What is Portfolio Diversification?

Worksheet

Diversification is holding a mix of assets to reduce overall portfolio risk — if one asset falls, others may rise, smoothing returns. The rule: don't put all eggs in one basket.

Questions

1. What is the main goal of diversification?
A) Maximize gains
B) Reduce overall portfolio risk
C) Avoid stocks
D) Guarantee profits

2. Which portfolio is better diversified?
A) 90% stocks, 10% bonds
B) 50% stocks, 30% bonds, 20% real estate
C) 100% stock index fund
D) 80% single company

3. What is correlation in investing?
A) Average return
B) How two assets move together
C) Time to buy
D) Total profit

4. When should you rebalance your portfolio?
A) Every day
B) Never
C) Annually or when allocation drifts 5%+
D) Only when losing money

5. An investor has €100k: €80k in one tech stock and €20k in cash. The tech stock crashes 50%. What is the portfolio loss?

6. The same €100k split: €40k stocks, €30k bonds, €20k real estate, €10k cash. Stocks fall 50%, bonds rise 5%, real estate flat, cash unchanged. What is the result?

7. A portfolio is worth €200k. Stocks are 50%, Bonds 30%, Real estate 20%. Stock market rises 20%, bonds 2%, real estate 5%. Rebalance. What allocation now?

8. Define: What is diversification?

9. Define: Why diversify?

10. Define: What are asset classes?

Answer Key

1. B) Reduce overall portfolio risk — Diversification spreads risk; losses in one asset are cushioned by gains elsewhere.

2. B) 50% stocks, 30% bonds, 20% real estate — Multiple asset classes and lower stock concentration = better diversification.

3. B) How two assets move together — Low correlation = good diversification; assets don't move in sync.

4. C) Annually or when allocation drifts 5%+ — Rebalance periodically to keep your target mix and lock in gains.

5. Concentrated loss = €80k × 0.50 = €40k loss. New portfolio value = €100k − €40k = €60k. Portfolio loss % = 40%. One stock bet = catastrophic risk.

6. Stocks: €40k × (1 − 0.50) = €20k. Bonds: €30k × 1.05 = €31.5k. Real estate: €20k × 1.00 = €20k. Cash: €10k. New total = €20k + €31.5k + €20k + €10k = €81.5k. Portfolio loss = €18.5k or 18.5% (much smaller!).

7. Stocks: €100k × 1.20 = €120k. Bonds: €60k × 1.02 = €61.2k. Real estate: €40k × 1.05 = €42k. New total = €223.2k. Stocks % = €120k / €223.2k = 53.7% (aim: 50%, rebalance). Sell €8.4k stocks → buy bonds/real estate to return to 50/30/20.

8. Spreading investments across asset classes to reduce risk — if one falls, others may rise.

9. Lower overall portfolio volatility, smoother returns, and protection against loss in any one asset.

10. Stocks, bonds, real estate, commodities, cash — each behaves differently in various market conditions.