When Less Can Potentially Bring More

View from the Observation Deck

1. If an investor seeks to outperform a benchmark index, such as the S&P 500 Index, one way to approach the challenge is to simply pare down the number of stocks one invests in.

2. As indicated in the chart, over the past 11 years (includes 2008 to show impact of financial crisis), the average number of stocks in the S&P 500 Index with positive annual price-only returns (does not include dividends) was 310, or roughly 61%. That means that approximately 39% of the constituents in the index, on average, were providing a drag on returns in a given year.

3. Here is a link to a similar post we did in January 2013 (click here). In this snapshot (1993-2012), which used total return performance figures, the average number of stocks in the S&P 500 Index that posted a gain for the period was 61%.

4. One of the ways in which an investor might attempt to generate a return that exceeds that of a benchmark index is to identify and eliminate those companies most likely to end up in the red at year-end. Easier said than done.

5. This is where professionals can add value for an investor. Financial consultants and packaged product vendors have a multitude of strategies designed to potentially outperform the broader market via less diversification.

Source: S&P Dow Jones Indices. Past performance is no guarantee of future results.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions and other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 Index is a capitalization-weighted index comprised of 500 stocks (currently 505) used to measure large-cap U.S. stock market performance.

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