

InvestWrite Essay



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Question: Why is “putting all of your eggs in one basket” a bad idea when you are saving and investing for your future? In other words, why is it a bad idea to invest your portfolio in only one asset class? How will you use the “eggs in a basket” advice as you plan ahead for your own financial future? Choose an investment in two of these three asset classes: stocks, bonds and mutual funds. Explain why you would choose each one. Also, talk about why it’s important to invest in more than one.

Investing 101 - Don’t Put All Your Eggs in One Basket

Stocks, Bonds, and Eggs in a Basket: according to legend, it all started about 1090 in England when King William II requested hard-boiled eggs for the festival in anticipation of the birth of his second daughter. A courtier consulted the Bishop of Sussex the night before on certain protocols. The bishop prophesized based on a dream he described that he should perhaps separate all the eggs to be served at the birth ceremony in different baskets, or there may be a catastrophe at the birth ceremony. The courtier failed to heed his warning and subsequently when a servant knocked over the basket of eggs, all were lost! The courtier was kept in bondage inside a stockade for having put all the eggs in one basket. A painful lesson learned thus provided the foundation for Investing 101.

Financially, “putting all your eggs in one basket” states that you should have diversity among your investments. Diversification is important because it serves as a “shield” against failing companies you might’ve been invested in. For example, you want to be invested in different companies, different countries markets, and different products. To see how important it is to diversify, let’s look at these two scenarios:

- You invest all of your money in one American company. Suddenly, the company begins to fail and becomes bankrupt. Even if you were able to sell your investments before it completely tanks, you lose a huge percent of your investment money.
- You invest all of your money in a variety of companies from a variety of countries. Suddenly, one of your companies begins to fail and becomes bankrupt. You’ve only lost a small percentage of your money, and that percentage could be balanced out from your other investments.

When I make investments in the future, I will always make sure I have a diverse range of companies and products and make investments according to my investment horizon. The last term means that I will choose what and how to invest my money based on the amount of time I plan to have that money invested.

Now, I also have a huge variety of *what* to invest in. There are bonds, stocks and mutual funds. Bonds are loans that you make to a company. Over time, the bond gains interest and when you sell it or when the bond comes up, you receive the money you loaned the company along with added interest. When you buy stocks, you become more a part-owner of the company than a loaner. If you buy a stock and its price goes down, you lose money. If you buy a bond and the company suffers in some way, you're still guaranteed your bond money plus interest back. Mutual funds are when many people invest in a variety of stocks and bonds for a short amount of time. One person called a fund manager trades and controls the investments.

Out of all of these choices, I'd invest in a stock and bond. I would because the bond would give me a predictable cash flow, while the stock, if successful, would create a higher, but less predictable cash flow. The type of stock I'd invest in would be an ETF. An ETF is an investment vehicle, or collective investment scheme, that holds groups of stocks or bonds. I'd choose an ETF because they have low cost, relative good tax efficiency, and stock-like features. A favorable ETF would be one that mirrors the S&P500 (symbol in the market is SPY). I'd also choose an ETF for my bond that would be similar to iShares iBoxx \$ Invest Grade Corp Bond (symbol in the market is LQD). I'd choose ETFs over a single bond or stock [because] I could have multiple stocks and bonds without having to control all of them separately. Basically, ETFs are mutual funds that act like stocks. Of course, these are just a couple of my investment choices and *not all* of my investment choices.

The lesson learned from the poor courtier from King William II's era has taught many to diversify risk, which is especially true when investing.