# Diversification

## What it is and why it's important

### Your Wealth.

When it comes to investing – whether it's in the Employee Savings Investment Plan (ESIP) or elsewhere – you've probably heard the term diversification. But what does it mean?

Any time you invest money in the stock market, you're assuming a level of risk – the possibility that you could lose money. If you put most of your money into one type of investment, such as single stocks, you are at even greater risk. That's because fluctuations in the market can cause wide swings in the value of a single stock. As such, Vanguard recommends limiting your balance in company stock to no more than 20 percent of your total plan assets. Any more than that could result in risks that outweigh the potential benefits of investing in company stock.

That's where diversification comes in. A diversified portfolio is one that includes a mix of assets, including stocks, bonds and other investments. Although diversification does not ensure a profit or guarantee against loss, spreading your portfolio across several asset classes can help mitigate risk and volatility. That's because different investments react differently to the same event. So, by holding two or more types of investments, when one is doing poorly, another may be doing well, helping to offset the losses.

## How to create a diversified portfolio

The following components can make up a diversified portfolio:

- **Stocks**: Stocks represent partial ownership of a corporation. A stock can increase or decrease in value through a rise or fall in the market price of its shares. Stock prices move unpredictably based on the issuing company's performance, market swings and the state of the economy. They provide the opportunity for higher growth over the long term, but carry a greater risk of loss in the short term.
- **Bonds**: Bonds are loans made to a company, government or government agency. Most bonds provide regular interest income and are generally considered less volatile than stocks. They also tend to have lower returns over the long term. If interest rates increase, bond prices usually fall; if interest rates fall, bond prices go up.
- **Short term reserves**: These are short-term loans to creditworthy borrowers. They are designed to conserve the principal value of your investment and provide income that rises and falls with short-term interest rates. Examples are U.S. Treasury bills, certificates of deposit (CDs) and money market funds. They generally provide the lowest returns in exchange for stability and easier access to your money.

## Don't forget about time and risk

Your time horizon and risk tolerance play an important role in diversification. Your time horizon is the number of years until you'll need the money, so it's constantly changing. Your risk tolerance is your attitude toward risk. Whether you're saving for a short- or long-term goal, you should only take on a level of risk with which you're comfortable.

## Vanguard resources

Vanguard offers a number of resources to help you choose a diversified portfolio to meet your time and risk comfort level. Visit the ESIP website to learn more about the services available.