So I recently watched an old video of one of Berkshire Hathaway's annual meetings. I personally love watching these because the answers Warren and Charlie give in their Q&A's are very straight forward, simple, and wise, if you ask me. I recently sent out a newsletter on diversification based on that video and my own personal thoughts on the subject, however here, I want to go a little bit more in debt on diversificatio. I'm sure a lot of people have heard of the 80/20 rule, which basically states that 80% of the results come from 20% of the effort. It doesn't just apply to work either, 80% of the wealth is held by 20% of the people, 80% of the engagement in a classroom, likely comes from only 20% of the students, etc. The crazy part is that it doesn't even need to be 80/20, it can be 90/10, 95/5, 99/1 even. So as you might assume, when it comes to investing, 80% of your results, come from 20% of your portfolio. This is something I've definitely noticed in my own portfolio and I've been trying to find that 20% of stocks in the stock market that can give me that 80% of the results.

There is definitely a myth that goes around that you should diversify, diversify, and when you've done that, great! Diversify some more. It is often thought that diversification for the sake of diversification is necessary to protect yourself just in case the market crashes tomorrow. But a sound investor shouldn't be worrying about whether the stock market tanks 5% today or 20% the following Tuesday, because they've put their money in good businesses. There is no point in being a walking index fund if you know how to pick stocks, it makes no sense. If your investments are keeping you up at night, maybe you should not have bought them in the first place. If you can't trust your investments, sell them, and buy something that doesn't keep you up at night. You are likely to do better with 5 really good businesses, than you are with 30 decent ones. But as Warren Buffet said in the video “diversification is a protection against ignorance,” so if you’re not clueless about identifying a good business, don’t diversify for the sake of diversifying. Put more money in the handful of good businesses that will get you the best results long term.

But, there might be times when you’ve been finding good businesses and haven’t really been selling out of many, or any, and you might build up a sizable portfolio with a variety of stocks. On the other hand, there might be times when you have 5 stocks in the portfolio, or less than that, and that’s perfectly fine. If you don’t understand it, stay away from it. Buying a lot of stocks you hardly comprehend, is likely to do you more harm than good long term. Looking at the p/e ratio isn’t enough, fully inform yourself, do all of the research, and if you really like what you see, and you’re very confident in that investment, buy it. Get good at evaluating companies, and diversification becomes useless.