Understanding concentrated stock positions

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A concentrated equity position can disproportionately affect your portfolio risk and return, which can have a significant impact on your ability to achieve your goals.

We outline strategies to help you better understand your concentrated position and the actions you can take to manage the position. Although there is no single definition of a concentrated stock position, a common description is a single equity stake that is 10% or more of a total portfolio allocation.

For investors with concentrated positions, we propose the following broader definition: A position whose return, risk or other characteristic dominates overall portfolio performance and can meaningfully interfere with an investor’s ability to achieve their financial goals.

For those fortunate enough to see their wealth accumulate through equity growth, the resulting concentrated equity position poses a high-risk, high-reward potential that can continue to build on wealth, but unfortunately, all too often, has resulted in capital destruction when the risks are not properly managed or diversified.

Generally, concentrated stock positions generate less reliable returns, are less resilient to external shocks, and may deliver less repeatable returns compared to holding a broad equity index. In our report Concentrated positions – How to manage the risks, we outline the importance of understanding these risks, the historical impact of a single security, and the benefits of diversifying and mitigating the risks of such positions.

Depending on your personal goals, risk appetite, tax, legal, and personal situation, there are a variety of strategies you can consider to help you manage the concentrated position:

\textit{Reduce and diversify}
If you are willing and able to reduce your concentrated position, creating a tax-efficient plan to sell and invest proceeds into a diversified equity index is one of the most impactful strategies to reduce concentrated risks and create a more stable risk-return profile. Evaluate the trade-off relative to your financial goals to right-size a position. Modest adjustments can often have a large impact when diversifying with an index. Corporate insiders can also set up a 10b5-1 plan to systematically sell their position while avoiding appearance or accusations of insider trading.

**Factor completion portfolio**
If you wish to retain your concentrated position, your financial advisor can help you to analyze the common market factors that are driving performance of your concentrated stock, and build a complementary equity portfolio that mitigates overexposure, or doubling-down on the risk factors inherent in the concentrated position, while optimally sizing diversifying factors and overall risks. The combination of this complementary portfolio with the concentrated stock position will provide a more diverse set of return drivers that can lower the total volatility of your wealth towards the goal of a more robust, holistic wealth experience.

**Exchange fund**
Another potential solution for achieving diversification, while deferring taxation, is through an exchange fund, where you exchange shares of selected stocks for shares in a professionally managed, diversified portfolio. This approach allows you to access the benefits of a diversified portfolio of stocks without triggering capital gains until the diversified portfolio is sold. Talk to your financial advisor about liquidity, holding period requirements of this type of strategy.

**Equity collar**
If you are unwilling or unable to reduce your concentrated position, options strategies are one solution to help protect the value of the concentrated position, while continuing to participate in some of the potential price appreciation or dividends. Forming an equity collar by selling out-of-the-money calls and buying puts allows the position to appreciate up to a point, but also limits losses on the downside. The amount of upside participation and downside protection can be tailored. It is important to consider the maturity date, shape of the volatility curve, and the costs of implementing this strategy, as the longer the maturity, typically the higher the cost for downside insurance provided by a put.

**Prepaid variable forward (PVF)**
Similar to the equity collar, you can enter into a private agreement with an investment bank to form an equity collar that also provides immediate liquidity and access to cash equal to the collar floor minus financing and collar costs. You retain all voting rights and receive all dividends with the PVF and the equity collar. The PVF provides enhanced benefit in that the cash can be used to finance a more diversified asset allocation.

**Charitable remainder trust (CRT)**
If you are charitably minded and would like your investments to continue to provide your family with lifetime income, CRTs can be an effective solution. This is especially true when your portfolio includes highly appreciated assets that they would like to diversify in a tax-efficient manner. Income will be paid to you (or another non-charitable beneficiary) for the life of the trust, and at the end of the trust term, the remaining assets will pass on to one or more charitable organizations that the donor or the trustee designates.

For more insights into which strategy may best fit your personal situation, contact your financial advisor and read our full report.

Read the original blog [Concentrated stock positions - What got you here is unlikely to get you there](#) 26 September 2022.

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