How Many Stocks Should You Own? IBD Provides Guidelines

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Conventional wisdom suggests a diverse portfolio is always a smart move.

IBD has long offered a different take. Namely, that if your goal is to pick winning stocks, then you don't want to own so many names that your best performers' gains end up getting watered down.

By limiting yourself to a smaller number of investments, the stocks making powerful advances can have a bigger impact on your portfolio.

"The winning investor's objective should be to have one or two big winners rather than dozens of very small profits," wrote IBD's founder and chairman, William J. O'Neil, in his best-seller ".

ConcentrateHe also says: "Broad diversification is plainly and simply often a hedge for ignorance.

But wait, you might think, isn't diversification useful for protecting yourself on the downside? Well, if there is a serious bear market, virtually all stocks will drop, as they did in 2008.

There are other ways to protect yourself. One main rule is the 7% or 8% sell rule, which states that investors should always sell a stock when it drops 7% or 8% below their purchase price — no exceptions, no hesitation.

If you stick to this rule, that will offer you protection on the downside. Note this type of rule isn't a unique IBD invention. Gerald M. Loeb, the famed investor and author of "The Battle for Investment Survival," advocated for cutting losses at 10%.

So how many stocks should you own? Well, it depends on the size of your portfolio, but O'Neil has offered a few guidelines.

If you have a relatively modest account with $3,000 in it, then he recommends limiting yourself to two stocks.

For an account with $5,000 to $20,000, three stocks might be a reasonable maximum, he wrote in "How to Make Money in Stocks.

He suggests going up to four or five names when you have $20,000 to $200,000 to invest. What about if you see a sixth stock that looks promising

You should "muster the discipline to sell your least attractive investment" before pursuing that new "tempting situation," O'Neil says.

What about the big dogs? Individual investors with sizable accounts still shouldn't bite off more than they can .

"Even investors with portfolios of more than $1 million need not own more than six or seven well-selected securities," O'Neil says. "If you're uncomfortable and nervous with only six or seven, then own 10. But owning 30 or 40 could be a problem.

Beyond watering down your big winners, another problem with diversification is that it can be hard to keep track of all your investments. At a certain point, it gets to be too many stock charts to analyze, too many earnings reports to track, and so on.

Yes, you don't want to put all your eggs in one basket. But you don't want to have so many eggs that you lose track of them. You want a reasonable number of eggs that you know well and can really keep an eye on.

Here's a closing quote on this subject from O'Neil: "The big money is made by concentration, provided you use sound buy and sell rules along with realistic general market rules. And there certainly is no rule that says that a 50-stock portfolio can't go down 50% or more."