

Importance of Diversification

November 26th 2020

What is Diversification?

Diversification is a risk management strategy that mixes a wide variety of investments within a **portfolio** across different asset classes , currencies and geographies

A diversified **portfolio** contains a mix of distinct asset types and **investment** vehicles in an attempt at limiting exposure to any single asset or risk.

The rationale behind this technique is that a portfolio constructed of different kinds of assets will, on average, yield higher long-term returns and lower the risk of any individual holding or security.

Why Now?

The unprecedented turbulence accompanying the global pandemic has galvanised many people to scrutinise their financial well-being.

Amid volatile equities, soaring gold prices and low interest rates, rarely has diversification in personal investing been more essential.

But as millions seek safe yet profitable havens for their cash or ensure growth strategies match savings goals, alternative platforms and asset classes beckon those craving passive investment with relative security, regular income or empowered growth.

Diversifying investments is seen as the best strategy, now as much as ever, as it enables investors to minimise risk while maximising rewards.

Risks

- **UNDIVERSIFIABLE RISK**

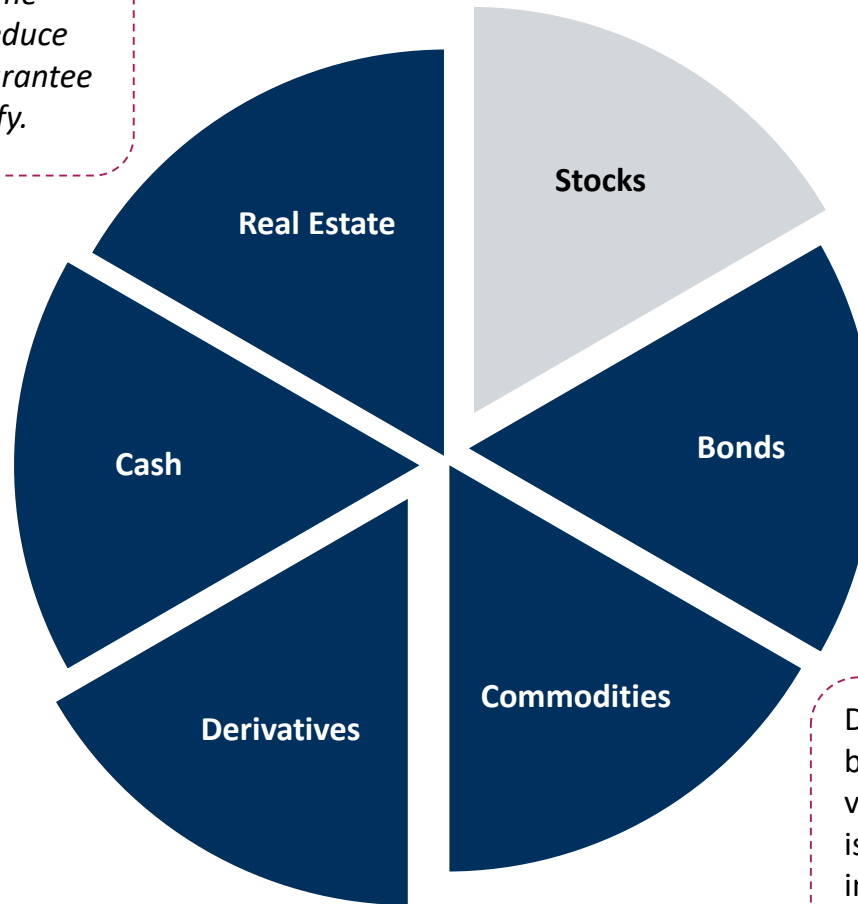
- Know as systematic or market risk
- This risk cuts across every industry in an economy and is not specific to a particular asset class. Some causes include changes in interest, exchange and inflation rates and political instability.
- These are risks that investors must accept and cannot be reduced through diversification.

- **DIVERSIFIABLE RISK**

- Know as unsystematic risk
- This is the risk that is specific to a particular company, industry, market, economy or country. Types of this risk include business and financial risks.
- These types of risks can be reduced through diversification.

Importance of Diversification

*Given the challenges that come with investing, one way to reduce **but not eliminate** (not a guarantee against loss) risk is to diversify.*



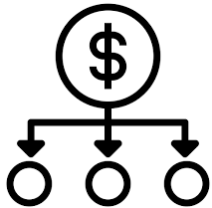
Diversification serves as one of the best ways to weather market volatility as the potential risk level is reduced by spreading investment across and within different financial assets.

