

## **Building Your Portfolio**

### **COURSE DESCRIPTION/INTRODUCTION**

Welcome to *Building Your Portfolio*, an eLearning course designed to guide you through the fundamentals of creating and managing a successful investment strategy. You'll explore the power of diversification—by company size, industry and asset type—and discover key allocation strategies that support long-term resilience. As the course progresses, you'll learn how to effectively manage your stock portfolio by avoiding common investment mistakes, setting clear return expectations and conducting regular reviews. Finally, we'll take a holistic view of your entire portfolio, introducing practical asset allocation techniques and real-world portfolio examples to help you make informed, confident investment decisions. Whether you're a beginner or looking to strengthen your current approach, this course provides a solid foundation for building a strong, well-managed portfolio.

### **LESSON ONE: BUILDING A RESILIENT INVESTMENT PORTFOLIO**

#### **INTRODUCTION**

In this lesson, *Building a Resilient Investment Portfolio*, you'll learn how to strengthen your investments through smart diversification and thoughtful planning. We'll start by exploring the power of diversification and why spreading your investments across different company sizes and industries can help reduce risk. You'll also discover practical allocation strategies to balance your portfolio and examine the role individual company stock plays in your overall investment picture. Finally, we'll introduce a holistic approach to portfolio building—one that considers your entire financial landscape to create a resilient, long-term investment plan.

#### **THE POWER OF DIVERSIFICATION**

Diversification is a cornerstone of prudent investing and a fundamental principle for long-term success. It involves spreading your investment capital across various assets to mitigate risk and enhance potential returns.

Before venturing into stock investments, it's crucial to establish a financial foundation. This includes building an emergency fund to cover unexpected expenses and financial setbacks, such as job loss. Aim to accumulate enough savings to cover several months' worth of living expenses.

Once you have a financial safety net, you can begin constructing a diversified investment portfolio. This often includes a mix of assets like stocks, bonds and real estate, or mutual funds that invest in these asset classes.

Maximize contributions to employer-sponsored retirement plans, especially those with employer matching. Employer matches are a valuable source of additional investment capital, and tax-deferred growth in these accounts allows your investments to compound more effectively.

This lesson focuses on diversification within your stock portfolio, specifically by company size and industry.

#### **DIVERSIFICATION BY COMPANY SIZE**

Companies are often categorized by their size, though the specific metrics used can vary.

- **Sales Revenue:** One method is to classify companies based on their annual sales revenue.
- **Market Capitalization:** Another common approach is to use market capitalization, which is calculated by multiplying the company's outstanding shares by its current stock price.

Both sales revenue and market capitalization can fluctuate, so a company's size classification may change over time.

## ALLOCATION STRATEGIES

Regardless of the method used to determine company size, it's essential to consider size when building a stock portfolio.

A common approach is to allocate your stock investments across different company sizes. This strategy aims to balance the growth potential of smaller companies with the stability of larger companies.

- **Large companies (more than \$10 billion in sales):** These are typically well-established companies with a long history and significant market share. They tend to be more stable but may offer slower growth.
- **Medium-sized companies (\$1 billion to \$10 billion in sales):** These companies are in a growth phase, offering a balance between growth and stability.
- **Small companies (less than \$1 billion in sales):** These are smaller companies with high growth potential but also higher risk.

Smaller companies, in general, have the potential to grow faster than larger companies. When a small company's products or services are successful, it can experience rapid sales and earnings growth. Larger companies, due to their size, often find it more challenging to achieve the same growth rates.

While allocation targets can serve as a helpful guideline, strict adherence isn't always necessary. Building a diversified portfolio takes time, and it's essential to prioritize investing in quality companies. As you focus on identifying strong companies, diversification will naturally occur.

Even with a well-diversified portfolio, imbalances can arise over time. Some companies may outperform expectations, while others may underperform.

To maintain diversification, consider periodically rebalancing your portfolio. This involves selling overvalued holdings and allocating capital to undervalued or promising companies.

## DIVERSIFICATION BY INDUSTRY

Companies can also be classified by the industry or sector in which they operate.

