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Don't let favorite stock derail your retirement

GUEST OPINION

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The past year has not been pretty for some individual stocks on Wall Street.

Companies once thought strong have been wiped out in a matter of a few days – their stock prices sent tumbling from $80 a year ago, to just pennies today.

The recent events reinforce the fact that holding individual stocks is extremely risky. Many investors may create false hope in that their stocks are still good, but it is the overall market that's keeping them pinned down. Just like 70 percent of people who feel they are above average drivers, many people feel the stocks they own will do better than the market and are not risky.

But the risk of an undiversified portfolio becomes more evident in market downturns such as these. The collapse of a single stock can heavily damage a portfolio with only a few stocks. It forces investors to go back and evaluate how they build and then manage their portfolios.

People acquire stocks in many different ways. The most common ways are either from their current or former employer, through inheritance or picking the stocks themselves. Usually, people have individual stocks that they are familiar with. When people are familiar with a stock, they tend to downplay the risk of that stock. Some common thoughts are: "The stock made my parents and/or grandparents wealthy, so it must be good" or "I am employed at the company, so I know the prospects of the company better than most" or they buy a well-publicized stock and say: "It has been doing well, so it should continue doing well."

Sometimes when an individual stock performs poorly, many investors will hold onto the stock and hope it comes back to the price when they bought it. Known as "anchoring" the connection with a stock takes on a bad love/hate relationship. As upset as they might be, they will give the stock another chance. The cycle can continue for a long time until the person just finally gives up on the relationship with the stock.

If the stock does begin to rise, the person will not want to sell it, because they are hoping they will get their money back. If the stock does get back to even, then they don't want to sell it because they believe it is going to really go up now. It can become a bad never-ending relationship.

The problem with holding a poor-performing or a good-performing stock is that there is opportunity cost associated with holding the stock. You must look at the risk and performance of the stock and compare it to the performance to a globally diversified portfolio with the same risk.

The main problem with people feeling that their individual stocks are not risky is the fact that everyone is talking about different stocks. Everyone has his or her favorite stock, but remember your stock may not be the same as someone else's stock. They are all different and collectively make up the total stock market.

Before you retire or transition into the next phase of your life, write down a plan to diversify your portfolio and reduce your risk. The basic plan would be to sell your large holding and invest the proceeds in a diversified portfolio over a period of time. You could sell the stock in 12 equal pieces on a monthly or quarterly basis until you are completely diversified.

If you are a company insider, make sure you clear your plan to diversify with your company's compliance department. Throughout the reorganization, you may have to pay some taxes on your gains, but that's better than risking a total loss on the single stock.

We feel it is always best to hold a globally diversified portfolio of stock and/or bond mutual funds based on your goals and risk tolerance. And while a diversified portfolio will still take some hits during a rough time on the market, there is less of a risk of losing all your money on a single stock.

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