



A STUDY ON PORTFOLIO DIVERSIFICATION IN
MALAYSIAN STOCK MARKET

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ABSTRACT

A well diversified portfolio is believed able to minimize the uncertainty of future investment's return, therefore unit trust has become new attraction to retail investors. Through diversification portfolio investment will be channeled to various stocks in share market. But the problem arises is how many stocks are required to make a well-diversified portfolio? Too many stocks will lead to high transaction cost and will reduce the total portfolio return, while too less stock will catch with under diversification. This study investigates what is the optimum number of stock that can help the investor to maximize the benefit of diversification in their investment. Using **Markowitz** (1952,1959) theory and simplified approach by Elton and Gruber (1977), a series of portfolio variance was derived to identify the ultimate diversification. 80 samples of stocks were randomly chosen from Bursa Malaysia for a period of 1999-2002. The finding is that in Malaysia share market, 13 stocks are enough to make a well-diversified portfolio. This finding is consistent with other markets in developed country.

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

For the past few decades, most investors are concentrating their money into a single investment stocks. Later, the trend changed, where the investment strategies are focused on diversifying in more stocks in order to gain higher return. However, there are risks that may affect the decision of having a portfolio which are uncertainty and unpredictability. There are risks that come from conditions in the general economies like business cycle, inflation rate, interest rates and exchange rates and these factors have an impact to the rate of return of each companies. Through diversification strategies, investors will choose several numbers of stocks to be invested, and based on their return; will reduce the possible portfolio risk¹. Moreover, a profit earned by several stocks will cover or offset a loss in other stocks residing in similar portfolio. They stabilize the portfolio return.