

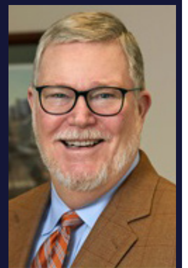
Invest Abroad

Investors are notoriously biased toward domestic securities, but to diversify your portfolio you need international exposure as well.

"It's important to include international stocks in order to benefit from growth overseas, especially when it happens while the U.S. stagnates," Egan says. "While the U.S. stock market currently makes up approximately 50% of total market capitalization, international stocks and bonds are playing an increasingly large role in portfolio investing as more and more economies grow to maturity around the globe."

Read the whole article at https://bit.ly/2lrQryG

For over thirty years, Jeff Klauenberg, CFP®, has focused on finding solutions to retirement problems. Klauenberg Retirement Solutions has continually aimed to be on the cutting edge of financial and retirement planning with comprehensive knowledge to develop solutions for their clients' retirement and estate planning needs.



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