IQIC - Portfolio Construction

#10: Building a portfolio

Portfolios as collectives

- **Picking investments vs. building a portfolio**
  - Picking asks: "Is this a good investment?"
  - Building asks: "Does this make my whole portfolio better?"
- A great stock can still be a bad fit
  - E.g. If you already own 3 tech stocks, adding a 4th just piles on more of the same risk
- A portfolio is judged as a whole, not stock by stock

Narrowing to a portfolio

- **Where do investment ideas come from?**
  - Start with your investment universe, or everything you're allowed to invest in
- **Core Process:** Start with the full universe → Filter it down with screens → Research what's left → End up with a short list
- Common filters: sector, company size, how easy it is to buy/sell, valuation, profitability
- E.g. Start with all 500 stocks in the S&P 500 → Filter down to 30 → Research and pick your best 10

Using exposures to determine fit

- **Does this investment belong in the portfolio?**
- **Risk:** How much could it swing or lose?
- **Diversification:** Does it add something new, like a different sector or country?
- **Correlation:** Does it move up and down with what you already own?
  - If it moves differently, it helps smooth out your portfolio
  - If it moves the same way, it just adds more risk
- **What you already own:** Are you already heavy in one area?
  - E.g. If 40% of your portfolio is tech, a new tech stock needs a really strong reason to get in

Portfolio weights & position sizing

- **How much do you put in each investment?**
  - This is called position sizing
- Equal weight: split your money evenly
  - E.g. $100,000 across 10 stocks = $10,000 each
- Conviction-based: put more into your strongest ideas
- Risk-based: put less into riskier investments
- Most investors set limits, like no more than 10% in any one stock
- Sizing matters as much as picking: a great idea at 1% of your portfolio barely moves the needle

What's next? Monitoring & Rebalancing.

- **Is the job done once you buy?**
  - No, a portfolio needs to be watched and adjusted over time
- As prices move, your mix drifts away from your plan
  - E.g. You start at 60% stocks / 40% bonds. Stocks rally, and now you're at 70/30 with more risk than you wanted
- Rebalancing means buying and selling to get back to your target
  - Some investors rebalance on a schedule (every quarter or year)
  - Others rebalance when something drifts too far (e.g. more than 5% off)
- Also revisit a holding if the reason you bought it no longer holds up

Putting it all together

- **Core Process:** Investment universe → Find opportunities → Check risk and correlation → Size your positions → Build the portfolio → Monitor it → Evaluate performance
- Performance evaluation uses everything from earlier: returns (Section 3) and risk-adjusted metrics like the Sharpe ratio (Section 6)
- Then the cycle repeats: what you learn from evaluating shapes your next decisions

Additional Resources

- Investor.gov: Beginners' Guide to Asset Allocation, Diversification, and Rebalancing
- Book: The Bogleheads' Guide to Investing (building, sizing, and rebalancing a simple portfolio)
- Portfolio Visualizer: Asset Correlations and Backtest Portfolio tools, to see diversification and rebalancing in action