

BUILDING BLOCKS FOR RETIREMENT

Diversification

Diversification Means More Than You Think

Mike and Denise* own a home in their town's most desirable neighborhood. Denise is a chemist with a pharmaceutical company — the town's largest employer. Mike owns a popular restaurant. Denise's company offers a 401(k) plan and matches employee contributions with company stock. Denise also invests a large percentage of her own contributions in her employer's stock.



Mike's portfolio is a diversified mix of stocks and bonds. He, too, owns stock in the pharmaceutical industry. Currently, their investments — including their home and the business — are worth \$1.5 million.

At Risk

But suppose the pharmaceutical industry takes a downturn. The value of pharmaceutical stocks will most likely plummet — and the value of Denise's 401(k) account will probably plummet along with them. Since Mike owns pharmaceutical stock, his portfolio may also lose value.

And what happens if the company begins to lay off workers? Since it is a large employer, the town's economy may suffer. People may cut back on luxuries such as eating out, which would hurt Mike's business. The real estate market might be flooded with homes for sale, causing property values to drop.

Avoid a Double Whammy

When you have investments that are closely tied to the industry in which you earn your living, a downturn could affect your portfolio's value as well as your income. Money that's invested in your home may also be vulnerable to an economic slowdown, so be cautious about investing in industries that have a significant presence in your area. Diversifying your investments across several sectors of the economy may be the best strategy for managing your exposure to risk.

* This article is based on a hypothetical situation. Mike and Denise are purely fictional characters.



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