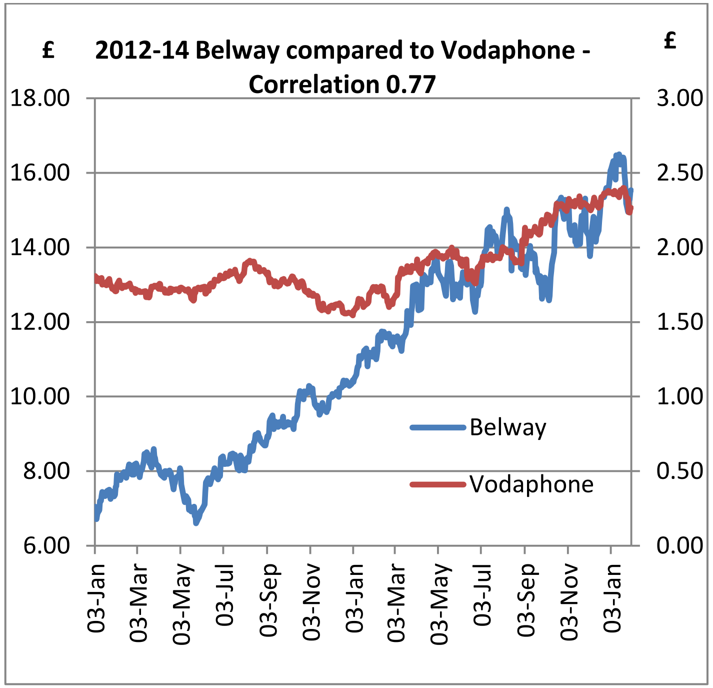
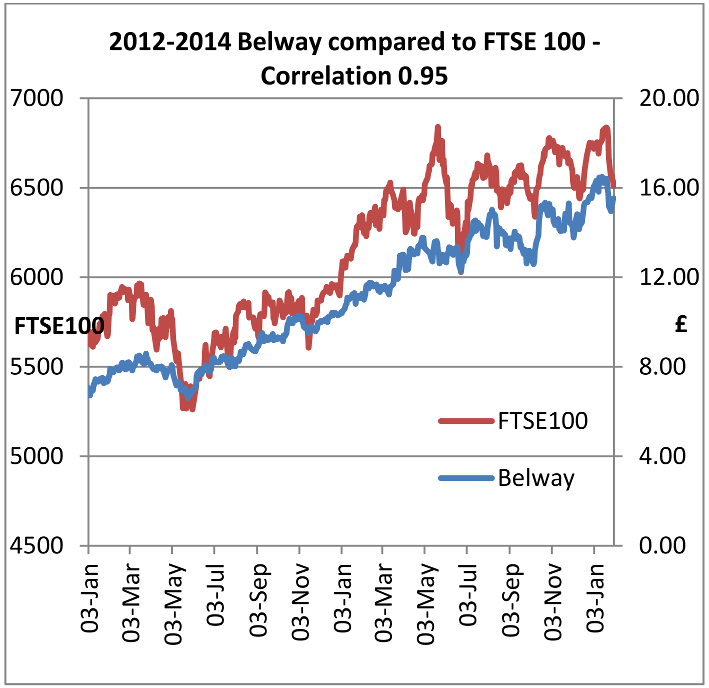
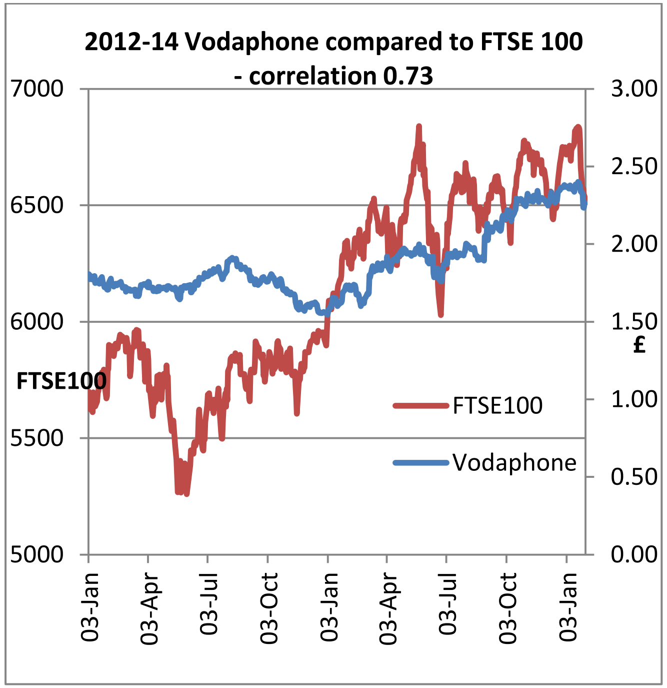
Diversifying Shares in a Portfolio







In January 2014, I decided to expand my portfolio by adding additional holdings of Vodaphone. In the event of market volatility, diversification will help to prevent the portfolio being vulnerable to sharp falls in just one share price. This allows a portfolio to hedge the risk of a falling share price.

There are 2 types of Risk – Market and Specific

Market Risk cannot be diversified way, and hence vulnerable to falls in the stock market. Something I am not able to control.
Specific Risk which can be diversified way through specific stock selection and to some extent can be controlled through choice of selection.
A portfolio should contain shares of varying correlations so as to prevent market risk destroying a portfolio in its entirety.

As an example, graphs above basically show that Bellway and Vodaphone (that are in my portfolio) are positively correlated with a 0.77. In other words when the market falls the full effect is not felt in my portfolio as risk is being diversified away. There is a greater probability that Bellway will move in sync with changes in the FTSE100 than with Vodaphone.

The Beta of a share shows how volatile the share is to the market. According to the Financial Times, the Beta for Bellway is 1.34 and for Vodaphone 0.486. [correct at 1 February 2014] Hence the impact of market moves in Bellway, are greater than Vodaphone. So when adding shares to a portfolio these factors come into play to ensure the portfolio is as balanced as possible so to prevent the impact of untoward market volatility. It's all about protecting investments in the ups and down of the market and so to ensure that not all eggs are in one basket.
I hope you found this interesting. I try to incorporate this kind of stuff when making investment decisions.

A little tip on correlations

How to determine correlation between shares

	A	B
1	**Values 1**	**Values 2**
2	2	6
3	3	2
4	5	8
5	4	7
6	0.2	4
7	0.5	0.11
8	8	1.66
9	1	2.88
10	0.6	1.99
11	0.2	1.55
12		
13	Co-relation Coefficient	
14	0.299514646	
15		

=CORREL(A2:A11,B2:B11)

Correlations range from +1 To -1.

The result 0.299 shows a small positive correlations. Lower correlations will protect a portfolio when market volatility is high