What to do if you have big wins in your share portfolio

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Highlight: It's easier to manage concentration risk if you hold direct shares, but not so simple if you're an ETF investor.

Body

Investors with exposure to artificial intelligence and weight loss drugs have done well in recent years. Stocks like Nvidia and *Novo Nordisk* have skyrocketed and now comprise a far larger percentage of portfolios. Too much of a good thing is a problem, however, reducing diversification and introducing *concentration risk*.

It was two decades ago that Nvidia replaced Enron in the S&P 500. Since then, Nvidia's shares have collapsed by more than 50 per cent three times.

Back then, SMSF investors either invested directly via shares or indirectly by paying an active fund manager. If they were worried investments that did brilliantly like ***Cisco*** would fall, they could sell it (or part of it) to de-risk their portfolio. They locked in profits and reduced risk.

For those types of investors today, nothing has changed. But for investors in exchange-traded funds (ETFs) - the single most disruptive trend in asset management over the past two decades - things are different. ETFs are passive, rules-based investments that - unlike active fund managers - cannot deviate from what the market does.

Exposure problem

ETF investors cannot sell the best performing parts of an ETF to de-risk it. They either own the entire ETF or they don't. So they face a new risk - when stocks do brilliantly, they can't reduce exposure without selling the entire investment.

Some of the most popular international ETFs in Australia include iShares S&P 500 ETF, Betashares Nasdaq 100 ETF and iShares Europe AUD ETF. These offer cheap and easy access to the global themes of AI and weight loss drugs.

Nvidia is up 149 per cent (in USD) to June 30, last month *briefly overtaking Apple and Microsoft* as the largest stock. Novo Nordisk, the maker of Ozempic, is up 41 per cent (in EUR) YTD and is the largest company in Europe.

To put these in perspective, at the end of 2022 Nvidia comprised 1.1 per cent of the iShares S&P 500 ETF, today it is 6.3 per cent. Over the same period Nvidia jumped from 3.3 per cent of Betashares Nasdaq 100 ETF to 8 per cent. In Europe, Novo Nordisk in the same period has jumped from 2.4 per cent to 4.2 per cent of the iShares Europe AUD ETF.

Investor options

Concentration risk in industries like tech or pharmaceuticals is normal, but it is higher than normal now.

So if you own a tech ETF, a US ETF or a Europe ETF, parts of your portfolio have drastically outpaced others and you now face a dilemma.

Concentration risk has given great returns, but will these stocks keep going up forever? Or will they *eventually lose market share to competitors and fall*

What goes up *eventually comes down*, as evidenced by ***Cisco*** and Intel in 2000. What should SMSF investors do?

For those wanting even higher Nvidia exposure, there's an ETF for you. You could invest in the triple-leveraged single-stock Nvidia ETF with an 888 per cent return to June 30. It sounds more like gambling, but each to their own.

The more cautious can reduce their Nvidia exposure. If you're invested in the Nasdaq ETF, shifting to the broader S&P 500 ETF would reduce (but not remove) your Nvidia exposure. Other options could include iShares S&P Mid-Cap AUD ETF or BetaShares S&P 500 Equal Weight ETF (where every stock is capped at 0.2 per cent of the ETF).

Perhaps counter-intuitively, don't reduce your exposure. An ETF captures the entire market (or sector) performance. If Nvidia keeps rising, you'll do well. If Nvidia loses market share, its AI competitors will gain market share. The same applies to *Novo Nordisk and its competitors*.

If an ETF owns the entire market, what you lose on one stock you gain on its competitors. By owning the entire Nasdaq or the S&P 500, you don't need to time your buys or sells and you don't care if Nvidia wins the AI race - you just care that the AI race keeps running.

Veteran US investor Peter Lynch once said, "Everybody is a long-term investor until the market goes down."

When Nvidia eventually loses steam in a correction, investors will obviously be tempted to reduce exposure. But investment choices shouldn't depend on what Nvidia does, but rather whether investors believe AI has peaked or has further to run.

If the AI enthusiasm continues in 2024 and into 2025, it's hard to see how all the dominant tech stocks won't recover after any short-term correction.

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