

The Importance of Diversification: Spreading the Risk

by Ted Dawson, Consultant

October 2025

Don't Let One Bet Define Your Outcome

“Never test the depth of the river with both feet”, Warren Buffett cautioned; a reminder that overconfidence in a single investment can be costly.¹ Behavioral finance shows that humans are prone to recency bias, chasing last year's winners and underestimating the possibility of sudden reversals.

Consider the investor who puts everything into a single “can't-miss” stock or sector. When that bet pays off, the rewards can be outsized. But when the tide turns, losses can be swift and severe. History is littered with examples: from the tech bubble to the financial crisis, concentrated portfolios have often magnified pain during downturns.

Diversification isn't about diluting conviction; it's about acknowledging the limits of foresight. By spreading investments across asset classes, sectors and geographies, the risk is reduced that any one event can derail your financial goals. The result is a portfolio that is more resilient, less vulnerable to shocks and better positioned for long-term growth, even if you don't “know” what's coming next.

What is Diversification

Diversification is the practice of spreading investments across different asset classes, sectors and regions. Effective diversification goes beyond just having many holdings. It's about choosing investments with different drivers. Instead of relying on one stock or market, blended assets may react differently to economic events.

A well-diversified portfolio could include various:

- **Asset classes:** Stocks, bonds, real assets and alternatives
- **Geographies:** U.S. and international markets
- **Sectors:** Technology, healthcare, energy and more
- **Styles:** Growth vs. Value, for example

¹ [Warren Buffett Quotes: 10 of My Favorites: TheCorporateCounsel.net Blog](#)

This report is intended for the exclusive use of clients or prospective clients (the “recipient”) of Fiducient Advisors and the information contained herein is confidential and the dissemination or distribution to any other person without the prior approval of Fiducient Advisors is strictly prohibited. Information has been obtained from sources believed to be reliable, though not independently verified. Any forecasts are hypothetical and represent future expectations and not actual return volatilities and correlations will differ from forecasts. This report does not represent a specific investment recommendation. The opinions and analysis expressed herein are based on Fiducient Advisor research and professional experience and are expressed as of the date of this report. Please consult with your advisor, attorney and accountant, as appropriate, regarding specific advice. Past performance does not indicate future performance and there is risk of loss.

The key is correlation: choosing investments that don't all move together. When one area struggles, others may hold steady or even rise, helping to smooth out returns over time.

Below, note how the leaders and laggards change each year. No single asset class consistently outperforms - diversification matters.

