How Diversified Should Your Stock Portfolio Be?

Description

The fundamental idea of diversification is to not have too many eggs in one basket. If something happens to one basket, you still have eggs in other baskets that are fine and dandy.

How many stocks do you need in your portfolio to be well diversified?

How many stocks you need depends on many factors, including if you hold other assets outside your stock portfolio. For example, an investor might not invest in residential real estate investment trust stocks if they owned some rental properties.

How many stocks you need also depends on what kind of stocks you hold. For example, if half of your stock portfolio is in Canadian banks and the other half is in energy stocks, your stock portfolio would probably be considered overly concentrated by most standards. Typically, you probably don't want more than 25% in one sector.

Do you need stocks in every sector?

The short answer is no. Most folks who've invested in commodity stocks such as **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) and **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX) in the last few years would probably say so.

Does that mean they're bad investments? Like all investments, they're sometimes bad investments, but not all the time.

There's a fair price for every business. I'm not talking about the stock price it's trading at, but how much the underlying business is worth. If a stock falls to a cheap enough valuation, it might be worth it to pick up some shares and sell it when the stock is closer to its fair valuation.

In the case of Cenovus and Barrick Gold, their stocks can appreciate strongly if the underlying commodity prices co-operate and head higher, and if their management focuses on reducing costs, increasing margins, and reducing debt.

How much should you have in each holding?

Depending on how long you have been investing for, you might have a big or small percentage of a stock in your portfolio.

For example, if you've only started investing this year, you might only have one or two stocks in your portfolio. And each might be worth 50% of your portfolio. If you're a retiree, you should have at least 20 stocks and perhaps, at most, 5% of your portfolio in each.

You should be aware of what percentage you have in a stock, so if it gets too big for your liking, you can trim it.

Some investors don't believe in clipping the wings of their winners, because stocks that appreciate higher tend to continue doing so due to having a winning underlying business led by a great management team.

Some more thoughts

When considering the matter of diversification, think about if the stocks move in the same way. For instance, utilities tend to move in a similar manner.

Take a look at the five-year price chart of **Fortis Inc.** (TSX:FTS)(NYSE:FTS), **Emera Inc.** (TSX:EMA), and **Algonquin Power & Utilities Corp.** (TSX:AQN)(NYSE:AQN) on Google Finance, and you'll see that their stocks tend to move up and down at the same time.

So, there may be little benefit in holding all three companies, other than eliminating company-specific risks.

Investor takeaway

There's no right or wrong way to diversify your portfolio, because at the end of the day, you need to bear the risk and be comfortable holding it.

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2. NYSE:B (Barrick Mining)
3. NYSE:CVE (Cenovus Energy Inc.)
4. NYSE:FTS (Fortis Inc.)
5. TSX:ABX (Barrick Mining)
6. TSX:AQN (Algonquin Power & Utilities Corp.)
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