

# Diversification: Strategies for Investing and Limiting Risk

*Volatility is the tendency of an investment to experience up and down price swings in a short period of time. The more pronounced and frequent the price swings, the more volatile the investment.*

As an investor, you want growth, but you also want some stability. You're willing to assume a certain amount of investment risk to achieve long-term growth, but want to limit your risk as much as possible. How do you accomplish these conflicting goals? By diversifying.

**Diversification — which simply means using a mix of different types of investments — helps smooth out the ups and downs in your portfolio and reduces volatility.**

At the same time, diversification provides an opportunity to take advantage of gains when and where they occur.

How does all this work? Different types of investment do not always move in the same direction at the same time. In fact, they can produce returns significantly different from each other under the same market conditions. As a result, mixing different types of investments helps smooth out overall performance.

## Multiple layers of diversification:

There are many ways an investor can diversify. Following are just a few examples.

### By major asset classes

Stable value investments are considered low-risk, low-return investments, which can offset the decline in the value of more volatile investments.

Bonds offer low to moderate risk and return. They are designed to provide a relatively stable return, and can also be used to offset declines in the value of more volatile investments.

Stocks represent the highest risk and return potential. This means they offer the opportunity for the highest long-term growth in exchange for considerably more volatility. The

volatility of stock investments can be reduced by mixing them with stable value and/or bond investments.

### By using a mutual fund

Mutual funds, by nature, have built in diversification. A mutual fund is a professionally managed pool of securities (stocks and/or bonds). When you invest in a mutual fund, your money is combined with the money of many other investors. So, rather than purchasing a single security — such as an individual stock or bond — you are investing in a proportionate share of the underlying investments held in the fund. Mutual funds often invest in dozens, even hundreds of companies that can represent a range of different industries. So, the funds themselves offer diversification by their number of holdings and industry representation.

### By company size

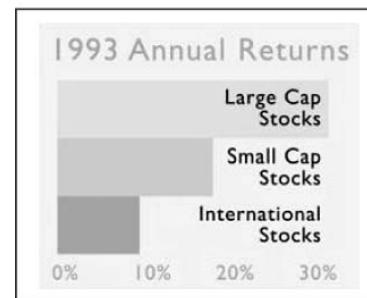
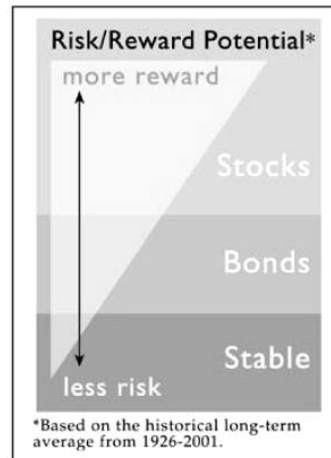
Stocks are often defined by the size of the company issuing the stock. Market capitalization measures a company's size in financial terms — large cap, mid cap, and small cap stocks. International stocks provide diversification opportunities outside the United States.

Each of these types of stock investments has a different risk and return pattern. The chart at right illustrates how they can provide significantly different returns.

Diversification is both a defensive and offensive tool. It helps reduce the negative impact of economic changes and market fluctuations on investments, while increasing their overall earnings potential.

**Diversification helps accomplish one thing all investors are looking for— the potential for higher earnings with lower risk.**

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