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DIVERSIFICATION: THE SYSTEMATIC CHANGE OVER

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ABSTRACT

The concept of Modern portfolio management differs from the traditional approach as it uses the quantitative methods to reduce risk of portfolio. Main objective of modern portfolio theory is to have an efficient portfolio, a portfolio that yields the highest return for a specific risk with the lowest risk for a given return. Returns can be increased up to maximum level by having an efficient portfolio, which provides the best result for an investor considering the profile of investor. For example After detailed analysis of some of the 2 scrip's of interest, an investor could form a portfolio with 5-6 scrip's (from Durable segments to capital goods and real estate) that was generating good returns with low risk. Again being more curious it may be thought that "Is it possible to earn even more with same risk profile or equal return with low risk profile???" The answer would definitely be yes. Little more effort needs to be plunged in and here comes either higher return or low risk. This is Portfolio Diversification. Diversification manages the risk in better way as it deals with reduction of the risk in a systematic manner. With the help of a proper managed and diversified Portfolio not only the return are maximised, but also the risk of sudden falling in the market value of the investment is managed. This article is an attempt to study the diversification with the context of Indian Investor's look out and considering the investor's need in an Indian Market. However this is also important here that Diversification is not limited to Portfolio Diversification, but also expands to beyond this and many types of diversification now exist.

Keywords: *Investments, Portfolio, Diversification, Return, Risk, Volatility, Management.*

Introduction

The final word goal of diversification is to cut back the volatility of the portfolio by offsetting losses in one asset class with gains in another asset class. A very common saying regarding investment is fit to understand the Diversification. It is like do not put all the eggs of yours into one basket. Diversification is based on this philosophy perhaps. It is a technique in which risk is reduced by diverting the total amount of fund to be invested into number of different categories of investments. It aims to maximise returns by investing in numerous areas that may each react differently to the identical event. Most of the investment managers do agree that there is however no guarantee regarding the non occurrence of the loss in case of diversification even, but it helps in reducing the loss with the minimum amount of investment and helps in achieving the goals. Here, we glance at why this is often true and the way to accomplish diversification in your portfolio. In practical terms, diversification is holding investments which are able to react differently to the identical market or economic event. For example in the times of high raise in the economy, the shares gives better return compare to Debentures or Bonds but contrary in case of decrease or under performance of the economy the bonds gives better return. By making a combination of both of it the risk is balanced totally.

Types of Diversification

- **Business Diversification:** When it is a robust and well-known name which can be transferred to the merchandise of other business. Judgments about the timing of a company's diversification effort are best made instance by instance, in line with company's own unique situation. However, some companies opted to try and do to form shareholder value with unrelated diversification strategies. Related diversification thus incorporates a strategic appeal from several angles. Companies that pursue a technique of unrelated diversification generally

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exhibit a willingness to diversify into any industry where there's potential marketplace for a company to grasp consistently good financial results. Whether the business would require substantial infusions of capital to modify out-of-date plants and equipment, fund expansion etc.

- **Stock Diversification:** Each strategy has advantages and drawbacks, and selecting the proper one for you ought to involve careful planning along with your financial, tax, and legal advisors. Many corporate executives, directors, and officers, especially those of fast-growing companies, find themselves during a quandary nowadays. If they own countless shares in those companies, their net worth will be substantial. So what's the downside? A portfolio that's top-heavy in one security poses tremendous downside risk. How, then, can an executive diversify his or her portfolio within the best, tax efficient manner? Here could be a brief observe some single-stock diversification strategies to assist an investor achieve three goals – to hedge, monetize, and diversify out of a concentrated equity position while deferring capital gains tax. Collars are forms of hedging strategies wont to limit the value risk of a stock and permit the investor to participate in further appreciation, up to a selected price. A collar also allows an investor to monetize that's, borrowing against a concentrated equity position. One well-known sort of collar is that the zero-premium collar, or zero-cost collar. A "put" could be a contract that provides an investor the proper, but not the duty, to sell a particular number of shares at a specified price until a specific date. A "call" gives its holder the correct, but not the requirement, to shop for a selected number of shares of stock at a predetermined price, until a particular date.
- **Portfolio Diversification:** Portfolio diversification concerns the inclusion of various investment vehicles with a range of features. The strategy of diversification requires balancing various investments that have only a small direct correlation with one another or better yet, actual indirect correlation. Low correlation usually means the costs of the investments aren't likely to maneuver within the same direction. There is no consensus regarding the right amount of diversification. In theory, an investor may continue diversifying his/her portfolio virtually infinitely, as long as there are available investments within the market that don't seem to be correlated with other investments within the portfolio. An investor should consider diversifying his/her portfolio supported the subsequent specifications such as types of investments which include different asset classes, like cash, stocks, bonds, ETFs, options, etc, Risk levels which broadly covers investments with dissimilar levels of risk allow the smoothing of gains and losses. The Type of industries is another factor which needs to be considered. Invest in companies from distinct industries. The stocks of companies operating in numerous industries tend to indicate a lower correlation with one another. An investor shouldn't invest only in domestic markets. Nowadays, index and mutual funds, still as ETFs, provide individual investors with a straight forward and cheap instrument for creating a diversified investment portfolio.