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	10 Years (Ann)
U.S. Equity REITs 2.8	U.S. Small Cap 21.3	Emerging Markets Equity 37.3	High Yield Municipals 4.8	U.S. Large Cap 31.4	U.S. Large Cap 21.0	U.S. Equity REITs 41.3	Commodities 16.1	U.S. Large Cap 26.5	U.S. Large Cap 24.5	Emerging Markets Equity 27.5	U.S. Large Cap 15.0
Municipals 5-Year 2.4	High Yield 17.1	International Developed Equity 25.0	Cash 1.8	U.S. Mid Cap 30.5	U.S. Small Cap 20.0	Commodities 27.1	Cash 1.5	International Developed Equity 18.2	U.S. Mid Cap 15.3	International Developed Equity 25.1	U.S. Mid Cap 11.4
High Yield Municipals 1.8	U.S. Mid Cap 13.8	U.S. Large Cap 21.7	Municipals 5-Year 1.7	U.S. Equity REITs 28.7	Emerging Markets Equity 18.3	U.S. Large Cap 26.5	Hedge Funds -5.3	U.S. Mid Cap 17.2	U.S. Small Cap 11.5	U.S. Large Cap 14.6	U.S. Small Cap 9.8
U.S. Large Cap 0.9	U.S. Large Cap 12.1	U.S. Mid Cap 18.5	U.S. Core Bond 0.0	U.S. Small Cap 25.5	U.S. Mid Cap 17.1	U.S. Mid Cap 22.6	Municipals 5-Year -5.3	U.S. Small Cap 16.9	Balanced 10.8	Balanced 13.5	International Developed Equity 8.2
U.S. Core Bond 0.5	Commodities 11.8	Balanced 15.4	TIPS -1.3	International Developed Equity 22.0	Balanced 13.5	U.S. Small Cap 14.8	High Yield -11.2	Balanced 15.4	Hedge Funds 9.1	U.S. Mid Cap 10.4	Emerging Markets Equity 8.0
Cash 0.0	Emerging Markets Equity 11.2	U.S. Small Cap 14.6	High Yield -2.1	Balanced 19.4	TIPS 11.0	International Developed Equity 11.3	TIPS -11.8	High Yield 13.4	High Yield 8.2	U.S. Small Cap 10.4	Balanced 8.0
Hedge Funds -0.3	U.S. Equity REITs 8.6	High Yield Municipals 9.7	U.S. Equity REITs -4.0	Emerging Markets Equity 18.4	Hedge Funds 10.9	Balanced 10.2	U.S. Core Bond -13.0	U.S. Equity REITs 11.4	Emerging Markets Equity 7.5	Commodities 9.4	U.S. Equity REITs 6.8
International Developed Equity -0.8	Balanced 5.9	U.S. Equity REITs 8.7	Hedge Funds -4.0	High Yield 14.3	International Developed Equity 7.8	High Yield Municipals 7.8	High Yield Municipals -13.1	Emerging Markets Equity 9.8	High Yield Municipals 6.3	High Yield 7.2	High Yield 6.2
Balanced -1.0	TIPS 4.7	Hedge Funds 7.8	U.S. Large Cap -4.8	High Yield Municipals 10.7	U.S. Core Bond 7.5	Hedge Funds 6.2	International Developed Equity -14.5	High Yield Municipals 9.2	Commodities 5.4	TIPS 6.9	High Yield Municipals 4.4
TIPS -1.4	High Yield Municipals 3.0	High Yield 7.5	Balanced -5.5	U.S. Core Bond 8.7	High Yield 7.1	TIPS 6.0	Balanced -16.0	Hedge Funds 6.1	Cash 5.3	U.S. Core Bond 6.1	Hedge Funds 4.2
U.S. Mid Cap -2.4	U.S. Core Bond 2.6	U.S. Core Bond 3.5	U.S. Mid Cap -9.1	TIPS 8.4	High Yield Municipals 4.9	High Yield 5.3	U.S. Mid Cap -17.3	U.S. Core Bond 5.5	U.S. Equity REITs 4.9	Hedge Funds 5.2	Commodities 4.0
U.S. Small Cap -4.4	International Developed Equity 1.0	Municipals 5-Year 3.1	U.S. Small Cap -11.0	Hedge Funds 8.4	Municipals 5-Year 4.3	Municipals 5-Year 0.3	U.S. Large Cap -19.1	Cash 5.1	International Developed Equity 3.8	U.S. Equity REITs 4.5	TIPS 3.0
High Yield -4.5	Hedge Funds 0.5	TIPS 3.0	Commodities -11.2	Commodities 7.7	Cash 0.5	Cash 0.0	Emerging Markets Equity -20.1	Municipals 5-Year 4.3	TIPS 1.8	Municipals 5-Year 4.5	Cash 2.1
Emerging Markets Equity -14.9	Cash 0.3	Commodities 1.7	International Developed Equity -13.8	Municipals 5-Year 5.4	Commodities -3.1	U.S. Core Bond -1.5	U.S. Small Cap -20.4	TIPS 3.9	U.S. Core Bond 1.3	Cash 3.2	Municipals 5-Year 1.9
Commodities -24.7	Municipals 5-Year -0.4	Cash 0.8	Emerging Markets Equity -14.6	Cash 2.2	U.S. Equity REITs -5.1	Emerging Markets Equity -2.5	U.S. Equity REITs -7.9	Commodities -7.9	Municipals 5-Year 1.2	High Yield Municipals 1.3	U.S. Core Bond 1.8

Sources: Morningstar, FactSet. As of September 30, 2025. *Periods greater than one year are annualized. Total returns in U.S. dollars. Hedge Funds as of August 31, 2025.

Three Potential Benefits of Diversification

Behavioral differentiator

Less whiplash supports better decisions. By reducing the frequency and severity of “gut-check” moments, diversification helps investors stick to policy, rebalance on schedule, stay invested and avoid costly market-timing mistakes that arise when volatility bites.

