

INVESTING FUNDAMENTALS

Diversification and Asset Allocation

Detailed practice, calculation, decision-making, and assessment

GRADES 9-12	TIME 2 x 42 min	GROUPING I / pairs / whole	PRODUCT Portfolio comparison brief
YOUR CHALLENGE Compare a concentrated portfolio with a diversified portfolio, calculate the effect of a market decline, and build an allocation that matches a fictional goal.			

Two Different Jobs

Asset allocation divides money among categories such as stocks, bonds, and cash. Diversification spreads money among multiple investments, both across categories and within a category. Diversification can reduce some risk, but it cannot prevent every loss.

Idea	What it means	Example
Asset allocation	Choose how much belongs in each asset category.	60% stocks, 30% bonds, 10% cash.
Across-category diversification	Use more than one type of asset.	Stocks plus bonds plus cash.
Within-category diversification	Spread money inside one category.	Many companies and industries, not one stock.
Rebalancing	Return a portfolio to its planned percentages.	Sell or add money after weights change.
LIMIT Diversification does not guarantee a profit or protect a portfolio from every market decline.		

Part 1 - Map Two \$10,000 Portfolios

Asset category	Portfolio A dollars	Portfolio A percent	Portfolio B dollars	Portfolio B percent
Stocks	\$9,000		\$5,000	
Bonds	\$0		\$3,000	
Cash	\$1,000		\$2,000	
TOTAL	\$10,000		\$10,000	

Calculate every percentage. Which portfolio is concentrated in one category? Which uses all three categories?

Part 2 - Run a Market Stress Test

Assume stocks fall 20%, bonds rise 4%, and cash rises 1% during the year.

Portfolio	Stock ending value	Bond ending value	Cash ending value	Total ending value	Dollar change
A					
B					

Calculate each asset value, add the portfolio total, and find the dollar change from \$10,000. Which portfolio loses less in this scenario? Why?

Part 3 - Diversify Within Stocks

Stock section	Allocation	What could happen?	Diversification question
Single-company portfolio	100% in one company	Company-specific news can affect the entire stock section.	
Broad stock fund	Many companies and industries	One company has a smaller effect on the whole section.	
Five stocks in one industry	Five companies, same industry	An industry-wide problem may affect all five.	

Explain why owning several investments is not always enough. What else should an investor check?

Part 4 - Build a Fictional Allocation

Casey is saving \$6,000 for a goal that is eight years away. Casey accepts some price movement but does not want the entire balance tied to stocks.

Category	Planned percent	Dollar amount	Reason for including it
Stocks			
Bonds			
Cash			
TOTAL	100%	\$6,000	

Create one possible allocation. Your percentages must total 100% and dollars must total \$6,000. There is more than one defensible answer.

Part 5 - Portfolio Comparison Brief

Decision check	My evidence
Allocation totals verified	
Concentration identified	
Stress-test result	
Across-category diversification	
Within-category diversification	
Goal and time horizon	
Limitation of diversification	
Fact still needing research	

Write a 150-200 word brief for Casey. Include your allocation, dollar calculations, evidence from the stress test, both forms of diversification, and a statement that diversification cannot prevent every loss.