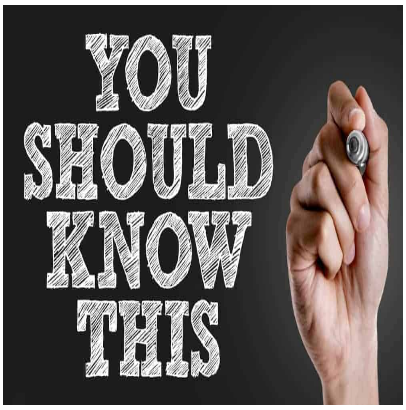

Investing 101: Healthy Diversification vs. Unhealthy Diversification

Description

Many young traders share screenshots of their portfolios on social media. Those portfolios aren't diversified. Some have either put all their money in **BlackBerry** or have a 40:60 split in Bitcoin and Dogecoin. That kind of portfolio is the death knell for your money. It is on such trades that hedge funds feed. Many retail investors exit the stock market, because of the losses they experience from unhealthy diversification.

What is unhealthy diversification?

There is a notion that having too many different stocks means your portfolio is overdiversified. The most common mistake investors make is that they search for the top stocks. Then they buy them without understanding those stocks. And when the stock falls, they panic and sell the dip. Great investors like Warren Buffett understand the business and its opportunities and challenges before investing in a stock.

The second common mistake in diversification is investors buy only into one sector or one trend. This is called sector bias. For instance, John loves dividends and is bullish on energy. So, his portfolio has all types of energy stocks like **Enbridge**, **Northland Power**, and **Suncor Energy**. This portfolio will give good returns during a recovery. But this very portfolio will fail in an energy crisis.

Then what is healthy diversification?

Healthy diversification makes your portfolio robust. Such a portfolio outperforms the market during the upside and also mitigates the risk of a downside. Now, the question is, how do you achieve healthy diversification? It depends on four factors:

- How much time you can stay invested.
- The money you can invest.
- The money you want to earn (financial goal).
- How much risk you can take.

You should consider your age, debt, expenses, number of dependents, dreams, and other things. You can have more than one goal: a mix of a short-, medium-, and long-term investment horizon. Every portfolio must have four types of stocks:

- Dividend stocks like Enbridge can secure your passive income.
- Growth stocks like **Lightspeed POS** can help you outperform the market and get short-term gains.
- Resilient stocks like **Descartes Systems** can give stable growth.
- Speculative stocks/recovery stocks like **Hive Blockchain Technologies** are highly volatile. They can double your money during small bouts of growth. Hence, it is imperative to book profits when you still can.

Depending on your risk profile, you decide how much money to allocate in particular stocks. Even if you are a risk taker, allocate more than 50% of your portfolio in dividends and resilient stocks and not more than 10% in speculative stocks.

Two stocks for a well-diversified portfolio

One good dividend stock is **BCE** (TSX:BCE)(NYSE:BCE). The company has Canada's largest telecom infrastructure that earns it regular cash flow through subscriptions. It is investing in 5G infrastructure and increasing internet penetration. A new technology commands a higher price. Moreover, 5G will connect many more devices to the internet, driving subscription volumes. This shows BCE has the potential to continue paying incremental dividends in the 2030 decade.

BCE has a 5.7% dividend yield and has been growing dividends at an average annual rate of 6.4%. The stock also surged 11% year to date and has the potential to give over 100% in capital appreciation in 10 years.

One resilient stock is **Constellation Software** (TSX:CSU). It operates as a private equity firm. It acquires vertical-specific software companies that cater to the niche market and enjoys stable cash flows. The mission-critical nature of these companies makes them sticky. By consolidating them into its umbrella, Constellation facilitates these companies with the management expertise and resources they need to accelerate their growth. Some acquisitions might succeed, and some might fail. But overall, they bring steady growth for Constellation. The stock has surged 24.5% in the last 12 months, which is in line with the five-year average return of 23%.

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TICKERS GLOBAL

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2. TSX:BCE (BCE Inc.)
3. TSX:CSU (Constellation Software Inc.)

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