What are the Advantage of Diversification

- **Reduces the Impact of Market Volatility:** A diversified portfolio minimizes the general risk related to the portfolio. Since investment is created across different asset classes and sectors, the general impact of market volatility comes down.
- **Reduces the Time Spent in Monitoring the Portfolio:** A diversified portfolio is more stable because not all investments will perform badly at the identical time. If you have got invested only in equity shares, you'll be spending plenty of your time studying the market movement and analyzing your next step. Similarly, if you've got invested solely into low-risk mutual funds, your all-time worry is going to be to search out avenues to extend returns. With diversification, you'll spend lesser time on the identical and therefore the portfolio won't require plenty of maintenance.
- **Helps seek advantage of various investment instruments:** By selecting mutual funds, investors may gain the good thing about investing during a mixture of debt and equity. Similarly, by investing in fixed deposits, investors enjoy a hard and fast return and a coffee risk. Hence, diversification of the portfolio will balance the danger and return related to different funds. Whether or not one fund doesn't perform well, the loss is also compensated by the profits made up of other funds.
- **Helps achieve Long-Term Investment Plans:** It's important for the investor to speculate indifferent high-performing sectors. If the market volatility encompasses a positive impact on

stocks, the investors are ready to generate higher returns on them. If it's a positive impact on debt, the investors are going to be ready to make the foremost out of mutual funds.

- **Helps Avail of Good thing about Compounding of Interest:** Selecting a investment company as an investment option allows investors to avail of the good thing about compounding interest. This suggests that each investment made will generate interest on the principal amount in addition as on the accumulated interest over the previous invested years. It's important to stay in mind that if you're investing in two different funds, the fund holding for both the schemes should be different; otherwise, diversification doesn't make any sense.
- **Helps keep the Capital Safe:** Not every investor is prepared to play a risky game. Diversification allows investors to realize their investment plans while maintaining the investment risk at a minimum. It's also a technique of playing safe within the volatile market.
- **Helps you to Shuffle amongst Investments:** Diversification may be a practical approach that each investor should cash in of. It allows investors to shuffle their investments and profit of the market movement.

This increases the chance and therefore the sources of earnings while keeping risks at a minimum. So as to assist you create the correct financial decisions, various mobile application with a singular feature are available. The app offers personalized investment recommendations to users and allows them to speculate anytime, anywhere.

Problems with Diversification

While there are many benefits to diversification, there could also be some downsides likewise. It should be somewhat cumbersome to manage various portfolios, especially if you've got multiple holdings and investments. Not all investment vehicles cost the identical, so buying and selling is also expensive from transaction fees to brokerage charges. And since higher risk comes with higher rewards, you will find yourself limiting what you start with. However, these products will be very complicated and don't seem to be meant to be created by beginner or small investors. For those that have less investment experience, and don't have the funding to enter into hedging activities, bonds are the foremost popular thanks to diversify against the exchange. They've all concluded that the simplest due to do that is by diversifying holdings into different asset classes, like stocks, bonds, gold, hedge funds and other strategies meant to smooth returns. But does it work? No. What diversification does is reduce volatility. As a result, asset allocation diversification doesn't help investment performance, it hurts it. For both professional investors and novices, your single biggest fear is being caught in an exceedingly major stock exchange decline of 40% or more, which is why portfolio managers and advisers diversify into bonds and other assets to scale back the volatility of the portfolio.

