Reprinted from:

THE NATION'S OLDEST WEEKLY BUSINESS JOURNAL

DENVER BUSINESS JOURNAL

VOL. 57 NO. 11 **September 23-29, 2005** 72 PAGES **$2.00**

Compliments of

INNOVEST PORTFOLIO SOLUTIONS

Diversification a key to help you preserve wealth

We all know someone who had significant wealth in one stock without any thought of hedging or diversifying -- only to see it plunge as the markets and economy changed. In the late 1990s, these huge positions were frequently in the technology sector.

PERSONAL FINANCE

RICHARD TODD

It's clear the same circumstances exist today for many in the energy and real estate markets. Perhaps there isn't a bubble in these sectors (some argue there is), but any time a single security represents a large portion of one's net worth, a thoughtful analysis should be conducted.

Strategies that should be considered include:

- **The outright sale.**

With long-term capital gain rates at 15 percent or less, selling a whole or partial position can be a solid move. Proceeds can be diversified to reduce portfolio risk and complement the remaining low basis stock.

- **Option hedging strategies.**

A put hedge is simply an insurance contract that guarantees a minimum sale price. Costs vary depending on length of time and the price floor -- the higher the floor, the more the cost. A "cashless" hedge involves also selling a call option against the stock to pay for the hedge. This is frequently called an equity collar.

The risk is that the upside on the stock is limited and the investor is in jeopardy of having their stock sold. Equity market volatility has been low the last few years, and equity collars have worked well for some investors.

- **Prepaid variable forward sales.**

Brokers sell pre-packaged products that make an immediate cash payment against the stock to allow for diversification. These contracts work when an outright sale doesn't make sense. Fees can be steep, however, and can be up to a 5 percent interest cost on the payment and up to 3 percent in commissions.

- **Exchange Funds.**

Investors deposit their concentrated positions in a private placement limited partnership comprised of many concentrated investors. No capital gains are triggered and the investor receives an ownership stake in a pool proportionate to the value of their contribution leading to better diversification.

When investors leave the fund, they receive a prorated share of the individual stocks in the fund. Expenses can be high, with management fees of 1 percent or more and 2 percent, plus private placement fees.

- **Charitable giving and other charitable techniques.**

There are many strategies for those that are charitably inclined.

An outright gift on a low basis stock (as opposed to cash) is obvious, but other techniques can allow the shareholder to receive the charitable tax deduction and a lifetime income. The transaction, however, is irrevocable and will involve a direct reduction of net worth, unlike traditional hedging strategies.

One of the most cost-effective ways to get better diversification is to make sure assets outside of the concentrated position are complementary. Frequently, the owner of an oil company, for instance, is not only heavy in their own company, but loaded with other energy stocks – "that's my business and that's what I know."

Concentration has created great wealth for investors, Diversification preserves it.

Richard Todd is a consultant and principal of Innovest Portfolio Solutions in Denver. Reach him at 303-694-1900 or richt@innovestinc.com