TIME

HOW MANY STOCKS SHOULD YOU HAVE IN YOUR PORTFOLIO?

By: Kevin Mercadante - May 14, 2023

If you're a self-directed investor looking to build a portfolio of individual stocks, asking yourself how many stocks you should own is one of the most important questions you'll need to answer. Financial advisors routinely recommend diversification, but how much is enough—and how much might be too much?

There are general guidelines, but we'll give you some more detailed answers.

How many stocks should you really own?

It's sometimes believed that the number of stocks you should have in your portfolio depends on its size. For example, it will vary significantly if you have $1,000, $10,000 or $100,000 to invest.

But as it turns out, the size of your portfolio may not be as important as it seems. That's because investing through fractional shares is commonly available with popular brokerage firms. It enables an investor with $1,000 to diversify in as many companies as someone with $100,000.

What's the right number of companies to invest in, even if portfolio size doesn't matter?

"Studies show there's statistical significance to the rule of thumb for 20 to 30 stocks to achieve meaningful diversification," says Aleksandr Spencer, CFA® and chief investment officer at Bogart Wealth. "Personally, I think risk tolerance and aptitude for research should be the real driver. Depending on one's risk comfort level, coupled with how deep into the weeds you're willing to go, a more concentrated portfolio can be OK too."

The importance of diversifying

The whole purpose of holding multiple stocks in a portfolio is diversification. That means holding enough securities so that a big drop in one won't cause your entire portfolio to take a big hit.

For example, if you hold five stocks in your portfolio, with 20% in each position, a 50% decline in one stock will translate to a 10% drop in the value of your portfolio.

But with 20 stocks in your portfolio, each representing about 5%, a 50% drop in a single stock will translate into a drop of just 2.5% in your portfolio.

Of course, whether you have 20, 30, 50 or 100 stocks in your portfolio, there's no guarantee diversification will completely prevent declines. But it will minimize the impact of a drop in a single stock.

How to diversify your portfolio

Diversification is about much more than simply holding a certain number of securities. It applies in different areas of your portfolio. Use the following guidelines to see how well your investments embody these principles.

In stocks

It's possible and desirable to invest in different types of stocks. Stocks fall into one of several broad classifications, and you can spread your portfolio among as many as possible.

For example, you may want to hold some of your portfolio in growth stocks. Those are stocks with a history of price appreciation. They typically pay no dividends (instead, extra capital is invested back into the business).

You may want to counterbalance that by adding dividend stocks. These are more mature companies that have longer track records, as well as a history of both paying and increasing dividends. The combination of the two categories can give you a healthy mix of growth and income in your portfolio.

You may also want to incorporate a mix of large-, medium- and small-capitalization stocks into your portfolio. That's because one cap-size group may outperform another. By positioning yourself in all three, you'll be able to get the benefit of outsized growth in at least one.

In industries

No matter how much you may believe in one or two industries, you should never concentrate your portfolio on those groups. If you're going to invest in 20 to 30 individual stocks, they should be spread across several different industries.

"If an investor is aiming to add diversification to their portfolio by handpicking or selecting certain funds or stocks, it is prudent to consider investing in companies of various sectors and different sizes," advises Jason Werner, investment advisor and founder at Werner Financial. "This could mean investing in sectors like technology, healthcare, energy, financials, or consumer goods."

The heavy concentration of growth in tech stocks from 2009 through 2021 may not be as reliable in the future. You can certainly hold tech stocks, but those positions should be counterbalanced with stocks in other industries.

Remember, diversification and a clear understanding of your risk tolerance are key in any investment strategy. It's always wise to take advantage of educational resources before making significant investment decisions. Consider using a self-directed investing tool such as J.P. Morgan, which offers learning guides to help you make informed decisions and allows you to trade stocks, bonds, mutual funds, and ETFs freely.

Maintain balance in your portfolio

Whether you own 20, 30, or many more stocks in your portfolio, you will need to rebalance periodically. That will keep high-performing stocks from being overrepresented in your portfolio.

There are different ways this can be done. For example, if you plan to hold 20 stocks, each representing 5% of your portfolio, you can choose to rebalance annually, semiannually, or quarterly. That will enable you to reset your portfolio at the original target of 5% for each stock.

It also has the benefit of enabling you to sell stocks and book gains on the strongest performers. At the same time, you will be buying the weaker performers at lower prices.

Another strategy is to rebalance when one or more stocks reaches an excessive allocation. For example, you might decide to sell some of a high-performing stock if it reaches 10% of your overall portfolio.

There are various strategies you can use, and any will be successful if they enable you to prevent any single stock or industry sector from being overrepresented in your portfolio.

Read the entire article here: https://bit.ly/3MxVPKi

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