Various systems exist for industry classification. Financial data providers often have their own classification systems.

While these systems may differ in their specifics, the precise categorization of each company isn't crucial for most individual investors.

The important principle is to avoid overconcentration in any single industry or sector.

- **Sector:** A broad grouping of industries (e.g., technology, healthcare, consumer staples).
- **Industry:** A more specific grouping within a sector (e.g., software, pharmaceuticals, food and beverage).

Diversification by industry helps to mitigate the risk that negative developments in a particular sector will significantly impact your portfolio.

There is no single rule for how much to allocate to each sector. The appropriate allocation depends on factors such as your risk tolerance and investment goals.

As a general guideline, consider spreading your investments across several different sectors.

## COMPANY STOCK

If you work for a publicly traded company, carefully evaluate the risks and rewards of investing heavily in your company's stock.

Concentrating a large portion of your assets in a single company's stock can expose you to significant risk. If the company faces financial difficulties, you could lose both your job and a substantial portion of your investments.

If your employer matches retirement contributions with company stock, consider diversifying your own contributions to other investment options within the plan.

While insider knowledge can be an advantage, remember that even employees can be surprised by unforeseen events that negatively impact a company's stock price.

## A HOLISTIC APPROACH

Remember to consider the diversification of your stock portfolio in the context of your overall investment portfolio.

If you own other diversified assets, such as stock mutual funds, bonds and real estate, strict diversification within your stock holdings may be less critical.

The overarching goal is to achieve a level of diversification that aligns with your risk tolerance and investment objectives.

## KEY TAKEAWAYS

- Diversification is essential for managing risk in an investment portfolio.
- Diversification can be achieved by allocating investments across different company sizes and industries.
- Company size can be measured by sales revenue or market capitalization.
- Industry classification systems vary, but the principle of spreading investments across sectors is important.
- Avoid overconcentration in any single company's stock, especially your employer's stock.

- Consider stock portfolio diversification in the context of your overall investment portfolio.

## LESSON TWO: STRATEGIES FOR EFFECTIVE STOCK PORTFOLIO MANAGEMENT

### INTRODUCTION

In this lesson, *Strategies for Effective Stock Portfolio Management*, you'll gain practical insights into building and maintaining a strong stock portfolio. We'll begin by outlining foundational steps for long-term success, emphasizing diversification as a core principle for reducing risk and improving stability. You'll learn how to avoid common investment mistakes that can undermine your strategy, as well as the importance of regularly reviewing your portfolio to stay aligned with your goals. We'll also discuss how to set realistic return expectations, helping you make informed decisions and stay focused on your investment objectives.

### BUILDING FOR SUCCESS

As a stock investor, it's essential to think beyond simply owning individual companies. The goal is to construct a well-managed portfolio, where your holdings work together strategically, rather than just a collection of unrelated stocks.

A diversified portfolio, balanced across company sizes and industries, is crucial for long-term success. Failing to diversify can expose you to significant risk, as demonstrated by the tech stock crash of 2000.

This lesson explores key principles of effective portfolio management, including diversification strategies and common pitfalls to avoid.

### DIVERSIFICATION: A CORE PRINCIPLE

Diversification remains a fundamental aspect of portfolio management.

To potentially enhance portfolio growth, consider an allocation that leans towards small and mid-sized companies, which often have higher growth potential.

A common guideline is:

- 25% large-cap companies
- 50% mid-cap companies
- 25% small-cap companies

Sector diversification is also important, though specific allocation targets may vary.

- Different classification systems exist for categorizing companies by sector.
- It's not always necessary to own stocks in every sector. Growth investors often focus on sectors with strong growth potential.
- However, avoid excessive concentration in any single sector, as it can increase vulnerability to sector-specific downturns.

Portfolio imbalances can occur when a single stock performs exceptionally well. While holding onto winners is generally advisable, consider selling a portion of your position if it becomes significantly overvalued or dominates your portfolio (e.g., exceeding 25% of holdings).

