

The first step in managing concentration risk is to understand how it might occur.

A diversified portfolio tends to be harder to achieve than simply following the mantra: don't put all your investment eggs in one basket. This basic strategy can help but it is often not enough to avoid concentration risk.

What is Diversification?

Simply put, all investments carry an amount of risk, including possible loss of capital. Diversification is about lowering the level of risk across your investment portfolio by spreading your investment across a number of assets and/or markets. Diversification generally reduces the impact of any single investment or asset type negatively affecting the value of your overall portfolio. In a way, it has a smoothing effect - you won't get the huge gains, but nor should you experience the big losses. Diversification won't guarantee gains or protect against losses but it does increase your chance of achieving more consistent investment returns over time. Keeping assets properly allocated also helps avoid the temptation to try and time the market.

Importantly; the way you diversify your own investment portfolio will depend on your objectives, your timeframe and attitude to risk.

What is a Concentration Position?

A concentrated position may be defined as the significant presence of a single security, securities of a single issuer or a certain class of security or market segment relative to an investors overall portfolio. No single formula or percentage of a particular security or class of securities suits all investors. Concentrated positions prevent diversification.

Some potential consequences of having a Concentrated Portfolio include: portfolio underperformance, portfolio volatility, reduction in income and capital loss if forced to exit at wrong time.

The first step in managing concentration risk is to understand how it might occur. Concentration can be the result of a number of factors.



Tips to manage Concentration Risk

The following tips can help manage concentration risk:

- 1 Diversify across, and within, the major asset classes and fund managers/issuers.** Do you hold multiple asset classes (such as stocks, bonds and real estate)? Are your stock holdings spread among different sectors (biotech, electronics, retail and emerging markets, to name a few)? Is your bond portfolio diversified by issuer and type of bond (corporate, state and government), and do the bonds mature at different intervals? Managed funds and exchange-traded funds (ETFs) can be helpful in achieving broad diversification, as can life-cycle funds, which have the added bonus of rebalancing automatically as you age. Be careful to invest with different fund managers or issuers too.
- 2 Review regularly and rebalance when needed.** Regardless of whether you manage your own portfolio or have it managed by a financial professional, perform periodic reviews of your holdings and make adjustments to ensure it coincides with your investment objective. If you are saving through a superannuation fund, your fund may offer automatic rebalancing, or rebalancing assistance through the fund administrator.
- 3 Look "under the hood" of each investment you own.** Read the fund's product disclosure statement (PDS) or visit the fund's website to see if your funds are holding positions in similar companies, or if they overlap with any individual stocks or bonds you may own. Make use of this information as you rebalance and examine your exposure to individual investments. Also be aware that some funds can be highly targeted to specific investments such as a single commodity, or emerging markets in a specific part of the world. Just because you hold only funds does not shield you from concentration risk.
- 4 Know how easily you can sell your investments.** To learn about an investment's liquidity, read the offer document or PDS or ask an investment professional. If a large percentage of your portfolio is tied up in illiquid securities consult an investment professional about potential remedies.
- 5 Understand what kind of investor you are.** The level of investment risk you're willing take to build your wealth influences the type of investment decisions you need to make. Are you willing to risk the potential of negative returns or capital loss to potentially grow your wealth more quickly; or are you more comfortable building wealth more slowly and conservatively to reduce the risk of losing money?

It's not always easy to tell when your portfolio is exposed to concentration risk. This is especially true of portfolios that contain complex investments. For instance, if you own a structured product linked to the performance of a specific stock, you may be exposed to concentration risk if you also own the individual stock in a brokerage account. Similarly, you could own a managed fund where the stock is one of the largest holdings. If you think your portfolio may suffer from over concentration, talk to a financial professional, and take appropriate action to manage your risk.