Brainy's Articles on

Share Trading**

Percent of portfolio
How much to invest?

Introduction

"I want to invest in a portfolio of shares, but how much of my investment capital should I commit to any one share parcel?" This is just one of the many questions that investors and traders ask when investing in the markets.

This Article in Brainy's series on Share Trading and Investing (number ST-6220) provides an insight into the subject of portfolio construction, and dwells on some aspects for the benefit of both share market investors and traders.

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Overview

In the ideal world, a new investor in the share market might start out with about $50,000 to invest (after lots of planning, preparation and careful consideration). But why $50,000? Could we manage with just $1,000 or less — like some experts recommend? See the very brief discussion on page 3 below which explores this topic. But let's just ignore the actual amount of money at this stage, and consider the question: *"What percentage of my investment capital should I invest into each parcel of shares?"*

Some investors who only have a relatively small amount of money (say $1,000) are happy to invest the whole lot into one parcel of shares. This means that if they don't choose wisely and the company goes belly-up, it might take all of their money.

For those investors who have a reasonable amount to invest, some of them are happy to invest up to about 20% of their capital into each share parcel, so their portfolio might be comprised of shares in just five companies. That is, if they have $50,000 for investment, they might invest $10,000 into each of five companies. Or if the investor has $100,000, they might invest $20,000 in each of five companies. But this imposes limitations on the investment activity. Understand why in the section, ***"About 10 companies? or 10 percent?"***, below.

Minimum parcel size

Before we look at how many companies to invest in, we ought to spend a minute to consider the minimum *parcel size*. That is, if I only have, say, $2,000 to invest in shares, is there anything wrong with investing $1,000 in each of two companies?

The short answer to this is: yes — there is a problem with this. In fact, there are two problems. The first problem is to do with risk and is related to a lack of diversification. But this is discussed in other eBook articles. Another type of risk with this situation is that if the company goes bust, then you have lost half of your investing capital. The second problem is the impact of brokerage fees, and this is discussed in the next paragraphs.

Don't forget that every time you buy a *parcel of shares*, and each time you sell a parcel, you need to pay a *brokerage fee*. If you use a *full service broker*, the brokerage fee might be in the order of $70 for each *trade*, for a grand total of $140 to buy, and then one day sell, the parcel. If you use an *online broker* and pay only $20 brokerage each way, that will be a total of $40 for what we call a *round trip*.

So, if you want to buy $1,000 worth of shares in one company, you will pay at least $40 brokerage (and up to about $140) by the time you sell the parcel and hopefully see a profit. For your share parcel to just break-even, the shares will need to increase in value by just $40 from $1,000 to $1,040 — that's a 4% increase just to break-even. If you actually want to achieve a 4% return, for example, (before inflation), then the shares will need to achieve an 8% increase in value. If you are hoping to amass some wealth in a reasonable time frame, then this sort of return is not very spectacular, and it might take you a while. And it will be worse if you pay a higher brokerage fee than $20 each way.

** - The two words *trading* and *investing* are often used somewhat interchangeably.

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are not available for free.

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and the Introduction and Overview pages.

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