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# For Portfolios, Simple May Be Best

## Research Finds Investors Fare Better by Purchasing A Few Stocks They Know



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When it comes to picking stocks, investors are better off buying a few companies they know very well than investing in many stocks they know little about.

New research finds that stock trades made by households holding only one or two stocks outperformed those with more diversified portfolios, according to finance professors at the University of Michigan and the University of Illinois at Urbana-Champaign.

Wealthier investors -- those with brokerage accounts of $100,000 or more -- who held concentrated portfolios also outperformed comparable households with diversified accounts by at least four percentage points a year. In fact, wealthy households that invested in many stocks underperformed the markets by about 1% a year.

That advantage appears to stem from having access to information, either through strong social or professional networks, that makes investors with concentrated portfolios better stock pickers, researchers said in a paper released last month. Although households with relatively large portfolios can afford to buy more stocks, they appear to concentrate their holdings because they have better information about those companies.

Simply reducing the number of stocks in one's portfolio won't automatically improve returns if investors don't have good information, says Clemens Sialm, assistant professor of finance at Michigan's Stephen M. Ross School of Business and one of the study's co-authors. The study analyzed 1,156,000 stock trades that individual investors made through a discount broker from 1991 to 1996.

The study also found that the outperformance of households with concentrated portfolios is particularly strong if they hold "local" stocks -- defined as companies located within a 50-mile radius of their residences. That is because investors who live near the company they are investing in are likely to know more about whether that business is worth investing in, Mr. Sialm suggests.

Meanwhile, investors with concentrated portfolios also outperform the broader market if they hold small stocks or companies not included in the Standard & Poor's 500-stock index, since those companies aren't likely to be well known or as widely followed.

On average, investors who held one or two stocks outperformed those who held three or more by about one percentage point during the year following a stock purchase. For households with portfolios of $25,000 to $100,000, the difference in returns for concentrated versus diversified investors is three percentage points. Households with stock portfolios valued at less than $25,000 didn't perform materially better.

The tradeoff, of course, is that holding fewer stocks increases the risk of those portfolios. The study did not look at the other investments the households may have had, such as retirement accounts or pension plans, so their brokerage accounts may comprise only a small portion of their total wealth.

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