Diversification in Investment – What It Is All About

Diversification in investment refers to the process through which one spreads his investments over several assets in order to reduce the risks he'll be exposed to. In layman's term, it is the practice of "not putting all your eggs in one basket" as an investor.

The US Securities and Exchange Commission provides an excellent example of this concept on its website, as follow:

"Have you ever noticed that street vendors often sell seemingly unrelated products – such as umbrellas and sunglasses? Initially, that may seem odd. After all, when would a person buy both items at the same time? Probably never – and that's the point. Street vendors know that when it's raining, it's easier to sell umbrellas but harder to sell sunglasses. And when it's sunny, the reverse is true. By selling both items – in other words, by diversifying the product line – the vendor can reduce the risk of losing money on any given day"
Source: www.sec.gov

The key takeaway from this example is this: **when we diversify, we reduce the risk of losing money.** However, not all successful investors believe in this. In fact, Warren Buffet, one of the world's richest man and most successful investors, argues that diversification is not the best investment strategy for the simple reason that it takes away responsibility of focusing on the best portfolios from the investor.

But as it may, diversification continues to play an integral part among many investors who do not have the skills and the personnel that are at the disposal of an investor like Warren Buffett.

So, what exactly is an ideal scenario in investment diversification?

Generally, a well diversified portfolio would have little exposure to any particular factor or event (such as an economy downturn). This, of course, is fairly difficult to achieve. But as a general rule of thumb, you could improve the diversification of your investment portfolio using one of these ways:

1) Increase the **number** of investments, or
2) Increase the **types** of investments

So, if you could increase your investment portfolio to 50 companies – great! If you could increase your portfolio to 500 – even better!

But how does one go about accumulating such an extensive portfolio? Wouldn't you need millions of Ringgits to do this? The good news is – that is a myth. With only a couple of thousands of Ringgits, you could invest in thousands of companies or properties using investment vehicles such as Exchange Traded Funds (ETFs) and Real Estate Investment Trusts (REITs).

So in reality, you don't need to be a millionaire to have a diversified portfolio. In fact, anyone can do it.

***