

What is Diversification?

Suggested Grade & Mastery Level

Grades 6-8

Suggested Time

45 minutes

Teacher Background

Diversifying investments is a widely used and highly successful way to reduce risk. Most financial planners agree with the admonition “don’t put all your eggs in one basket. By investing in different types of stocks, bonds, and/or mutual funds, the value of your entire portfolio should not be wiped out if one investment fails.

Because it is very difficult to accurately predict how any one company will perform over time, diversification is a strategy that helps to protect your portfolio.

The Stock Market Game is a great way for students to learn about diversifying by analyzing the stocks in their portfolio. In this lesson students learn to diversify their SMG portfolios by investing in companies from different industries. Students will use a financial website to complete this lesson.

Vocabulary

Diversification: an investment strategy in which you spread your investment dollars among different markets, sectors, industries, and securities. The goal of the strategy is to protect the value of your overall portfolio in case a single security or market sector takes a serious downturn and drops in price.

Index: An index reports changes, usually expressed as a percentage, in a specific financial market, in a number of related markets, or in an economy as a whole. Each index — and there are a large number of them — measures the market or economy it tracks from a specific starting point, which might be as recent as the previous day or many years in the past.

Industry: A group of companies producing similar products or services.

Portfolio: A collection of investments owned by one individual or organization.

Risk: The chance of losing all or part of the value of an investment.

Risk Tolerance: An individual investor’s ability to accept loss of some or all of the money they have invested. A person’s risk tolerance is based on a number of factors



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including age, financial stability, amount of time before the invested funds are needed for other purposes, etc.

Sector: A group of stocks, often in one industry. The performance of any single stock in a sector can be measured against the performance of the group. Pharmaceutical companies, for example, are part of the health care sector.

Performance Objectives

Students will be able to:

- Define diversification, risk tolerance, industry, index.
- Conduct Internet research on different investment options.
- Interpret company and industry charts to determine which investments to make with their SMG teams.
- Create a diversified portfolio selecting stocks.

Materials

Activity Sheet 1: How Diversified are these Portfolios?

Activity Sheet 2: How Diverse is Your SMG Portfolio?

Springboard Activity

Ask your students:

- Home Depot is a hardware store. Why does it also sell tissues?
- Walmart is a discount retail store. Why does it also sell fruits and vegetables like a supermarket?
- Amazon started out as an online bookstore. Why is it selling everything from AA batteries to Nike sneakers?
- Why do you think stores just don't sell one product?

Discuss the idea that stores diversify products to increase profits by meeting a variety of customer demands.

Explain that investors protect their portfolios by diversifying their investments, just as stores sell a range of products to make more money.

Procedure

Arrange students in SMG groups. Distribute the *Activity Sheet 1: How Diversified are these Portfolios?*



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Novice Level

Guide the students through the first portfolio.

Ask

1. How many different stocks are in the portfolio?
2. How many different industries are represented in the portfolio?
3. How many shares are in each stock?
4. Can a portfolio be diversified based on the quantity of shares?

Have students discuss Portfolios B and C in their SMG teams and agree on a definition of diversification based on the analysis of the portfolios. Record their responses.

Have the SMG teams review their current SMG account holdings or their planned investments. Distribute *Activity Sheet 2: How Diverse is your SMG Portfolio?* Have each team complete side one and rate the diversification of their portfolios on a scale of 1 to 5.

Apprentice Level

Have SMG teams complete *Activity Sheet 1: How Diverse are these Portfolios?* to establish criteria for a diversified portfolio.

Have the teams review their current SMG account holdings or their planned investments. Distribute *Activity Sheet 2: How Diverse is your SMG Portfolio?* Have each team complete side one and rate the diversification of their portfolios on a scale of 1 to 5.

Have students build a diversified portfolio using Yahoo Financial Tools and chart the industries using an E spreadsheet.

Have them create a pie chart in EXCEL illustrating the percentage for each industry.

Master and Grand Master Levels:

Have SMG teams complete *Activity Sheet 1: How Diverse are these Portfolios?* to establish criteria for a diversified portfolio.
Have teams review their current SMG account holdings or their planned investments. Distribute *Activity Sheet 2: How Diverse is your SMG Portfolio?*

Have each team present "Putting our Plan into Action" to class using PowerPoint or some other presentation tool. (Names/Tickers of specific companies in portfolio may be omitted to protect the team's position.)

