

Weathering the Storm

How Diversification Helps Protect Your Portfolio

June 2024

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In the world of investing, there's a golden rule: diversification. It's like the age-old advice of not putting all your eggs in one basket. By spreading investments across various asset classes, market sizes, industries, and even geographical locations, you can significantly reduce risk and create a more stable portfolio. We often say, wealth can be built through concentrated positions, but wealth is maintained through diversification. Here's how diversification helps you navigate the often-choppy waters of the investment world.

Taming the Volatility Beast

Imagine you've invested heavily in a tech company whose stock soars during economic booms. But when a recession hits, the tech industry might be disproportionately affected, causing the stock's value to plummet. Diversification acts as a safety net. By including assets with a history of performing differently in various economic climates (like bonds, which tend to rise when stocks fall), you create a buffer. Even if one area experiences a downturn, the overall impact on your portfolio is lessened. Think of it like a seesaw. When stocks go down (one end dips), bonds can go up (the other end rises), helping to maintain a more balanced position.

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Asset class diversification starts with a variety of asset classes. These are broad categories of investments, each with its own risk-return profile: **Stocks** represent ownership in companies and offer the potential for high growth but also carry higher risk of price fluctuations. **Bonds** are essentially IOUs from governments or corporations, offering regular interest payments and typically lower volatility than stocks. **Real estate** can be directly owned (like rental properties) or invested in through funds, offering potential for rental income and long-term appreciation but with lower liquidity (meaning it might take time to sell).

Cash equivalents are highly liquid assets like money market accounts or short-term certificates of deposit (CDs) that provide a safe-haven for your money but typically offer lower returns. By including a mix of these asset classes, you tailor your portfolio to your risk tolerance and investment goals. Someone nearing retirement might prioritize bonds for stability, while a young investor with a longer time horizon might prioritize stocks for potential growth.

Market capitalization refers to a company's total market value. **Large-cap companies** (think Apple or Microsoft) are typically more stable. **Small-cap companies** (think Bancorp or Applied Industrial Technologies) have the potential for higher growth and higher risk. Diversifying across market caps offers a balance between stability and growth potential.

Sector savvy pertains to spreading investments across different sectors and/or industries. Different economic sectors experience their own unique cycles of growth and decline, influenced by factors like consumer trends, technological advancements, and government regulations. By strategically including sector diversification, you can:

- **Reduce risk from sector-specific downturns.** Let's say a global pandemic cripples the travel and tourism industry. If your portfolio is heavily weighted towards airlines and cruise lines, you might experience significant losses. Diversifying across sectors like healthcare or technology can help mitigate the direct impact of sector/industry specific downturns
- **Capture growth opportunities in different areas.** Different sectors perform better at different times. For example, during a period of economic expansion, technology and consumer discretionary sectors might outperform because of higher earnings growth. Conversely, during a recession, defensive sectors like consumer staples and utilities might outperform because of more reliable earnings. By managing stocks across multiple sectors, you're better positioned to capture growth during an entire economic cycle.

Global investing involves investing in assets across multiple countries. Economic conditions and investment opportunities vary around the world. Different Developed Economies experience their own cycles of growth and decline. For example, a recession in the United States might not significantly impact a booming economy in Indonesia. By including investments in various countries, you lessen the impact of a downturn in any single region. **Developing Economies (a.k.a Emerging Markets) can offer exciting investment opportunities.** These markets might experience higher growth rates than developed markets, but also come with additional risks like political instability, lower regulatory and reporting standards, and/or currency fluctuations. A strategic allocation to emerging markets can boost a portfolio's potential returns, but it's crucial to weigh the risks.

Public versus private investing pertains to investments in publicly traded versus privately-held companies. **Public investments**, like stocks and bonds, can be bought and sold easily on exchanges, providing investors with flexibility to access their capital when needed. These companies are required to disclose financial information more frequently and are affected by noise of the market, which can lead to greater price volatility. **Private investments**, like private equity, private credit, or real estate partnerships, can offer potentially high returns but come with less liquidity (meaning they're harder to sell quickly) and more complexity (added tax filings). These investments are typically not available to the general public and are often subject to higher suitability standards (investors meeting certain income or net worth thresholds) that may restrict investment. Private investments often don't move in lockstep with the public markets and this lack of correlation can further enhance portfolio diversification by reducing overall volatility. **A strategic mix of public and private investments can provide your portfolio with exposure to both established companies and the exciting world of high-growth potential ventures.** However, it's crucial to understand the limitations of private investments and ensure they align with your risk tolerance and investment horizon.

By **incorporating these diversification strategies, you create a portfolio that's less susceptible to market whims** and more likely to weather financial storms. Remember, diversification is a journey, not a destination. As your investment goals and risk tolerance evolve, so should your portfolio's asset allocation. Consulting a financial advisor can help you develop a personalized diversification strategy tailored to your unique financial needs.

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