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Portfolio Perspectives: Want to Diversify Concentrated Positions? 3 Ways to Manage Risk & Preserve Wealth

By Dynamic's Asset Management Team

A concentrated stock position isn't the result of poor planning; it's the result of your success.

Whether that success was a long career at a growing company, shares that have been passed down through generations, or founders' equity that's appreciated significantly. A single stock, or a small group of stocks, may now represent a disproportionately large percentage of total investable assets.

However, when 20% or more of a portfolio is tied to one company, the opportunity created by that success can also introduce meaningful risk. The key is not simply to reduce concentration but to do so thoughtfully, tax-efficiently and in alignment with long-term goals.

What Is a Concentrated Stock Portfolio?

A concentrated stock portfolio exists when a significant portion of an investor's wealth is invested in one company or a handful of securities. In many cases, these positions also carry substantial unrealized capital gains.

This type of concentration often develops through:

- Inherited stock with a low-cost basis
- Restricted stock units (RSUs) or other equity compensation
- Founder or executive ownership
- Long-term appreciation of a single holding

While concentration can feel reassuring — especially when the company is familiar or personally meaningful — it can also introduce risks that are easy to underestimate.

The Risks of Concentration

The most obvious risk is single-company risk. If that company underperforms, faces regulatory pressure or experiences unexpected challenges, the impact on overall wealth can be significant. But concentration risk extends beyond company-specific headlines.

Individual stocks tend to be more volatile than diversified portfolios — meaning larger swings in value, both up and down. For executives and employees, there may also be correlation risk: income, benefits and investments may all be tied to the same organization.

There's also opportunity cost. A portfolio heavily weighted toward one stock may miss out on growth opportunities across other sectors or asset classes. And for many investors, the tax implications create an additional challenge. Selling shares to diversify may trigger substantial capital gains taxes, making it difficult to act even when it's financially prudent. The result is often a feeling of being "stuck" between risk and taxes.

3 Ways to Diversify Concentrated Positions

The good news: Investors aren't limited to an all-or-nothing decision. Here are three strategies to discuss with your financial advisor that can help manage risk, improve diversification and potentially reduce the tax impact:

1) Direct Indexing

Direct indexing allows investors to replicate a benchmark, such as the S&P 500, by owning the individual stocks that make up the index rather than purchasing a mutual fund or ETF.

This structure provides greater flexibility. Because the underlying securities are owned directly, portfolios can be customized around existing concentrated positions. It also enables ongoing tax-loss harvesting, potentially generating tax savings that can help offset gains elsewhere in the portfolio.

Plus, the tax-loss harvesting from direct indexing can be used to sell down a concentrated stock over time.

For investors seeking diversification without sacrificing tax efficiency, direct indexing can be a powerful tool.

2) Option Overlay Strategies

Options can also be used to manage concentrated positions without immediately selling shares.

Protective put strategies may provide downside protection by establishing a price floor on a highly appreciated stock. *Covered call* strategies can generate income while reducing some exposure to further upside volatility.

Bonus: The protective put and covered call strategies can be combined to achieve the best of both worlds.

When thoughtfully implemented, option overlays can help investors manage risk, generate income and potentially defer capital gains, particularly in situations where preserving wealth is more important than maximizing additional upside.

3) Exchange Funds

For investors with long-time horizons who prioritize tax deferral, exchange funds offer another alternative.

In an exchange fund, investors contribute their concentrated stock to a pooled vehicle alongside other investors with their own concentrated positions. In return, they receive units of a diversified portfolio. After a required holding period, investors can exit the fund with a diversified basket of securities.

This approach allows for diversification without an immediate taxable event, though it requires patience and careful planning.

Turning Concentration into Opportunity

A concentrated position can be both a strength and a vulnerability. It often represents years of hard work, loyalty and success. But preserving that success requires moving from passive exposure to intentional strategy.

Managing concentration isn't about abandoning a company you believe in. It's about aligning your portfolio with your broader financial goals: reducing uncompensated risk, improving diversification and being mindful of tax implications along the way.

Your advisor can work with you to evaluate concentrated positions within the context of your entire financial picture. The right approach depends on time horizon, tax considerations, liquidity needs and risk tolerance. But with thoughtful planning and the right tools, concentration can shift from a source of anxiety to a well-managed component of long-term wealth strategy.

Invest with intention.

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