

Ep. 203 Part One - 60% of Stocks Lose Money: Why Diversification Beats the Hero Stock Myth

SPEAKERS

Eric, Patti Brennan

Patti Brennan

Patti Brennan

Hi everybody. Welcome to the Patti Brennan Show. Whether you have \$20 or \$20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Folks, joining me today is none other than Eric Fuhrman, our Chief Planning Officer. We have a really interesting podcast with lots of great statistics today on the issue of concentration risk. Now, before you hit that button and say, “Oh, I don’t need this—I don’t have stock,” hold on. Keep listening, because we’ve got a lot of really good stuff for you today.

Eric, welcome to the show. Thanks for joining me again.

Eric

Yeah, great to be here again. There’s just something—this magical quality—the podcast studio...

Patti Brennan

And you bring it. You’re bringing it, yeah?

Eric

And there’s just something about the interaction too. A lot of good stuff comes out of these podcasts.

Patti Brennan

That we put out here. You know what, Eric? I’m going to share something with our viewers and listeners. We do this stuff late at night, and we were working on the podcast for today, and I was really getting excited about some of the things we were talking about.

I thanked you for the amount of work and research you did to put this together today, and you said, “Well, you get me excited, because you really like this stuff as much as I do,” right?

And there really is a lot to it—and it’s really important. Because, you know, we have a purpose here. The purpose is to embrace the complexity to deliver clarity and confidence in all aspects of your financial affairs. So thank you so much.

Eric

For everything you do. Yeah, no problem. I think the important thing is there's a positive feedback loop between the two of us. The momentum just feeds on itself.

Patti Brennan

One another. But yeah.

Okay, so we're talking about concentration risk. I think what you wrote here was fascinating: history highlights that great financial success and financial ruin have one common denominator. What is it?

Eric

Concentration—usually in a single enterprise or investment, and so forth.

Patti Brennan

It's so true. We hear so much about the really, really wealthy people who concentrated all of their money in one company. They were the CEOs, they may have founded the company—think about Bezos or Elon Musk. You hear all about that.

What you don't hear about are all the people who lost their wealth because they had it all in one basket.

Eric

Yeah, and I think that's maybe the disservice here—the media ecosystem we live in always captures and highlights the successes. That's what attracts a lot of attention.

Patti Brennan

A lot of eyeballs. A myopic focus on winners. Now, I like positive news too, but we have to keep it real, right? That's what gives people confidence.

We can't technically say "peace of mind," according to regulators, but it really is about confidence. What is going to give you the highest probability of being able to live the way that you want to live? That's what really matters.

Eric

And I think, from our perspective, it's a little different. To your point, in the media—magazines and so forth—you're getting a very skewed view of rare but incredible success stories.

But in our day-to-day role, with our fiduciary responsibility to allocate capital—people's life savings—you realize that what you see in the press obscures the statistical reality. There are an incredible number of failures, not just in the economy, but also in the public stock market, where we operate.

That's why there's such an emphasis on diversification and reducing or mitigating risk wherever we can. Because ultimately, someone works their entire life—we have to make sure we're deploying their investments in a responsible way.

Patti Brennan

You know, we all know the statistics about businesses and the probability that a business is going to succeed after five years—it's really low, right? And then to succeed across generations, over many decades, it's even more improbable.

And I think what we learned this week was—Hendrik Bessembinder, I can't pronounce his name—he updated his research from 2016 and looked back over 100 years. So why don't you highlight some of the things that came out of that study?

Eric

Yeah, so just to go back one step—if you think about private businesses, America is really founded on the spirit of entrepreneurship. And you're right—the Bureau of Labor Statistics tracks this data.

A new business has about an 80% survival rate after one year. But when you get to five years, it drops to about 50%.

Patti Brennan

50% fail, yep.

Eric

And when you get to 10 years, only about 35% of businesses succeed—about 65% fail.

The reality is, we operate in a competitive environment, and those statistics are more or less reflected in the public markets for common stock.

That's where, to your point, Hendrik Bessembinder—he's a professor at Arizona State University—comes in. He originally published this study in 2016 and has updated it periodically. The anchoring point is 1926, so now we have 100 years of data—which sounds like a big enough sample size.

Patti Brennan

It's been around long enough.

Eric

Exactly, to draw some reasonable conclusions.

And what that study shows—and it really mirrors what we see in private business statistics—is that about 60% of stocks over that 100-year period were net wealth destroyers.

Patti Brennan

That is incredible. So here you are, willing to invest for the long term, quote unquote, and you lost money 60% of the time in individual stocks.

But yet, we hear about what the stock market does over time. So what's going on there? Are the winners just outperforming by such a large margin? That, I think, is the real takeaway.

