# Concentrated Positions in Your Portfolio – The Elephant in the Room

The Elephant in the Room

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BetterInvesting™
The Leader In Investment Education

Seminar 219

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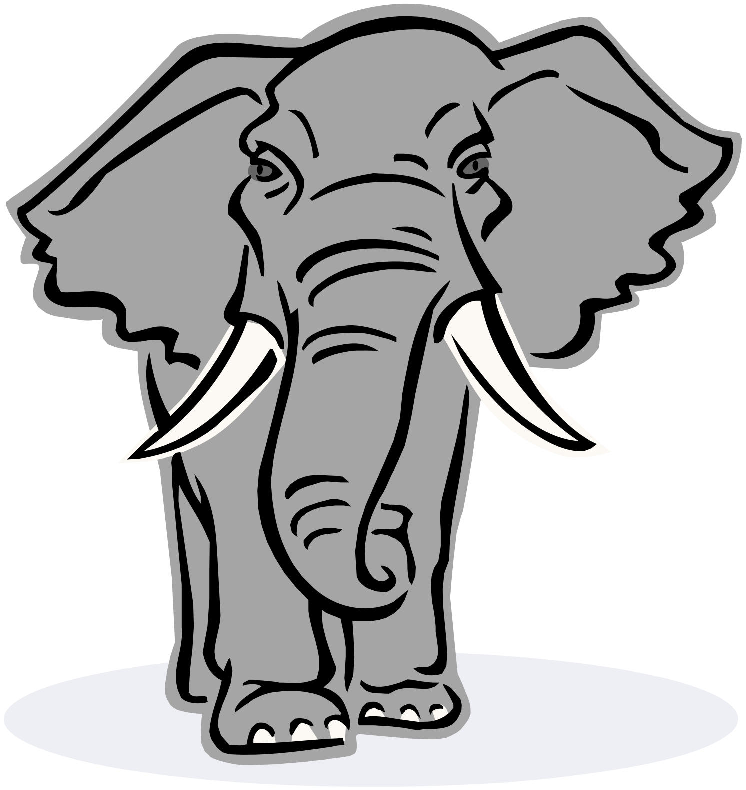
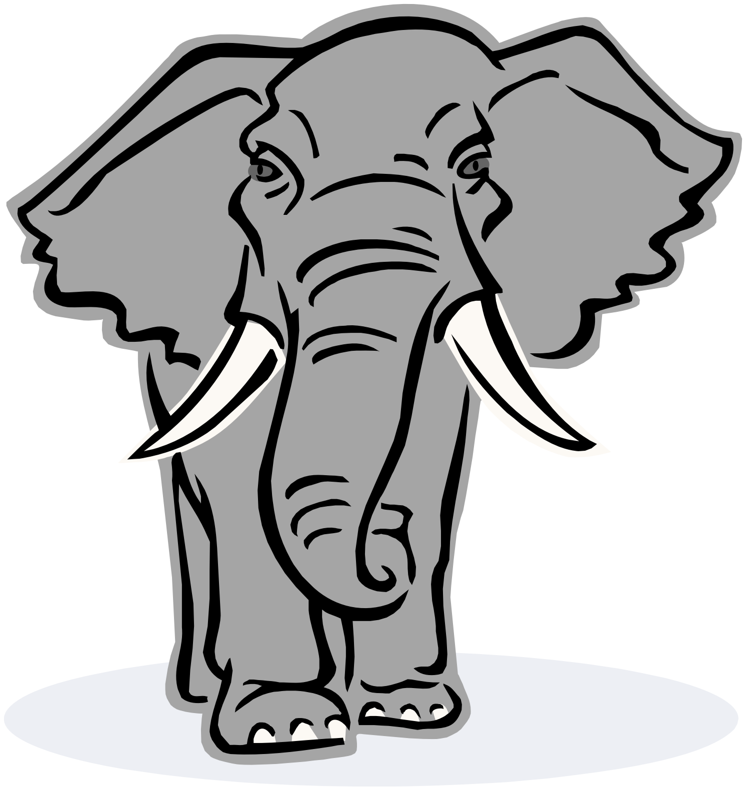
# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **Managing a portfolio around a concentrated position(s) may be one of the most difficult concepts in investing.**



# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **A “concentrated position” = investment of disproportionate percentage of a portfolio.**



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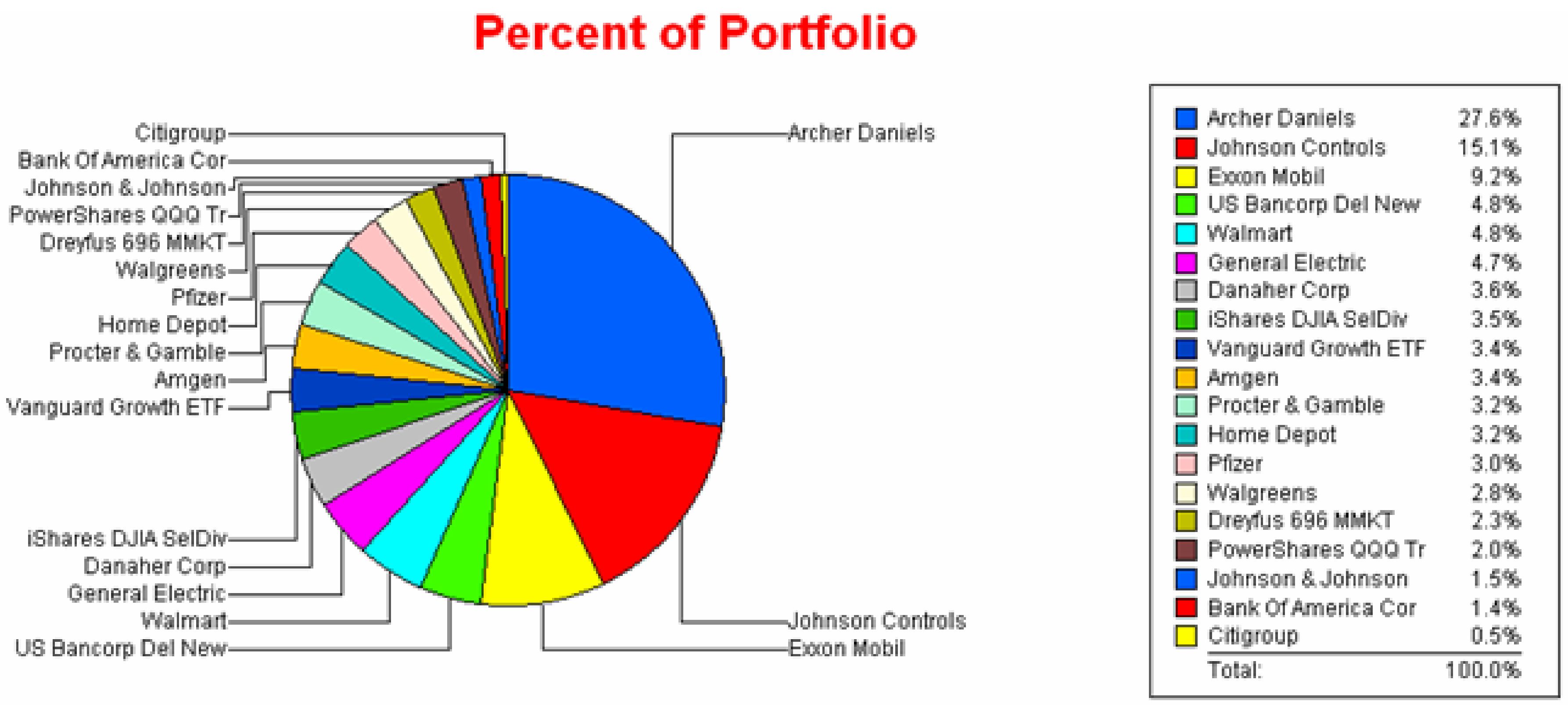
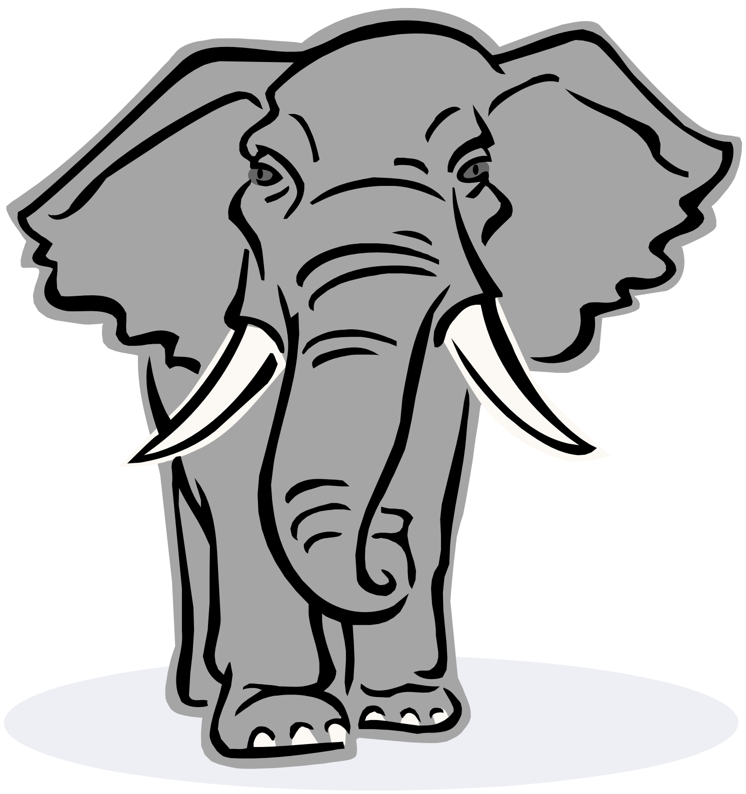



