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INVESTMENT SERVICES

Time To Diversify

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If you are concerned about market risk — and you should be — it's probably worth having a refresher on *diversification*.

I think there are at least five useful forms of diversification.

Diversification *across asset classes*

Diversification across asset classes is probably the most popular form of diversification. Stocks versus bonds versus crypto versus gold versus ostrich farms versus collectibles versus art, etc. In short, you are owning asset classes that, hopefully, are not 100% correlated with each other. Thus, when one asset class is tanking, your chances increase of owning an asset class that is doing well.

Diversification *within* asset classes

This form of diversification focuses on an individual asset class. For example, within equities, you own large cap, small cap, midcap, international, growth, value, sectors, etc. In bonds, you might own short term, intermediate term, and long-term bonds, corporates and treasuries, convertibles and high yield. Again, the aim is to own various investments within the same asset class that are not perfectly correlated.

Diversification *across time*

The third form of diversification is diversification across time. One form of time diversification is dollar-cost averaging in which individuals invest a regular amount of money in their investments over some regular interval of time, regardless of market conditions. Another form of time diversification is dividend reinvestment, which forces investors to invest on a quarterly basis. I think time diversification is an underrated form of diversification because it strips emotion from the decision-making process and eliminates that dangerous urge to market time.

Diversification *across strategies*

I think it is a good idea to have a core investment strategy. Having a core investment strategy builds discipline into an investment program, and that's important. However, no investment strategy works in every market environment, which is why it is a good idea to introduce different approaches in an investment portfolio. For example, perhaps your core strategy is growth at a reasonable price. It may make sense to add another strategy at the margins, perhaps a contrarian strategy. The idea is to bring into a portfolio various styles and strategies that are not necessarily correlated with one another.

Over, please

Diversification *across money managers*

Related to diversification across strategies is diversification across money managers. Money managers usually have a singular approach to investing. Some may be dividend focused. Others may be momentum managers. Still others look for deep value. Diversification across money managers should bring together a number of noncorrelated approaches that can enhance portfolio diversification.

One final point about diversification. Proper diversification doesn't mean you must have exactly the same percentages in U.S. stocks and international stocks, or growth stocks and value stocks, or growth strategies and value strategies. It's perfectly fine to have a tilt in one particular direction. But concentration – whether it is a singular focus on a type of stock or strategy – will boost the risk profile of your portfolio.

Diversification has been called "the only free lunch" in investing for a reason. Controlling risk via proper diversification will go a long way to keeping you in the game and, therefore, maximizing the power of time in an investment program.

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