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Diversification

Diversification – spreading your money between different kinds of investments (called 'asset classes') and different kinds of investment product – helps reduce the risk of your overall investments (referred to as your 'portfolio') under-performing or losing money. This guide will show you how it's done.

Beyond cash – diversifying across investments

The key to diversifying – and successful investing in general – is to spread your money across different kinds of investments, called asset classes. The main asset classes are set out below – with the first four being the most common.

Asset Class	Examples and comments	Risk profile
Cash	Savings and current account balances, savings bonds, premium bonds and other NS&I products, Cash ISAs and any cash you have at home.	Low – but your money's buying power is eroded over time if inflation is higher than the interest rates paid.
Fixed interest securities – also called bonds. Essentially a loan to a company or government for a fixed period.	Gilts (Government bonds), overseas bonds, local authority bonds and corporate bonds (loans to companies).	Relatively low and returns predictable if held to maturity, however traded prices can be volatile.
Shares – also known as 'equities'. A stake in a company.	You can hold shares directly or through an investment fund where you pool your money with other people's, like with a unit trust, OEIC (open-ended investment company) or life fund.	Investing in single company is high risk. Investing in a fund provides more diversification, but risk levels will depend on the type of shares in the fund.
Property	Includes residential or commercial property and buy-to-lets, and investments in property companies or funds.	Price can vary and be more volatile than with bonds. Potential for gains but also losses.
Alternative investments	Includes gold, art, antiques, collectibles, fine wines and other investments that do not fall into the 4 main asset classes.	Risk profile unpredictable - very much depends on prevailing (niche) market conditions and quality of asset.

Each kind of asset behaves differently. For example, when stock prices fall, the prices of fixed interest securities may go up. If you have a mix of investments in your portfolio, it's unlikely that they'll all lose value at the same time.

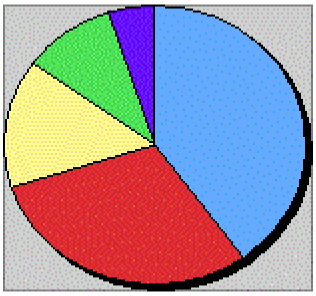
Diversifying within an asset class

There are many opportunities for diversification, even within a single kind of investment. For example, with shares, you can spread your investments between:

- the UK and overseas markets
- different sectors (industrials, financials, oils etc)

large and small companies

This is an example of how large pension funds diversify, using a portfolio mix that offers a balance between growth for the future (shares and property) and stability for current payments (fixed interest securities).



To see how your investments compare, start by making a simple list. Write out the different investments you have and their value, sorting each by asset class. Here's an example:

Investments summary – example

Investment type	Amount
Cash	
Instant access savings account	£1,500
5-year savings bond	£5,000
Fixed interest securities	
UK Gilts fund in an ISA	£15,000
Shares	
Shares in BT	£2,450
FTSE 100 fund in an ISA	£5,000
With-profits endowment – part of this may be in shares and part in fixed interest securities	£10,000

Investment type	Amount
Property	
Buy-to-let	£150,000
Alternative investments	
None	
Total	**£218,950**

Do you need to improve your diversification?

You may see from your list of investments that your portfolio is too heavily concentrated in one area. Here are some common problems to look out for:

If all your cash is in **a single savings account**, you should think about spreading it between an instant access savings account and other alternatives, like cash bonds or an investment fund.

If you have a lot of cash – more than six months' worth of living expenses – you should consider putting some of that excess into investments like shares and fixed interest securities, especially if you're looking for long-term growth on your money.

If you're heavily invested in a single company's shares – perhaps your employer – start looking for ways to **add diversification**.

Consider your appetite for risk

While diversification is important, you should keep in mind how much risk you are prepared to accept on your money. If it is important to you to avoid losses, you may want a portfolio that has less in shares and more in cash and fixed interest securities held to maturity, for example.