



Fisher Funds

Investor Education Centre

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So many eggs, so many baskets – 19/04/09

The week after Easter seems a perfect time to talk about eggs and baskets. We're not talking about the chocolate variety, but the rather more serious investment egg.

You've probably heard the saying "don't put all your eggs in one basket". It is used widely to describe diversification - the strategy of spreading your money among a number of different investments to reduce your risk. The logic is that if you own a number of different investments and one does badly, your whole portfolio won't be affected as much as if you just owned the poor performer.

Working through an example quickly illustrates the value of not having all your eggs in one basket. If you owned just one stock and its price fell 30%, your portfolio would fall 30% in value. If you owned five stocks in equal amounts and one of them fell 30%, your portfolio would lose just 6% in value (assuming the other stocks didn't change).

Diversification is not just about the number of different investments you own – it's also about the type of investments. If they are all similar investments that are impacted by the same things, then having a number of them doesn't necessarily protect your portfolio.

For example, if you own five stocks in the retail sector, chances are they would all fall in value in a recession when people stop buying.

There is another strategy used in investing which is the opposite of diversification. It is known as concentration and can be described as "Putting all your eggs in one basket, and watching that basket carefully".

This strategy involves selecting a small number of investments and trying to reduce risk by making sure you know each of them very well. It's a strategy I have used over the years with much success, but it is not for the faint-hearted as one wrong bet can make a big impact on your performance.

The appeal of a concentrated portfolio compared with a diversified portfolio is that it can lead to higher returns. The more you diversify, the harder it is for any one of your investments to make a significant impact on your returns.

Legendary US fund manager, Peter Lynch, talks about "*diworsification*", where you can diversify so much that you cancel out potential gains. For example, if you have 100 different investments with the same amount in each, even if one of them trebles in value, it will only lift your portfolio by 3%.

It's a bit like Easter eggs really ... one is never enough, two are nice, but twenty might just make you sick!

The strategy that is right for you will depend on your risk appetite and what you are trying to achieve from your investments. There is no right or wrong approach. We all need to find the best approach to suit ourselves and the risks we are prepared to take.

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