WHAT IS DIVERSIFICATION?
Diversification is a strategy in which you increase the number and types of investments in your portfolio to reduce overall risk. Many times this is referred to as “never putting all your eggs in one basket.” Diversification is more than just investing in different asset classes such as stocks, bonds, international securities and short-term investments, which is commonly called asset allocation. It takes it a step further by diversifying within each asset allocation category as well.

HOW TO INCREASE DIVERSIFICATION
• Add investments to your portfolio
  Adding investments to your portfolio can reduce the overall risk. Risk, or the variability of returns, can be separated into two components—diversifiable risk and market risk.

  Diversifiable risk is unique to a specific security that can be offset by the unique risk of other securities in the portfolio. Theoretically, each additional security would reduce the amount of diversifiable risk until this risk was ultimately gone. Including at least 12 to 18 securities in a stock portfolio may reduce the majority of diversifiable risk. However, as shown in the following chart, not all risk can be eliminated.

  Market risk is the uncertainty associated with all stock investments, brought on by factors such as unexpected macroeconomic changes. The remaining market risk partially explains why you expect to earn a return greater than the implied risk-free rate of a Treasury security.

• Diversify within investment classes
  Just as it is crucial to have an ample number of stocks in a portfolio, it is also important to make sure the exposure is spread within each investment class. Ideally, stocks chosen should have a low or negative level of correlation, meaning that they perform differently at various times in the economic cycle. As one declines, another may remain stable or even increase.

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A well-diversified stock portfolio may include stocks from different sector classifications, investment styles or economic-cycle sensitivities. As illustrated in the graph below, the popular S&P 500 Index has broad sector exposure. Other stock styles frequently used for diversification are growth and value.

A diversified fixed-income portfolio may include securities with differing maturities, interest rates, credit ratings or issuers. Different types of fixed-income products include U.S. Treasury securities, federal agency securities, money market instruments, corporate securities and municipal securities.

- **Avoid highly concentrated positions**
  Highly concentrated stock positions are a growing concern for many investors. As stocks and options are increasingly used as a source of compensation, it is important to understand the hazards. Too much wealth in a single stock leaves the owner at risk in the event of a significant decline. Since holding a large position in a single stock exposes investors to excessive risk in their net worth, it is common to periodically sell shares of that stock. At a minimum, you should evaluate any concentrated positions in your investment mix and build a diversified portfolio around it.

A good portfolio is not simply a collection of investments. Your financial advisor can help you manage risk and return by analyzing how the investments in your portfolio fit together based on their correlation.

The power of diversification will become apparent when different investments fall in and out of favor over time. This equalizing effect will ultimately help reduce the overall risk of your portfolio and possibly even increase your rate of return.

**Diversification does not assure against market loss.**

*Indexes are unmanaged statistical composites that measure the changes in the various financial (stock or bond) markets. An investment cannot be made directly into an index. Past performance is not indicative of future results.*

*Piper Jaffray does not provide legal or tax advice.*