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Assessment

Novice and Apprentice Levels:

Have each student write a paragraph explaining diversification and giving examples of how investors can diversify their portfolios using stock bonds and savings.

Master and Grand Master Levels:

Have each student develop an investment strategy for a 60 year old person retiring in five years who can invest 100,000 but cannot afford to lose money and explain why his/her strategy is the best plan for the investor.

Application

Novice and Apprentice Levels:

Have students review their SMG portfolio to analyze the diversification of their holdings. Have them write a plan to diversify and improve the portfolio.

Master and Grand Master Levels:

Have SMG teams examine their holdings from one industry sector. Have them research the sector and explain to the class why they may change their holdings in companies in that industry sector.

Enrichment Activities

Have students develop a diversification tip-sheet based on what they have learned. Have each SMG team develop a strategy for investing; i.e.: invest in environmentally friendly companies; invest in new, entrepreneurial companies.

Ask

If you have narrowed your investment options by deciding to follow a particular strategy, does this mean that you cannot now have a diversified portfolio? Explain your answer.

Answer Keys

Activity 1

Which is the most diversified portfolio listed below? Explain.

Portfolio C is the most diversified since there is a wider range in the types of companies, unlike Portfolio A and B that have more of the same type of companies.



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Using the stocks listed above, create a diversified portfolio using this chart. Pick at least one stock from each portfolio.

Answers may vary. Below is an example of what responses may look like.

Symbol	Quantity	Industry
FISV	100	Business Software
SBUX	200	Specialty: Eateries
JPM	100	Bank
RAIL	100	Railroad
EBAY	100	Ebay
CSK	100	Paper Products
TIF	200	Jewelry
ESRX	100	Health Services
UNS	200	Electric: Utilities



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Activity Sheet 1: How Diversified are these Portfolios?

Portfolio A		Portfolio B		Portfolio C	
Symbol/ Quantity	Industry	Symbol/ Quantity	Industry	Symbol/ Quantity	Industry
FISV 100	Business Software	JPM 100	Bank	SBUX 500	Specialty: Eateries
TD 100	Bank	AAPL 150	Personal Computer	TIF 200	Jewelry
ADES 100	Specialty Chemicals	INTC 200	Semi- conductors	BK 100	Banks
NYT 100	Publishing Newspaper	GOOG 100	INT-info Provider	GOOG 100	INT-info Provider
ALL 100	Insurance	MSFT 300	Software	CSK 100	Paper products
CI 100	Healthcare	EBAY 100	Online Retail	NCC 100	Banks
RAIL 100	Railroad	DELL 300	Personal Computer	UNS 700	Electric: Utilities

Which is the most diversified portfolio listed below? Explain

Using the stocks listed above, create a diversified portfolio using this chart. Pick at least one stock from each portfolio.

Please explain the thought behind your choices.

Symbol	Quantity	Industry



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Activity Sheet 2: How Diverse is your SMG Portfolio?

On the table below list the shares in your SMG Portfolio or planned portfolio. Use market cap to determine risk tolerance – A **Small Cap** company: Less than \$1 billion; a **Mid Cap** company: \$1 billion to \$5 billion; a **Large Cap** company: Over \$5 billion.

SMG ACCOUNT HOLDINGS			
Ticker Symbol	Shares Held	Company	Risk Tolerance
NKE	300	Nike	High, mid-cap (127B)

**The information provided is for instructional purposes and does not reflect current stock quote information*

On a scale from 1 to 5; with 5 the most diverse, rate your SMG portfolio:

1 2 3 4 5

ACTION PLAN: List the steps your team plans to diversify your SMG Portfolio.

Putting Our Plan into Action: Review the chart and discuss your findings with your team. After completing the chart decide your investment strategies. Use market cap to determine risk tolerance – A **Small Cap** company: Less than \$1 billion; a **Mid Cap** company: \$1 billion to \$5 billion; a **Large Cap** company: Over \$5 billion. If your account holdings are classified as high risk, find ways to minimize the risk. Be sure to consider the inclusion of bonds and mutual funds.

Investment Type– Stocks, Bonds, Mutual Funds, EFT	We selected this investment based on: <ul style="list-style-type: none"> • performance compared with other companies • market capitalization • potential for moderate and sustained growth other: specify	Risk Tolerance Level High, Medium or Low (use market capitalization)	Share Ticker and Quantity