

Is Your Portfolio Overweighted? Know When to Say When

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THE JOURNAL OF WEALTH MANAGEMENT, Spring 2001

Abstract

It is widely accepted that diversifying one's portfolio by adding more securities leads to the elimination of idiosyncratic, but not systematic, risk. Previous studies suggest that holding up to just ten distinct stocks is enough to gain the full economic benefit of diversification. Moreover, these studies suggest holding different stocks in different industries to have effective diversification. In practice, however, many investors maintain a highly concentrated portfolio, particularly within a growth-oriented sector, like technology. This study presents a method of determining the minimum number of stocks to hold in various industries while still being diversified. The authors seek to determine the number of stocks necessary to eliminate idiosyncratic risk within an industry. The authors' results show that industry-concentrated investors should hold no less than ten stocks in their portfolio. However, diversification across industries is still recommended, as systematic risk is lower when investors diversify across all sectors.