

Opinion [Investing in funds](#)

How many stocks should a portfolio hold?

There are good arguments for holding many more than 30 stocks

JAMES HENDERSON



Croda, a company that started in business by extracting lanolin from sheep wool has been one of James Henderson's successful investments © Joann Randles/Cover Images/Reuters

James Henderson YESTERDAY

The story of 20-year-old student Jake Freeman, who made \$110mn (£93.7mn) trading shares in Bed Bath & Beyond, seems to have [angered](#) a surprising number of people.

He invested in a single stock every dollar he and his friends could scrape together — \$27mn of them it turns out. People seem undecided between being most irritated by his wealth or his luck. The outcome could have been very different.

The story raises the question of how many stocks an investor should hold. Academic research typically suggests 20 to 30 provide enough diversification to restrict the impact of a single stock imploding while offering the potential for reasonable returns.

It is also popular to argue that investors have only a limited number of good ideas. For strong performance they need to back those ideas with [strong conviction](#).

Consequently, portfolios must have only a short list of holdings. So ubiquitous is this

argument it may seem curious that I am now going to argue the opposite.

Risk taking

Early in my fund management career I was reprimanded during an annual review for my lack of *bad* performance.

It had been a strong year for the portfolio. When my senior colleague asked which companies had been disasters, I was quick to reply, rather smugly: “None!” His response took me by surprise. “You can’t be taking enough risk, then. It’s like tennis — if you don’t serve some double-faults you’re not trying to hit the second serve hard enough.”

While it is frustrating when a holding disappoints, an investment that goes wrong can cost your portfolio only the amount that was put in. Successes, on the other hand, can generate many multiples of the original price.

Over the years I have experienced failure and success many times. I still smart over construction company Carillion, whose real debt position was understated in its accounts.

But I can look back on some big winners. Perhaps one of the best was [Croda](#), a Yorkshire business that extracted lanolin — the grease found in sheep wool — for cosmetics, leather dressing and as a waterproofing agent. It grew into a multinational specialist chemical business. I bought the shares at £1.70 in the early 1990s. It is around £67 today.

Smaller-cap investing, which I specialise in, often produces a binary outcome — great success or abject failure. By holding 100-120 stocks I mitigate the potential damage of failures and increase my chances of unearthing winners. This is the opposite of focused investing but is not investing without focus.

To boldly go

Longer lists allow you to be more pragmatic. They allow you to become bolder — to serve harder. With a long list you can test a more diverse array of companies early in their path to growth — opening the door to some of the best potential returns from running your winners.

You can wait patiently for the slow burners to ignite — I think of [Serica Energy](#), whose share price went sideways for several years but is up 120 per cent in the past year. You

can slowly add to holdings as confidence builds and back managers you trust who are attempting to change the fortunes of a flagging or stagnant company. In every market cycle many of the best returns come from companies that are turnarounds.

A good example is Johnsons Service Group, a provider of hotel laundry services and workwear, which, awash with debt, faced a near-death experience in the 2008-09 financial crisis. We had a small holding and participated in a rescue rights issue, taking on extra shares. The focus of the business shifted to textile rental — table linen, towels and bedding, as well as workwear for various industries.

It has been a good recovery story. Covid and recession fears mean it has dropped back sharply from its £2.15 high in February 2020, but at 91p it is still much higher than the 2008 rescue rights issue price of 20p. Fortunately, we took some profits near the highs.

High-conviction investment managers will probably want more reassurance and certainty that a company is as it appears, enabling them to tick all the process boxes. They will prefer companies and management to have a long-term record, making it harder to back early-stage companies.

They will want substantial evidence that turnarounds *are* turning. This is probably sensible if you are running a small number of stocks. But the problem with this approach is that once all the boxes are ticked the valuation of the company tends to be high. Share prices climb a wall of worry in investor perceptions. To get a bargain it is usually necessary to buy before all the issues are resolved.

The impact of failures is less damaging if holdings are small but that does not mean you can become lax about good investment disciplines. Each company you hold will face challenges and risks. It is important to ensure they are not the same risks — that your portfolio is diversified. When a holding becomes expensive — or when confidence is lost in the management — a long list must not be an excuse for hanging on and hoping. Every holding must matter and be closely watched.

Stay vigilant

This brings me to one of the perceived problems with long lists — how to properly follow lots of companies. I could flip this concern the other way. How does a high-conviction manager — or a **DIY investor** — with a short list of holdings know that the

conviction manager of a [DIY investor](#) with a shortlist of holdings know that the stocks are relatively good value if the manager is not looking at and understanding the alternatives in the market?

Running long lists can be hard for a DIY investor. It takes time. The costs of trading stocks in smaller proportions undermine profitability, too.

I think 10 good large-cap stocks is enough to form a core equity portfolio for most private investors who have the time and expertise to do their research and monitor their portfolio. I assume they will hold other assets — some bond funds, cash, property — so they have portfolio diversification beyond these stocks. They might then have some “longlist” funds run by managers specialising in small- and mid-cap companies.

My core argument here is not to say how a portfolio should be run but to try to rebalance much of the modern commentary that I believe over-emphasises the benefits of “shortlist”, high-conviction investment. There is no one correct method to construct a portfolio.

Each investor needs to find an approach that suits their temperament, time and talent. Unless, of course, this leads you to throw every penny you have at one stock. Freeman’s experience notwithstanding, that is a strategy far too likely to leave you without a bed or a bath but in hot water.

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