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# What is **Diversification** in Investing

A common explanation of diversification is the act of ***"not putting all your eggs in one basket."***
This sentiment has been echoed by many famous investors, namely Warren Buffett.

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Academically, diversification is defined as the process of selecting and allocating a portfolio's investment assets in a manner that reduces exposure to sources of risk.

Every financial instrument is subject to certain risk factors, and a portfolio that is overly concentrated in a single instrument (or group of instruments with similar risk profiles) tends to be much more sensitive to those risk factors and more volatile as a result.



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Risk therefore comprises all the variables that could alter the trajectory of an investment's return, whether positively or negatively. Examples include: market risk, interest rate risk, geographical risk etc.

"The more volatile the returns of a portfolio, the harder it is for investors to develop reliable profit expectations."



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In general, the more assets your portfolio holds, the more diversified and resilient to different types of risk it is.



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# The Benefit of **Diversification**

- Obtain more returns for the same risk compared with an undiversified portfolio.
- Obtain the same returns for less risk compared with an undiversified portfolio.
- Reduce volatility (lower standard deviation) and portfolio fluctuations.
- Minimize portfolio drawdowns (peak-to-trough losses during a crash).

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# How to **Diversify** Your Portfolio

- Diversification is primarily achieved through proper asset allocation, which determines what categories of investments are held in your portfolio, and in what proportions relative to each other.

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- Portfolios should therefore have a balanced mix of different asset classes depending on the investor's goals, risk tolerance and investment horizon. Example includes shares, bonds, mutual funds, commodities etc.

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