Over Diversification

The term Diversification has morphed into a buzzword accustomed describes inefficient diversification because it relates to a complete investment portfolio. rather like a lumbering corporate conglomerate, owning too many investments can confuse you, increase your investment cost, add layers of required due diligence and result in below-average risk-adjusted returns. Read on to find out why financial advisors may have an interest in over diversifying your investment portfolio and a few of the signs that your portfolio could also be diversified. Most financial advisors are honest and hard-working professionals who have an obligation to try to to what's best for his or her clients. However, job security and private gain are two factors that might motivate a financial advisor to over diversify your investments. When giving investment advice for a living, being average can give more job security than attempting to face out from the group. Fear of losing accounts over unexpected investment outcomes could motivate an advisor to diversify your investments to the purpose of mediocrity. There are some signs which indicate over diversification in portfolio:

- Owning too many mutual funds within any single investment style category: Some mutual funds with very different names are quite similar with respect to their investment holdings and overall investment strategy. These categories group together mutual funds with fundamentally similar investment holdings and methods. Investing in additional than one fund within any style category adds investment costs, increases required investment due diligence and customarily reduces the speed of diversification achieved by holding multiple positions. Cross-referencing Morningstar's investment trust style categories with the various mutual funds in your portfolio may be a simple due to identify whether you own too many investments with similar risks.

- Excessive use of multimanager investments: Multimanager investment products, like funds of funds, are often an easy way for little investors to achieve instant diversification. If you're near retirement and have a bigger investment portfolio, you're probably more contented diversifying among investment managers in an exceedingly more direct manner. Is it really to your benefit to own a financial advisor monitoring an investment manager that's, in turn, monitoring other investment managers? It's worth noting that a minimum of half the cash involved in Bernard Mad off's infamous investment fraud came to him indirectly through multimanager investments, like funds of funds or feeder funds. Before the fraud, many of the investors within these funds had no concept that an investment with Mad off would be buried in the labyrinth of a multimanager diversification strategy.
- Owning an excessive number of individual stock positions: Too many individual stock positions can result in enormous amounts of required due diligence, a sophisticated tax situation and performance that simply mimic a index, albeit at a better cost.

Conclusion

At the time when traditional portfolio theory was a commonly accepted concept, the easy diversification of investments supported the law of enormous numbers, meaning namely that the correlation among the returns of the individual securities held in a portfolio was ignored, which frequently resulted in an excessive number of investment portfolio components, and thereby in an excessive cost of portfolio management. Efficient diversification is the new model of investment diversification proposed by the MPT. This sort of investment diversification takes into consideration the degree of the correlation among returns on individual securities, thus minimizing investment risk and including an optimal number of securities in a portfolio and also maintaining the identical level of the expected return. The amount of securities in a portfolio required so as to attain the satisfactory effects of diversification depends on the correlation among returns on individual securities. A positive correlation implies a bigger number of securities, whereas a negative correlation requires a smaller number of securities to be included in an efficiently diversified portfolio. If there are a awfully small number of securities in an exceedingly portfolio, that leads to a potentially high unsystematic risk, whereas an oversized number of securities incur high transaction costs both in terms of making such a portfolio and in terms of the high costs of portfolio management. The final conclusion is that the quantity of the securities held in a very portfolio should be increased as long as its marginal benefits within the variety of reduced investment risk reach the amount of its marginal costs in terms of increased portfolio management costs. The equality of the monetary value and marginal benefits could be a condition for maximizing diversification benefits. The opinions presented during this paper are geared toward emphasizing the importance of diversification as an investment strategy, as well as the importance of its advantages, disadvantages and limitations. By identifying the shortcomings and limitations, their significance is diminished, whereas the importance of diversification as an investment practice is improved. This implies the direction of future research: to do to research this issue, which is remarked because the diversification puzzles within the financial literature, which should include the weather of behavioral portfolio theory.

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