

## What is Diversification?

### Suggested Grade & Mastery Level

High School - all levels

### Suggested Time

45 minutes

### Teacher Background

Because it is very difficult to accurately predict how any one company will perform over time, diversification is a strategy that helps to protect your portfolio. It is a widely used and highly successful way to reduce risk. Most financial planners agree with the admonition “don’t put all your eggs in one basket.” By investing in different types of stocks, bonds, and/or mutual funds, the value of your entire portfolio should not be wiped out if one investment fails.

The Stock Market Game is a great way for students to learn about diversifying by analyzing the stocks in their portfolio. In this lesson students learn to diversify their SMG portfolios by investing in companies from different industries. Students will use a financial website to complete this lesson.

### Vocabulary

**Diversification:** An investment strategy in which you spread your investment dollars among industry sectors.

**Index:** Reports changes, usually expressed as a percentage, in a specific financial market. Each index measures the market from a specific starting point. Some indexes are: Dow (NYSE), S&P 500 (NYSE), Russell (NASDAQ), etc.

**Industry:** A group of companies that make the same products, i.e. pharmaceutical companies

**Portfolio:** A collection of investments owned by one individual or organization.

**Risk:** The chance of losing all or part of the value of an investment.

**Risk Tolerance:** An individual investor’s ability to accept loss of some or all of the money they have invested. A person’s risk tolerance is based on a number of factors including age, financial stability, amount of time before the invested funds are needed for other purposes, etc.

**Sector:** A group of stocks, often in one industry. The performance of any single stock in a sector can be measured against the performance of the group. Pharmaceutical companies are considered in the health care sector for example.

### Performance Objectives

Students will be able to:

- Create a diversified portfolio selecting stocks from at least six industries
- Conduct internet research on investment options, write a summary of their findings and present their findings to the class
- Interpret company and industry charts to determine which investments their SMG team should make
- Define diversification, risk tolerance, industry, index

## Subject Areas

Social Studies, Mathematics, Technology, English Language Arts, Economics, Business

## Materials

- <http://finance.yahoo.com> - Students can learn about different industries and explore the top industries to help them select stocks for their teams' portfolio at the Yahoo! Finance homepage. The web page provides data on best and worst performing industries.
- [http://biz.yahoo.com/ic/ind\\_index.html](http://biz.yahoo.com/ic/ind_index.html) - Students interested in learning about different industries may find the Yahoo! Finance Industry Index of interest.
- [www.thestreet.com](http://www.thestreet.com) - Students can learn about various stocks and their performance.
- Activity Sheet 1: How diversified are these Portfolios?
- Activity Sheet 2: Industry/Sector Research
- Activity Sheet 3: How Diverse is Your SMG Portfolio?

## Springboard Activity

Write the word "diversification" on the board.

### ASK

- Where are you diversified in your current lives?
- What about the clothes you wear, the classes you take, the food you eat, etc.?
- All of your clothes don't look the same, you don't take all English classes or all math classes and you don't eat only pizza. Why do you diversify in these areas?
- What are the pros and cons of being diversified in these areas?

Spend some time discussing the responses to the questions above before proceeding to the questions below.

- Do you agree that having a diversified financial portfolio (purchasing stocks from different industry sectors) lessens the risk of losing money?
- How do you think your team needs to go about creating a diverse portfolio?

Elicit student suggestions on the last question and list them for later reference.

## Procedure

Distribute the Activity Sheet 1: How Diversified Are These Portfolios?

Have students work independently or in SMG teams to develop guidelines that their SMG team should follow to build a diversified portfolio. Afterwards, work as a class to develop a set of "Rules for Diversification."

Elicit rules such as:

- Select investments from at least three industries;
- Buy different financial products such as stocks, preferred stock, and mutual funds;
- Diversify holdings even within an industry. (This means that if investing in the entertainment industry, for example, invest in the stock of high cap company such as Disney to balance an investment in a start-up, low cap, animation company that appears to have potential for growth.)

### Novice Level:

Have students discuss the findings from **Activity Sheet 1: How Diversified are These Portfolios?**

#### ASK

- How many different industries are represented in each portfolio?
- Can a portfolio be diversified based on the quantity of shares?
- What do you notice about the portfolios? Are any “heavy” with one particular industry?

Have students complete **Activity Sheet 2: Industry/Sector Research** and meet in their SMG teams to review their current SMG Account Holdings page or plan investments.

Distribute **Activity Sheet 3: How Diverse is your SMG Portfolio?** and have each team complete side one.

### Apprentice Level:

Have SMG teams build a diversified portfolio using Yahoo financial tools. They should chart the industries they research in Excel and create a pie chart illustrating the percentage of each industry represented in their portfolios.

### Master and Grand Master Levels:

Most professional money managers specialize in one industrial sector. This allows professional money managers to become experts on the companies in their sector.

Have the members of each SMG team choose one industry sector to study so he/she becomes an expert in a sector for his/her SMG team. Have each student research five stocks in their industry sector and present his/her findings to the team.

## **Assessment**

Using the data from their research, have students create a PowerPoint presentation on diversification with a minimum of five slides and a maximum of ten.

The slides should include:

- a pie chart showing distribution of the team’s current or planned investments
- a list of the three industries team members think will help fulfill their goals for diversification and growth
- a list of at least two rules the team plans to follow to assure that their portfolios remain diversified.
- other slides, at the team’s discretion, that enhance or illustrate the concept of diversification.

### Novice and Apprentice Levels:

To reinforce what students learned in the lesson on risk, have them describe the stocks they have selected, explain the risk tolerance of each and discuss the diversification of the team’s portfolio in an oral or written presentation.

[Master](#) and [Grand Master](#) Levels:

Have each student research his/her assigned industry sector and create a presentation that convinces investors to invest in companies in that sector. Have students include growth statistics and economic factors that affect the sector they have researched.

## Application

[Novice](#) and [Apprentice](#) Levels:

Have several students list their team's portfolio from **Activity Sheet 3** on the board and compare the portfolios. Have the class discuss which portfolio best illustrates a diversified portfolio.

Have students review their current SMG portfolios to determine if they diversified. If a team decides their portfolio needs diversification, they must explain how they will go about creating diversification in it. If they feel their portfolio is diversified, they must present their reasons for reaching that conclusion.

[Master](#) and [Grand Master](#) Levels:

Form industry sector workgroups composed of experts from the SMG teams. Have these expert workgroups develop and deliver presentations to the entire class on why SMG teams should invest in their sectors. These presentations must include sector growth statistics and the economic factors that affect the sector.

## Enrichment Activities

Homework: Based upon the work completed in class, have students develop a tip-sheet to help investors diversify their financial portfolio. Make sure that they address how investors can maintain diversification when they have a specific investment strategy like socially responsible investing or investing only in companies that are less than five years old.

Teams should answer the question: If you have narrowed your investment options by deciding to follow a particular strategy, does this mean that you cannot now have a diversified portfolio? Explain your answer.