**Sample graph from BetterInvesting Portfolio Manager v5**

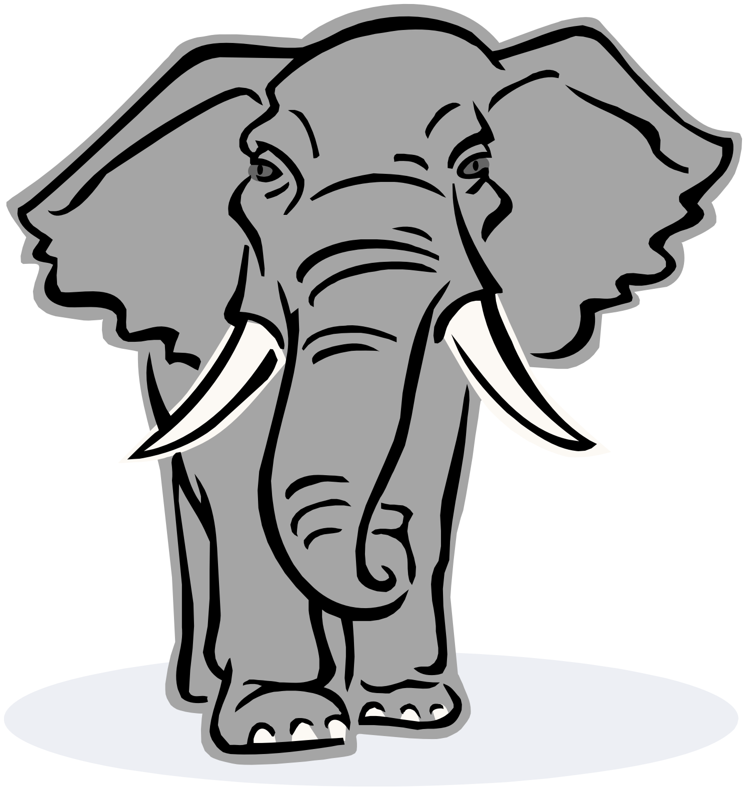
# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **Why difficult to manage?**
  - Low cost basis
    - Delay taxes
  - Emotional attachment
    - Inherited;
    - Stock owned thru thick and thin;
    - Company stock of 30+ years.



