

Does Owning a Large Number of Funds/ETFs Mean You are Truly Diversified?

Mutual funds are an easy way for investors to gain exposure to a number of different asset classes and investment styles. While I am a firm believer that individual investors can consistently outperform the market by investing in individual stocks, it does take a level of dedication, patience and discipline that many investors do not have.

However, there are also a number of mutual fund investors who “collect” funds over the years and end up holding dozens of funds. Many times, the knee-jerk response to holding so many funds is “diversification,” though without paying attention to the underlying holdings of the funds, they may actually be overly concentrated in individual companies or sectors

This is where tools such as Morningstar’s Portfolio X-Ray are helpful. You enter in your portfolio and it will show you the exposure to individual stocks held by your funds.

For example, take a portfolio invested in nine mutual funds and ETFs. Its funds are invested across the market-cap spectrum, while some are focused on small-cap value stocks, OTC stocks, REITs, consumer cyclical stocks and insurance stocks. Equal dollar amounts are invested in each fund, so each fund has roughly the same weighting in the portfolio.

Entering this portfolio into Morningstar’s premium portfolio manager and running an X-Ray report, though, reveals some interesting results. Our “diversified” portfolio is 50% invested in what Morningstar classifies as “cyclical.” Over 19% of the portfolio is invested in financial services companies, nearly 14% in technology stocks and 15% in consumer defensive stocks.

Drilling down even further, we can see the exposure to individual stocks. Three stocks make up more than 1% of the portfolio’s net assets: Kraft Heinz, AbbVie and Tesla, while Apple makes up 0.98%. While none of these weightings are overly concerning to me, out of a fund portfolio with literally hundreds of not thousands of individual stock holdings, this may catch some my surprise.

If you are invested in a more than eight mutual funds, you may want to see what your TRUE portfolio allocation is relative to a total market fund. You may also discover that you are paying more simply to be invested in the total market.

This was a topic of a 2014 *Computerized Investing* article, which used the Morningstar X-Ray report. The article is available to CI subscribers [here](#).

AAll Weekly Survey Question

To get an idea of how many funds and ETFs our readers hold in their investment portfolios, we asked them this question:

How many mutual funds or exchange-traded funds (ETFs) do you hold in your investment portfolio?

Here are the results:

How many mutual funds or exchange-traded funds (ETFs) do you hold in your investment portfolio?

Between six and 10 funds : 36% - Votes: 943



Between 11 and 20 funds : 26% - Votes: 683



Less than five funds : 22% - Votes: 575



More than 20 funds : 10% - Votes: 252



I do not invest in mutual funds or ETFs : 7% - Votes: 173



In all, 2,626 readers responded to our weekly survey. In addition, my apologies for excluding those of you invested in five funds, which our answer choices did not accommodate.

The majority of our readers—62%—are invested in between six and 20 funds, with over one-third invested in six to 10 and a little over one-quarter invested in 11 to 20 funds. The results were what I was expecting: our readers prefer a more hands-on approach to investing, which means they tend to invest more in individual stocks than index funds. In this survey, 17% of readers do not have any passive equity investments as part of the equity portion of their portfolio. I was a bit surprised to see that three-quarters of respondents (76% in all) are worried to some extent about political risk affecting U.S. markets in the coming months. One-third (33%) are either worried or very worried while 43% are somewhat worried.

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Perhaps most surprising to me is the 10% of readers who are invested in more than 20 funds. These are the people who may want to consider performing a portfolio analysis to see if they are diversified as they think they are.

Weekly Special Question

To follow up on last week's question, I wanted to get an idea of what may lead someone to invest in a "large" number of mutual funds or ETFs. So we posted this special question:

If you hold more than eight mutual funds or ETFs, what is your rationale for doing so?

In all, 317 readers responded to this question.

I wasn't surprised that the most-mentioned reason—by a three-to-one margin over the next highest group of responses—for holding more than eight funds is for diversification purposes. However, it is important to understand the overlap between the funds you own to make sure you aren't actually overly concentrated in a certain style or sector (unless that is what you are aiming for).

Other themes we found among the answers include:

- More exposure to various asset classes, sectors and industries, market cap segments and countries
- Multiple investment accounts, such as IRAs, 401(k), etc.
- Recommended by their financial advisor
- To have a balanced portfolio
- Accumulated funds over a number of years

Here is a sampling of the responses:

- “Diversification: My 32 funds encompass 20 Morningstar categories.”
- “Because I want some exposure, but not too much, to various international and emerging markets, to various size and style categories like small cap value, and to various alternative asset classes like precious metals and mortgage REITs.”
- “Being overly diversified will hold back your growth potential.”
- “Capital gains taxes.”
- “Different accounts with different available choices.”
- “No rationale. I need to reduce the number.”

Everybody has an opinion! Why not give us yours? Participate in our weekly member poll, updated every Monday, and see the results online at <http://www.aaii.com/memberquestion>.