## AVOIDING COMMON INVESTMENT MISTAKES

Both novice and experienced investors can fall prey to common mistakes that can hinder portfolio performance:

- **Selling after a price drop:** Don't automatically sell a stock simply because its price has declined. If the company's fundamentals remain strong, it may be an opportunity to buy more.
- **Holding onto losers:** Avoid holding onto underperforming stocks indefinitely, hoping for a recovery. It's often better to cut your losses and reallocate capital to more promising opportunities.
- **Using stop-loss orders:** Stop-loss orders, intended to limit losses, can trigger sales during normal market fluctuations, causing you to miss out on potential rebounds.
- **Selling winners too early:** While locking in profits is tempting, selling winning stocks prematurely can prevent you from capturing further upside potential if the company continues to perform well.
- **Holding onto overvalued winners:** Conversely, don't hold onto overvalued stocks indefinitely. When a stock price significantly exceeds the company's intrinsic value, it's prudent to sell.

## REGULAR PORTFOLIO REVIEW

Regularly review your portfolio to ensure it aligns with your investment goals and risk tolerance. A quarterly review is often recommended, coinciding with company earnings announcements.

During these reviews:

- Assess the performance of your holdings against your expectations.
- Investigate any significant deviations from expected results.
- Evaluate whether your companies are still fundamentally sound.
- Consider replacing underperforming companies with stronger ones.

Conduct a more comprehensive review of your portfolio's diversification (by size and sector) at least annually. Rebalance your portfolio by adding or selling stocks to maintain your target allocations.

## SETTING RETURN EXPECTATIONS

- Establish reasonable return expectations for your portfolio.
- Your expected return may vary depending on your portfolio composition, with smaller companies typically having the potential for higher returns.
- If your portfolio's expected return falls significantly below your target, consider adjusting your holdings.
  - \* Evaluate whether you have too many slow-growth stocks or if some of your holdings are underperforming.
- Successful portfolio management involves actively managing your holdings, selling underperformers or overvalued stocks, and reinvesting in companies with stronger growth prospects.

## KEY TAKEAWAYS

- Effective portfolio management involves diversification, avoiding common mistakes and regular review.
- Diversify your portfolio by company size and sector to reduce risk.
- Avoid selling stocks solely based on short-term price fluctuations.
- Regularly review your portfolio's performance and make necessary adjustments.
- Establish and monitor your portfolio's expected return.

## LESSON THREE: STRATEGIES FOR MANAGING YOUR ENTIRE PORTFOLIO

### INTRODUCTION

In this lesson, *Strategies for Managing Your Entire Portfolio*, you'll learn how to take a comprehensive, big-picture approach to investing. We'll start with the concept of holistic investing—considering all your assets, goals, and risk tolerance to create a well-balanced portfolio. You'll gain a clear understanding of asset allocation and explore practical strategies for distributing your investments across different asset classes. Through real-world portfolio examples and actionable management tips, this lesson will help you make informed decisions, maintain balance over time, and build a portfolio that supports your long-term financial goals.

### HOLISTIC INVESTING

For most individuals, stock investments are just one component of their overall financial picture. Many people also have employer-sponsored retirement plans, spousal retirement accounts and college savings plans.

Managing these various accounts and ensuring they work together effectively can be a complex undertaking.

Furthermore, changes in tax laws can influence the attractiveness of different investment vehicles, adding another layer of complexity to portfolio management.

This lesson explores strategies for managing your entire investment portfolio, considering the interplay between various account types and asset classes.

### UNDERSTANDING ASSET ALLOCATION

Asset allocation involves dividing your investments among different asset classes, such as stocks, bonds, real estate investment trusts (REITs), and cash. You can invest in these asset classes directly or through mutual funds or exchange-traded funds (ETFs). Some investors strongly advocate for strict asset allocation strategies, believing that the way you allocate your portfolio is the most critical investment decision. They may set specific targets for different sub-classes within asset classes (e.g., small-cap stocks, growth funds) and adhere to these targets rigorously. While diversification across asset classes is a prudent approach to mitigate risk, it's not the sole determinant of investment success. Owning a diversified portfolio of poor-performing investments is not a winning strategy.

