



Asset Allocation

Why Do Most Investors Choose Concentration Over Leverage?

2Q 2012

Risk is a major theme this quarter. Although equity markets have rebounded and Europe has averted another banking crisis, capital markets remain unusually uncertain. We focus on risk management as a source of “alpha” and examine the case for risk-based diversification.

Volatility is a useful measure for risk, but like any single number, it’s incomplete. There are other risks that are harder to quantify, but vital to building portfolios. Return-seeking investors must take risks the question is which to take and to understand the tradeoffs involved. In “Reflections” we consider one of the most significant tradeoffs investors face: leverage versus concentration. We find that most investors choose concentration risk, and we present arguments for an alternative approach.

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