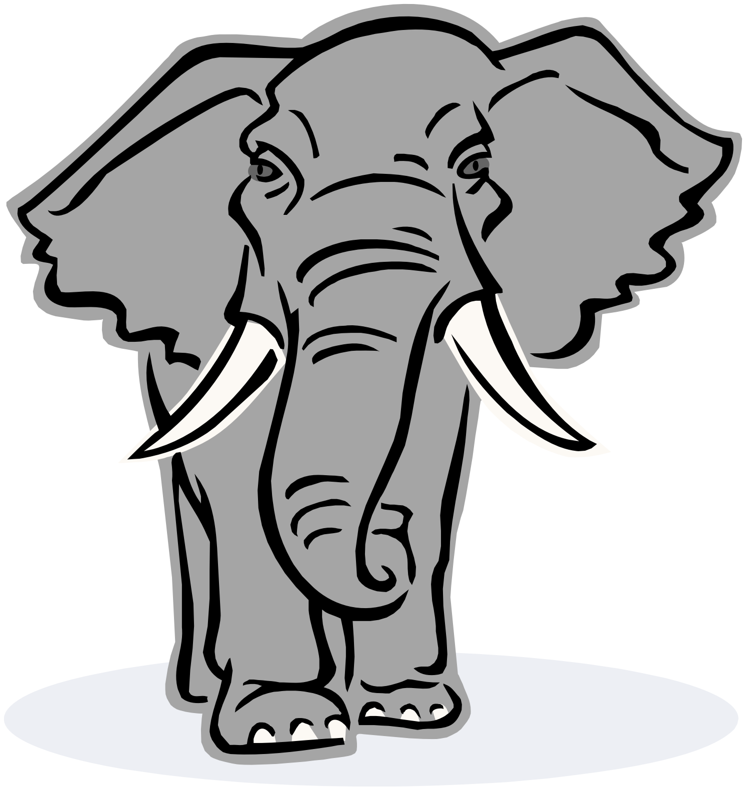
# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- Penny-Wise....
- Near term justification to delay taxes
  - Selling concentrated position results in immediate tax
  - Low basis = significant tax
  - Federal & state/AMT
    - 15% + ???



# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- Pound Foolish!
- Dollars saved today by delaying a taxable event could potentially cost an investor significantly more in the future...
  - Cost of potential disaster
  - Cost of changing tax laws
  - Cost of lost opportunity



# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **Cost of Disaster...**
  - **How likely concentrated position will drop more than the tax trying to avoid?**
  - **Remember: stocks affected by infinite # of variables, impossible to consistently predict!**

# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

| Year | # of 500 largest companies that underperformed S&P 500 by > 15% | Probability of underperformance |
|---|---|---|
| 1996 | 151 | 30% |
| 1997 | 159 | 32% |
| 1998 | 285 | 57% |
| 1999 | 279 | 56% |
| 2000 | 151 | 30% |
| 2001 | 121 | 24% |
| 2002 | 116 | 23% |
| 2003 | 109 | 22% |
| 2004 | 93 | 19% |
| 2005 | 95 | 19% |
| 2006 | 124 | 25% |
| Source: FactSet | 10-Year average ('97-06) | 31% |

# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **Over past 10 years, on average, 31% of this universe underperformed by greater than 15%.**
- **Stated another way, 1 time in 3 an investor would be better off accepting the immediate 15% tax burden and diversifying than risking 15% drop from normal market fluctuations.**

| | # of 500 largest companies that underperformed S&P 500 by > 15% | Probability of underperformance |
|---|---|---|
| | | 30% |
| | | 32% |
| | | 57% |
| | | 56% |
| | | 30% |
| | | 24% |
| | | 23% |
| | | 22% |
| | | 19% |
| 2005 | 95 | 19% |
| 2006 | 124 | 25% |
| **Source: FactSet** | 10-Year average ('97-06) | **31%** |

# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **Cost of Changing Tax Laws...**
  - **Holding concentrated position(s) does not *avoid* paying capital-gains taxes, it merely *delays* them.**
  - **Some investors argue they will reduce concentrated position(s) when taxes less burdensome**
  - **History is not on their side....**

# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **Cost of Changing Tax Laws...**
  - **Since 1916, the capital-gains tax rate has changed more than 25 times;**
  - **Capital-gains tax rates have not been this low since 1933;**
  - **In 17 of the last 91 years, the capital-gains rate has been at 15% or below;**
  - **In 74 of the last 91 years, the capital-gains tax rate has been above 15%**
  - **The highest capital-gains tax rate was 77% in 1918.**

# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- Cost of Changing Tax Laws...
  - given current capital-gains tax environment is significantly favorable to historic data, little reason to tolerate risk of concentrated position(s) in hopes of delaying inevitable taxable event.

# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- Cost of lost opportunity...
  - Holding a concentrated stock position that underperforms the market year in and year out causes lost opportunity and becomes increasingly difficult to catch up...

# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

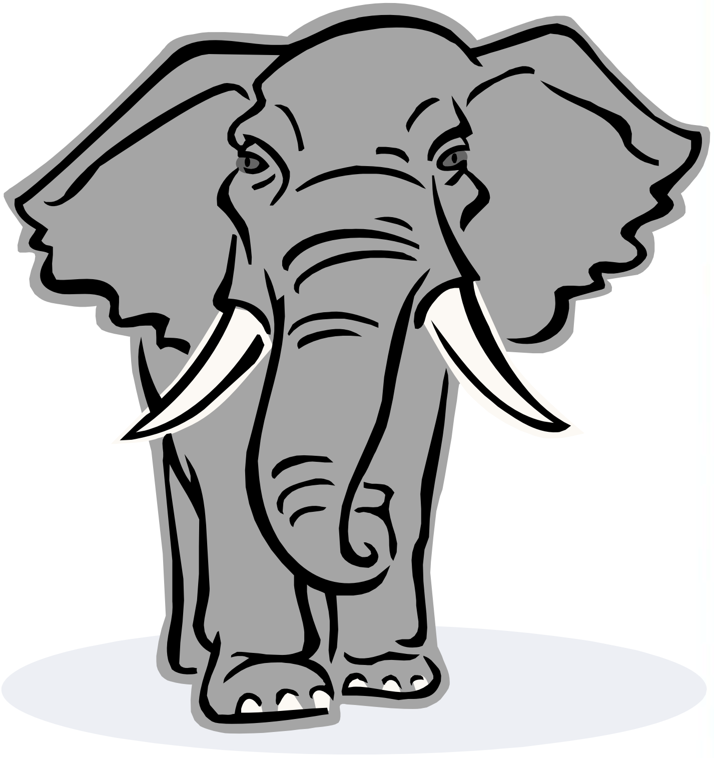
| $10,000 invested @ 7% annual growth rate | $10,000 invested @ 3% annual growth rate | Return required to catch up |
|---|---|---|
| $10,700 | $10,300 | 11.2% |
| $11,449 | $10,609 | 15.5% |
| $12,250 | $10,927 | 20.0% |
| $13,108 | $11,255 | 24.6% |
| $14,026 | $11,593 | 29.5% |

$2,433 better than underperformers...

Increasingly difficult to catch up

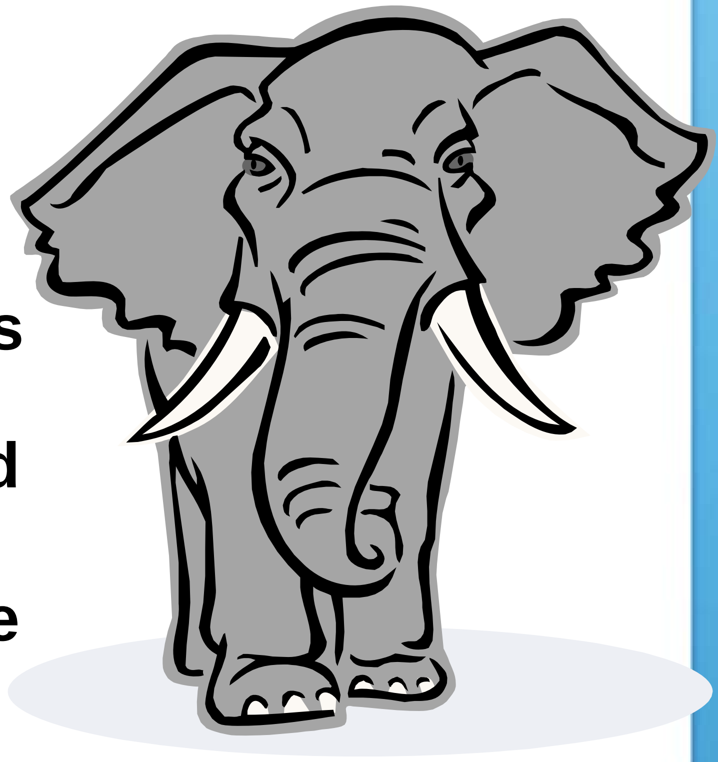
# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **This class will now review steps for managing the ‘Elephants’ in your portfolio utilizing features provided in the BetterInvesting Portfolio Manager software program:**
  - **Identify reports showing concentrated positions;**
  - **Tax consequences in paring these positions;**
  - **Rebalancing considerations.**



# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

- **Summary:**
  - Ignoring concentrated positions is an unjustifiable risk taken every single day;
  - Implement strategy to alleviate this risk;
  - Be aware concentrated positions sometimes involve legal restrictions or unique tax-related situations;
  - Our discussion meant to provide general framework for addressing concentrated positions.

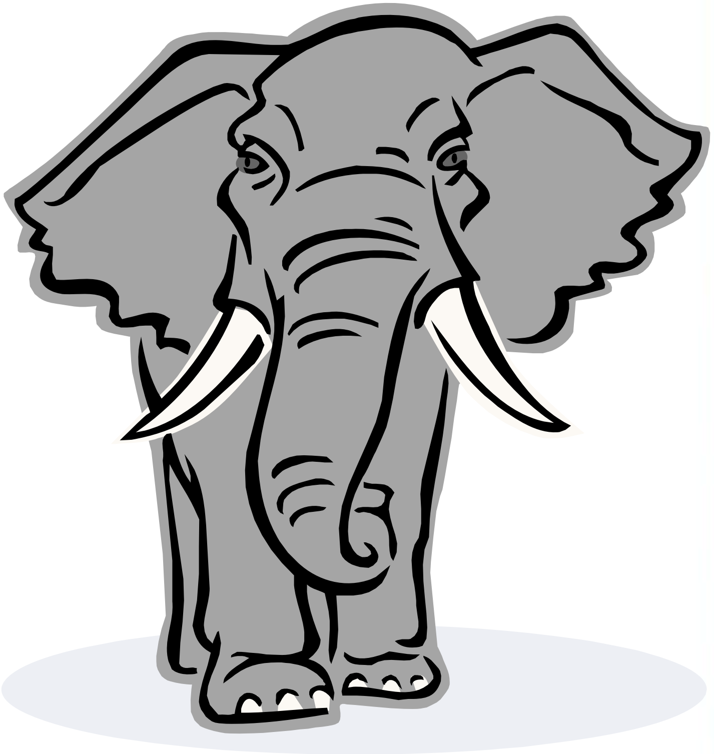


# Avoiding Concentrated Positions in your Portfolio – the Elephant in the Room...

One of the iron laws of investing:

"You can get rich by under-diversifying. But you cannot stay rich by under-diversifying."

- Financial Advisor June 2007



# Requirements & Purchase Information Portfolio Manager v5.

- $129 for BetterInvesting Member
- $169 non BetterInvesting Member
- Available here at BINC 2009
  - BetterInvesting Software Sales in Expo
  - Call BetterInvesting:
  - @ 877-275-6242, ext. 4
- Web sites:
  - www.betterinvesting.org
  - www.biportfoliomanager.com
  - Free Demo Available

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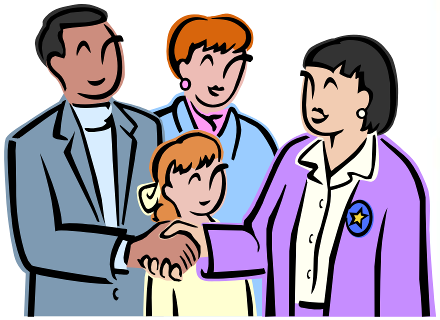

and introduce others to this opportunity.

# Questions?

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