## PRACTICAL ASSET ALLOCATION STRATEGIES

While rigid adherence to asset allocation targets may not be necessary for everyone, it's beneficial to establish some general guidelines to avoid excessive concentration in any single asset class or sector.

The following portfolio examples, inspired by NAIC resources, illustrate how asset allocation can be tailored to different investor profiles. These are examples and not specific investment recommendations.

### PORTFOLIO EXAMPLES

#### **Retirees or Near-Retirees:**

This portfolio prioritizes income generation and capital preservation while maintaining some growth potential to outpace inflation.

- Stocks:
  - 30% large-cap stocks
  - 10% mid-cap and small-cap stocks
  - 10% international stocks
- Bonds:
  - 25% high-quality short-term bonds
  - 25% high-quality intermediate-term bonds

#### **Middle-Aged Investors (40s and 50s):**

This portfolio strikes a balance between growth and stability, gradually shifting towards more conservative investments as retirement approaches.

- Stocks:
  - 40% large-cap stocks
  - 20% mid-cap and small-cap stocks
  - 10% international stocks
- Bonds:
  - 30% high-quality intermediate-term bonds

#### **Younger Investors (20s and 30s):**

This portfolio emphasizes growth, as younger investors have a longer time horizon to weather market volatility.

- Stocks:
  - 50% large-cap stocks

- 25% mid-cap and small-cap stocks
- 15% international stocks
- Bonds:
  - 10% intermediate-term bonds

### Real Estate Investment Trusts (REITs):

Some investors include REITs in their portfolios for income generation and diversification, as their performance may not always correlate with stocks.

### PORTFOLIO MANAGEMENT TIPS

- **Tax Efficiency:** Consider placing investments that generate significant interest income into tax-deferred accounts (e.g., 401(k)s, IRAs) and investments that generate capital gains and dividends into taxable accounts.
- **Time Horizon:** Align your investment strategy with your time horizon. For example, college savings plans require a shorter time horizon than retirement savings, so they may warrant a more conservative approach as the child gets closer to college age.
- **Regular Review and Rebalancing:** \* Review your entire portfolio and its asset allocation at least annually. \* Rebalancing involves adjusting your portfolio to maintain your target asset allocation by selling some investments that have performed well and buying others that have underperformed. \* Rebalancing helps control risk and ensures you benefit from market cycles.
- **Utilizing New Contributions:** If you regularly contribute new money to your investment accounts, use those contributions to rebalance your portfolio rather than selling existing investments.

By adopting a holistic approach to portfolio management and considering the interplay between different accounts and asset classes, you can increase your chances of achieving your long-term financial goals.

### KEY TAKEAWAYS

- **Adopt a Holistic Approach:** Effective portfolio management involves coordinating all of your investment accounts—such as retirement plans, college savings, and taxable accounts—to ensure they work together toward your financial goals.
- **Understand and Apply Asset Allocation:** Dividing investments across asset classes like stocks, bonds and REITs helps manage risk and align your portfolio with your time horizon and risk tolerance.
- **Tailor Strategies to Your Life Stage:** Asset allocation should evolve over time; younger investors may focus on growth, while retirees typically prioritize income and capital preservation.

- **Review and Rebalance Regularly:** Conduct annual portfolio reviews and rebalance as needed to maintain your target allocation, enhance tax efficiency, and ensure your investments stay aligned with your objectives.

## **COURSE CONCLUSION**

Congratulations on completing *Building Your Portfolio*! Throughout this course, you've built a strong foundation in portfolio construction and management, starting with the essential principle of diversification—by company size, industry and asset class. You learned how to create a resilient stock portfolio by avoiding common mistakes, reviewing your holdings regularly, and setting clear expectations for returns. Finally, you explored how to manage your entire investment portfolio holistically, considering all account types, life stages, and risk levels, and applying practical asset allocation strategies to support long-term success. By combining these lessons, you are now equipped with the tools to confidently build and manage a well-balanced portfolio tailored to your unique financial goals. Keep reviewing, rebalancing and refining your approach—your future self will thank you.