

BEHAVIORAL & FINANCIAL INSIGHTS

Why Diversify?

The truest reason to diversify is to manage the risk associated with a future that we cannot accurately and consistently predict. We simply don't know, with certainty, which assets will outperform and which will underperform.

When we invest during a period when one asset vastly outperforms all others, it can be frustrating to remain diversified. We may be tempted to sell the underperformers and reallocate the proceeds to those outperforming. Despite this inclination, there is strong evidence to suggest that diversification is the best strategy. Here are a couple of real-life examples:

Example #1

Over the past 10 years (2015–2024), technology stocks as a “sector” performed best – by a significant margin. Energy stocks were the worst performers. However, did you know that for the previous 10-year period, energy was the best performer? And, wouldn't you know, technology was the worst!¹ So, which sector or asset class will perform best or worst over the next 10 years? Since no one knows, we diversify.

Example #2

An in-depth analysis – appropriately titled *The Agony and The Ecstasy* – of the Russell 3000 index (the 3,000 largest publicly traded U.S. stocks) over the span of 35 years (1980–2014) found that a whopping 40% of the stocks in the index were extreme losers – suffering a catastrophic loss of 70% or more from their highs and never recovering. Simultaneously, a small percentage of stocks were responsible for the majority of the index's overall gains, indicating that significant positive returns were concentrated in a limited number of companies. In fact, only 7% were extreme winners!²

How do you make sure you own the extreme winners? It's very difficult, if not impossible, to do so without being diversified. In order to help us own the extreme winners that drive a lot of the stock market gains over time, we diversify.

Final Thoughts

As opposed to trading, investing is a long-term journey. Diversification works very well over market cycles, making the journey far smoother. I am here to help you take the long view and make the best decisions in line with your personality, life goals, and aspirations.

¹ A Wealth of Common Sense, *The 2024 Sector Quilt*, Jan 15, 2025.

² JPMorgan, *The Agony & The Ecstasy: The Pros and Cons of Concentrated Positions*.