Eric

Yeah, and I think you hit the nail on the head. There is a significant population of firms that lose money. But the reality is, most of the incredible wealth creation we've seen in the U.S. equity markets over the last 100 years has come from a very narrow subset of extreme winners.

There are some really interesting statistics. If you look up the study—it's available online—go to page 25, the last page. There's a great summary table.

The statistic that really jumps out to me, Patti, is that the U.S. market has created about \$90 to \$91 trillion of wealth—trillion, with a "T."

And half of that wealth has come from just 46 companies out of roughly 29,000.

Patti Brennan

29,000—so that is far less than 1%. It's a fraction. It's like one-tenth of 1%, right?

Eric

Well actually, in the table it says 0.158%.

So it's a really small number, but it gets back to this point: whether you think about private businesses or publicly traded companies in the stock market, a broad portfolio can create a lot of wealth over time.

But trying to cherry-pick? Oh my goodness—the odds are just dramatically stacked against you finding the right one at the right time. Markets are competitive.

And again, it really is a very small population of extreme winners that drives most of the wealth creation. In statistical terms, there's an extreme positive skew—a handful of outliers driving most of the results.

Patti Brennan

Good luck picking which ones are going to be the outliers in the future, right?

Eric

Yeah. Think back to the 1950s—the “Nifty Fifty.” Xerox...

Patti Brennan

Right. All those companies.

Eric

The market is creative destruction. Only a few of those companies stood the test of time. They may have been great for a period—but are they great over 50, 60, even 100 years?

So yeah.

Where we tend to see concentration risk is in areas people can't avoid—like business owners, where a lot of their wealth is tied up in one enterprise.

But where we really focus is on people who own stock in their employer—publicly traded companies—where there *is* a liquid mechanism to diversify.

Patti Brennan

So let's address that. Eric, why do people hold on to large positions?

Eric

Yeah—and it's complicated.

A lot of it is psychological. There's often a sentimental connection. You've got a great story about your own experience.

Patti Brennan

When I first started as a financial planner, the firm I worked for in Philadelphia had me do a financial plan on myself and my husband. It was actually a wonderful experience because I got to understand how people feel.

Ed and I were driving into Philadelphia, and he said, "What do you think they're going to tell us?" I said, "I don't know—I'm not allowed to be involved."

So we go into the meeting, and they're presenting their recommendations. One of them was: *we recommend that you sell your IBM stock.*

We had 100 shares at the time. And I looked at the principal of the firm and said, "Well, I don't want to do that."

He said, "What do you mean you don't want to do it?"

And I said, "For whatever it's worth, you didn't ask us a really important question."

He said, "What's that?"

I said, "Do you have any sentimental attachment to this IBM stock?"

And the answer was yes. My dad worked for IBM. I'm an IBM baby. We had the Think pencils, all the gear—everything. And when Ed and I got married, we received 100 shares of IBM stock.

I didn't want to sell it. We had a sentimental attachment.

And from that point on, the firm started asking that question.

Now, one of the things we do here, Eric—and I think this is important—is sometimes we have to save clients from themselves. If that sentimental attachment leads to too much risk—more than you can afford—that's not okay.

I had another client who worked for a pharmaceutical company. He had a lot of money in that one stock. He believed in the company, loved it—even after being downsized.

So I said, “Let me run the numbers.”

What if the stock goes to zero? Would you still be okay? Because what we’re trying to avoid is financial ruin from having all your eggs in one basket.

I ran the numbers—they were going to be fine. So we held onto the stock, but we structured other strategies around it—a synthetic dividend, things like that—

Eric

To diversify around it.

And just for those listening—how do we define concentration? It’s not black and white.

Generally, anything above 5% of a portfolio starts to become concentrated. And to your point—what if it goes to zero? What if there’s a catastrophic loss?

Because when you look at the data, many stocks suffer losses they never recover from.

But we often see people with 20%, 50% of their balance sheet in one stock. That gets risky—very real, very quickly.

And back to your story—yes, there’s sentiment. Sometimes it’s tied to a parent or inheritance.

But for others, it’s tied to success. Their life changed because of that stock.

And there’s a bias there—people take past success and assume it will continue.

Patti Brennan

That it’s going to keep going.

Eric

Exactly.

There’s an old saying: assuming it won’t rain tomorrow because it didn’t rain last week is a good way to get soaked.

Assuming a “hot stock” will just keep going up—that’s a good way to get hurt.

Patti Brennan

What I think is so fascinating is that most of the stocks that suffered catastrophic losses were valued at reasonable price-to-earnings multiples.

Even the pros—look at private equity. We've had clients make private investments and lose everything.

It's really hard to own a business in a competitive environment and succeed over five years, ten years—over an investing lifetime.

Why take on that risk if you don't have to?

Eric

Yeah, precisely. And part of it is this belief that past experience predicts the future.

