

# The financial consequences of concentrated stock portfolios

“30 to 40 stocks are insufficient to achieve full diversification”

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## What is the focus of the paper?

This paper examines the financial consequences of concentrated stock portfolios (for example as a result of ESG strategies), using backtests on a global dataset of stocks. The researchers analyze to what extent portfolios with fewer stocks lead to concentration risk due to incomplete diversification and due to the possibility of investors experiencing regret if the specific stock selection for concentrated portfolios turns out poorly.

## What are the key findings?

The results show that, in contrast to conventional wisdom, portfolios with 30 to 40 stocks are insufficient to achieve full diversification. That requires a significantly larger number of stocks. In addition, the study finds that in concentrated portfolios the final returns can vary greatly depending on the specific selection of stocks. The authors refer to this new, second dimension of concentration risk as FOMO (fear of missing out) risk: even in portfolios with hundreds of stocks, stock selection is crucial and investors may regret their choice if it turns out poorly relative to other choices.

## What are the implications?

- Diversification in small portfolios can be improved by carefully selecting stocks based on correlations and volatility, by limiting the weight of individual stocks, and by following the market's sector distribution.
- These measures “accelerate” diversification, but even then, 30 to 40 stocks are insufficient for full diversification.
- Furthermore, the specific stock selection can lead to large differences in returns, possibly leading to regret on the part of investors if a different choice would have turned out better (FOMO).

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Want to know more? Read the paper:

**FOMO in equity markets? Concentration risk in (sustainable) investing**



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