Why you need to diversify your investments



Opportunity for Higher Returns

- The higher the risk, the higher the potential return
- Diversifying your investment provides you the opportunity to get higher returns while maintaining the same level of risk.



Spread your Risk

- This is like the popular phrase, ‘do not put all your eggs in one basket’.
- While individual financial asset can suffer severe declines, it is very rare that any two or three assets with very different sources of risk and return, like government bonds, gold and equities, would experience declines of the same magnitude at the same time.

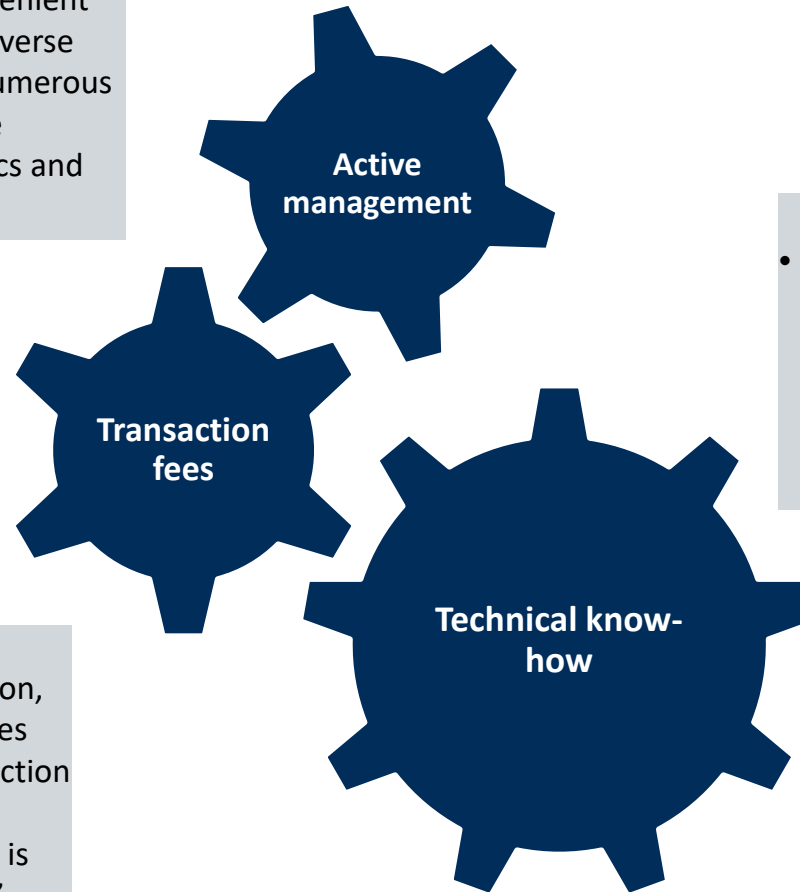


Reduce Exposure to Volatility

- A well-diversified investment across different markets will help mitigate the effect of inherent volatility associated with each market, given that there is little or no level of correlation between these markets.

Issues with Diversification

- It may become inconvenient to manage a widely diverse portfolio which has numerous investments that have different characteristics and driving factors.



- Some diversification strategies involve hedging which may be too complicated or may not be available in certain markets.

- In the process of diversification, an increased number of trades may lead to increased transaction fees and brokerage charges which may reduce returns. It is important not to “overtrade”

Closing remarks

The benefits of diversification hold only if the securities in the portfolio are not perfectly correlated—that is, they respond differently, often in opposing ways, to market influences.

Despite the benefits that come with diversification, it is important to note that, it is not a guarantee against losses but a means to minimize your risk exposure.

Investments can be spread between mutual funds which are inherently diversified with a wide range of securities.

Over the long term, diversified portfolios do tend to post higher returns

Invest in FBNQuest Mutual Funds today and diversify your investment portfolio!

Closing remarks

It's important you construct your portfolio so you are well-diversified and have appropriate allocation, meaning not being overly exposed to one asset class, market or currency. A lot depends on individual goals as there is no one-size-fits-all approach

Invest in FBNQuest Mutual Funds today and diversify your investment portfolio!



Thank you

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