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Rainey Asset Management

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In this Issue:

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Mistaking Stuff for Diversification

(2nd of 7 Deadly Investor Traps)

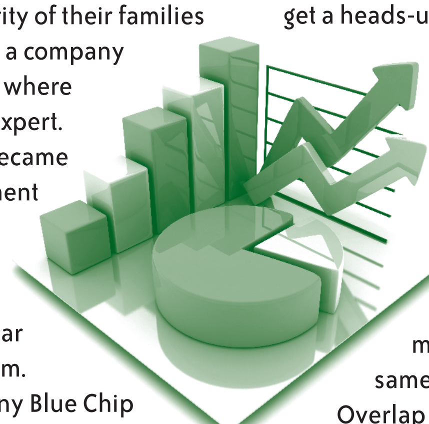
By Ric Cochran

How diversified are you?

Do you really know?
Put another way, do you know how to scientifically measure diversification?

Most portfolios I review containing individual stocks and bonds are the least diversified. Only the very wealthy can afford to be invested in even a hundred different individual stocks or bonds and that's not much diversification. Some have numerous holdings concentrated in only a few asset categories. They're often blissfully unaware of how dangerous that can be.

I've spoken with investors who tell me the company they retired from is "into a lot of different things." They suffer from familiarity bias. Some even feel it would be disloyal to sell the shares in "their company" to be properly diversified. I'm haunted by conversations I've had over the years with people who stubbornly destroyed the financial security of their families being too heavily invested in a company where they worked or a field where they believed they were an expert. Remember GM shares that became worthless when the government took them over? Ask Merrill Lynch employees about their shares. Ask former employees or investors in Bear Stearns, Enron, or WorldComm. Those are but a few of so many Blue Chip companies whose fortunes changed.



Think someone at your old workplace will let you know when it's time to sell your shares? Good luck! If they actually had inside information, even selling their own shares would be insider trading. People go to jail for that. Ask Martha Stewart. Think anyone really on the inside wants to risk going to jail just to help when they already see their own shares are trapped, because they can't trade on non-public information, and they may be about to lose their own job, too? I've seen companies issue denials that anything was wrong within hours of filing bankruptcy, terminating everyone, being shut down by regulators, or government agents showing up with warrants and dollies to haul away computers and filing cabinets. Do executives keep quiet because they're evil? Or could it be when you're about to see your company collapse, and your job with it, you may not want to spend your next few years fighting federal charges and hoping the attorneys you're spending lots of time with can keep you out of jail? New employers might consider that too much of a distraction. That's why you won't get a heads-up from your old work buddies and why they'll get their clocks cleaned, too, if they're overinvested and the company fails.

Do you think you're diversified because you have some mutual funds? Maybe you have lots of funds. You might be surprised how many of your mutual funds invest in many of the same things. It's called fund overlap. Overlap not only reduces investors' diversification while increasing volatility, there can be other problems like increased hidden transaction costs. For example, let's say you have a number of funds with overlap in their holdings.

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Louisiana News

PUBLIC WORKSHOP
Thursday, September 12, 2013

SHREVE MEMORIAL LIBRARY
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10am / S.A.F.E. Planning : Don't Lose Your Home & Savings To Pay For A Nursing Home

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In the South ... the word "jeet" is actually a question meaning, "Did you eat?" "Fixingto" is one word that means "I'm going to do that."

Mistaking Stuff for Diversification *Continued...*

One fund you're invested in might decide to reduce their inventory of XYZ shares. Another fund you're invested in may think XYZ shares are a bargain and load up on them while your other fund is selling. Yet another of your funds might see the action in XYZ and act as a spoiler attempting to profit from the short-term action. All that buying and selling will incur transaction costs invisible to most investors because trades within the funds don't show on client statements. Imagine paying to move money from your left pants pocket to your right. Does it make you feel better not to be aware you're paying for it? Or do you want to know so you can avoid wasting money?

I find most individual investors lack sophisticated portfolio analysis tools to measure diversification within portfolios and I haven't met many advisors who even know they exist, much less have access to them. Yet I believe it's vital to scientifically measure portfolio diversification and volatility to reduce risks, reduce hidden costs which pull down returns, and help investors achieve better outcomes. An in-depth portfolio analysis is a smart way to begin seeking better returns and peace of mind. ■ Ric Cochran writes and speaks about investing for everyday people. He's an investor coach at Rainey Asset Management.

A Florida senior citizen drove his brand new Corvette convertible out of the dealership. Taking off down the road, he pushed it to 80 mph, enjoying the wind blowing through what little hair he had left.
"Amazing," he thought as he flew down I-95, pushing the pedal even more.

Looking in his rear view mirror, he saw a Florida State Trooper, blue lights flashing and siren blaring. He floored it to 100 mph, then 110, then 120. Suddenly he thought, "What am I doing? I'm too old for this!" and pulled over to await the trooper's arrival.

Pulling in behind him, the trooper got out of his vehicle and walked up to the Corvette. He looked at his watch, then said, "Sir, my shift ends in 30 minutes. Today is Friday. If you can give me a new reason for speeding--a reason I've never before heard -- I'll let you go."

The old gentleman paused then said: "Three years ago, my wife ran off with a Florida State Trooper. I thought you were bringing her back."

"Have a good day, Sir," replied the trooper.