BrightPath WEALTH PLANNING, LLC | Peace Of Mind, By Design

Concentrated Stock: Minimizing Single Stock Risk in Your Portfolio

As a fiduciary, Buckingham advisors are committed to illustrating all investment options available to our clients, identifying pros and cons of each opportunity and assisting in making informed decisions based on your personal investment plan and financial life. One way we support our clients is by minimizing single stock risk in your portfolio caused by stock concentration.

Stock concentration most often occurs when you:

- Receive company stock as part of compensation
- Buy company stock through a 401k
- Acquire stock through an employee stock purchase plan (ESPP)
- Inherit shares from family members
- Purchased shares years ago and the value increased over time

We define a concentrated position as a single stock or handful of stocks making up 10% or more of someone's investable assets.

While the stock may have performed well, past performance is not an indication of future success. As the position in your portfolio grows, company news and earnings results will have a greater impact on your financial future. Below are three strategies to reduce risk in your portfolio while still owning shares.

Take Baby Steps

If the stock pays a dividend, make sure the disbursement pays to cash versus reinvestment. Since dividends are taxed when paid, this is a tax-free way to reduce the position as you are no longer buying additional shares. You can also use the cash to diversify your portfolio.

Another option is to stop purchasing additional shares unless there is an advantage to doing so, such as a discount offered in an employee stock purchase plan (ESPP). If you continue buying given the discounts of an ESPP or other program, think about selling an equal value of already vested shares to prevent adding to your overall position. This approach allows you to take advantage of the discount, incur limited taxes and stop the growth of the position.

Use Financial Instruments to Limit Downside Risk

You may want to consider options to earn income from stock holdings or protect a position from a downturn. This can be an effective strategy if there is limited price movement. You can create a floor price to sell positions, helping to take the emotion out of the investment and limit further losses. It's worth noting, these strategies can be expensive and may cause large tax consequences if the stock price moves past the option price.

Another opportunity to increase diversification without selling the position is an exchange traded fund (ETF). Investors can pool their position with other investors' concentrated positions to create their own investment vehicle. While this strategy provides some diversification, these vehicles can be costly and have limited liquidity. .

Implement Tax-Efficient Strategies to Reduce Exposure

For clients looking for more control and flexibility, gifting and tax-efficient selling may be a wise approach. Gifting is a tax-free way to reduce concentration risk in your portfolio. You can give shares directly to a charity or donor advised fund (DAF). In turn, the charity or DAF will sell the position without incurring capital gains taxes and the full amount will benefit the charity. You may also consider using your annual gifting limit to pass shares to family members who are in a lower tax bracket. Your relative can continue to hold the shares or sell them to reposition their overall portfolio.

You may also look to strategically sell shares when you are in lower income years, such as after you retire and before taking social security. Or you can consider allocating an amount for taxes each year, and sell the corresponding shares accordingly.

Whether your goal is to slow the growth of the position, hedge downside risk or work to reduce single stock risk in your portfolio, Buckingham is dedicated to educating you on the strategies available and assisting in implementing the ones that best align with your values, goals and unique circumstances.