Efficiency

Diversification can improve risk-adjusted returns, the return received for each unit of risk, by combining assets so the whole is more efficient than the parts. Combining assets with different risk/return profiles and correlations can place a portfolio closer to the efficient frontier, where you either take less risk for the similar return or seek more return for similar risk. It's the portfolio-level benefit that security-by-security thinking can miss.

Resilience

By spreading investments across regions and sectors, a portfolio is built with the goal to withstand surprises. Whether it's a sudden policy change, a market shock or a natural disaster, diversification helps ensure that no single event derails your financial goals.

What Diversification is Not

Diversification doesn't mean your portfolio is immune to losses. It may help reduce the risk of any single investment hurting your results, but it can't shield you from broad market declines or systemic shocks. It's not a one-time fix, either. As asset correlations and market trends shift, a diversified portfolio needs ongoing attention. Without regular rebalancing, your mix can drift and lose its protective benefits.

And more isn't always better. When too many similar investments are added, one may think they're spreading risk. In reality, overlapping holdings can concentrate risk in disguise. Effective diversification is about thoughtful selection, not just quantity.

Putting it to Work: A Practical Checklist

Start with objectives & constraints.

Clarify purpose, time horizon and liquidity needs (emergency cash, near-term withdrawals). Align risk tolerance with what you can *financially* and *emotionally* withstand.

Build the core.

Use broad, low-cost building blocks across equities, bonds and real assets, where suitable. Favor diversified index or core funds to capture market beta efficiently before adding complexity. Keep position sizes meaningful and avoid overlapping that could add cost without new risk or return exposure.

Add diversifiers thoughtfully.

Introduce non-U.S. and small/mid-cap exposures to broaden opportunity, where suitable. Value/quality tilts, inflation-aware and tax-advantaged income are also helpful diversifiers.

Rebalance on a cadence or band.

Choose rules you'll follow in good and bad markets. Examples: calendar-based (quarterly/annual) *or* band-based (rebalance when weights breach set thresholds) to enforce buy-low/sell-high behavior.

Consider costs & taxes.

Benchmark every holding's expense ratio against lower-cost alternatives. Keep in mind after-tax strategies like asset location, tax-loss harvesting and minimizing realized short-term gains, so every basis point supports your objective.

Common Questions About Diversification

How many funds do I need?

Focus on capturing distinct sources of return, different asset classes, regions and styles. More tickers don't always mean more diversification; overlapping holdings can recreate the same risk.

What if everything falls at once?

During market stress, correlations can spike and even diversified portfolios may decline together. The goal is to reduce risk concentration, not eliminate risk. Diversification can help cushion the impact, but it cannot prevent all losses.

When should I adjust?

Review your portfolio when your goals, timeline or risk tolerance change. Otherwise, stick to your rebalancing policy, adjusting only when allocations drift outside set bands or on a regular schedule.

Do I need alternatives (private credit, hedge funds, etc.)?

Only if they serve a clear role (income, diversification outside traditional public equities) and you accept illiquidity, fees and complexity.

How much cash should I keep?

This will vary per investor. Generally, keep near-term needs (e.g., 6–12 months of spending) in cash or cash equivalents so long-term assets can stay invested.

Don't let recency bias or overconfidence steer your investment journey. It's tempting to chase last year's top-performing asset, assuming the trend will continue. Markets are cyclical, and yesterday's winners can quickly become tomorrow's laggards. By diversifying, you avoid putting all your faith in a single story and give yourself a better chance to capture returns across different environments.

For more information, practical tips, research and updates on building more diversified portfolios, [sign up for Fiducient Insights](#).

About the Author



Ted Dawson
Consultant

Ted provides investment consulting and financial planning services to private families, corporate executives, nonprofit organizations, family trusts and other substantial investors. He focuses on providing clients personalized advice and expertise on portfolio design, asset allocation, investment policy statements, manager search process and overall investment management. Prior to joining the firm, Ted served as an Associate Financial Advisor at Merrill Lynch. He graduated from Boston College with a bachelor's degree in political science and economics. In his free time, Ted enjoys golfing, skiing, fishing and camping.