Patti Brennan

And I think the other thing is, people buy into the stories. It's all about the story, right?

What made the stock go up and up and up—and why do you think it's going to keep going?

Take your example with Fiserv. It was up 11 straight years—unbelievable growth. It peaked in the first quarter of last year at \$238 a share. It had a compounded return over those 11 years of 11%.

Of course someone's going to buy into that story and say, "This is a great company"—only to find themselves owning a stock today worth \$56. That's a 76% drawdown.

So what's really interesting—and we'll get to this later—is what makes stocks go down so fast? I mean, it's fast.

Think about Novo Nordisk, the maker of Ozempic—the drug that's changing so many lives. The stock went up and up and up. The story was working. Everything looked great.

And then it lost 71%—even though people are still using the product.

Eric

Yeah, and that's the tough part. Every company has a story—and that story is told through the financial statements.

If you're someone who actually enjoys reading income statements, balance sheets, or cash flow statements—which isn't many people—you can see incredible success in the numbers.

But to your point, especially in public markets, the ground shifts quickly. Very quickly. Sentiment can change on a dime.

And the mechanics aren't that complicated. Any investment—whether it's a bond, a private business, or a stock—is worth the sum of its future cash flows, adjusted for risk.

But when something changes—news, expectations—those future cash flows get revised downward, and the perceived risk goes up.

Patti Brennan

Look what happened to Boeing, right? Who could have predicted a door blowing off a plane?

And yet the stock dropped significantly as a result. That's an example of something completely unpredictable that can have a real impact on people's wealth.

Eric

Exactly. And that's where liquidity comes in. Liquidity is a great thing—until bad news hits.

Because then you see those exaggerated declines.

Patti Brennan

It's like riding an elevator and the cables snap—it just drops.

Investing over time is more like an escalator going up. But when it goes down, it's like that elevator.

Eric

Yeah, in trading terms, that's called a "gap down." It closes at one price, and the next morning—

Patti Brennan

It opens 30% lower.

Eric, I learn something new every day with you.

Alright, so here's something we hear all the time: *"I don't want to pay the capital gains tax."*

Let's talk about that. You have an example here with Apple.

Let's say someone invested \$200,000, and now it's worth \$2 million. That's \$1.8 million in gains. Why would anyone want to sell that?

Eric

Yeah, and I think taxes are one of the biggest reasons people hold on—along with that belief that the stock will keep going.

Nobody wants to settle up with Uncle Sam.

In this case, Apple is what Peter Lynch would call a “10-bagger.” You turned \$200,000 into \$2 million. That's incredible.

But here's the reality: individual stocks are extremely volatile. And most people who've made money in a stock have simply been on the favorable side of that volatility.

It can go the other way.

So when you look at the tax cost—maybe 15% to 20% of the position—it feels painful. It's a big number.

But compare that to the downside risk. Apple, historically, has had drawdowns—including two around 79%.

Patti Brennan

79% in its lifetime.

Eric

Exactly.

And what you tend to see is when the tide turns, it turns fast. Stocks can drop 30%, 40%, 50%—quickly.

Patti Brennan

And then you're left with regret. You look back and say, “I wish I had just paid the taxes.”

In this example, the tax bill is about \$483,000. That's roughly a 27% blended tax rate—including capital gains and other taxes.

Yes, it's close to half a million dollars.

But you still keep about \$1.5 million—you keep 75% of it.

And instead of gutting it out through massive drawdowns—where even the *best* drawdown was still minus 24%—you’ve removed that risk.

It may make more sense to pay the tax and avoid exposing yourself to that kind of loss.

Eric

And I think the trick is this: when you think about it, the tax bill is usually nowhere near as bad as some of the drawdowns.

But if the stock declines, now you’re in a position where you’re saying, “How can I sell it now?” You want to get back to where you were.

Patti Brennan

Right, exactly.

Eric

And then it just perpetuates. You don’t sell—and it potentially keeps going down.

Patti Brennan

Okay, so what do we do in those situations? I’ll play devil’s advocate: “Well, it’s Apple—it’s going to come back. It always does.”

And it certainly could. It’s not like you won’t make money in a diversified portfolio—you will. It’ll just be more diversified, with less risk of significant drawdowns.

Eric

Yeah, and again, it depends on each person. But ultimately, we have to admit—nobody knows what’s going to happen.

Anyone can make a prediction about the future. So we have to use prudent risk management.

Look at the overall picture of your net worth and say, “Let’s at least start gradually reducing the position.”

Scale it back over time. The hardest step is the first one—but once you take it, it gets easier.

Patti Brennan

Right. Because you have a plan. You have a strategy.

We lay it out and say, “This is how we’re going to mitigate risk and reduce the amount of pain you feel all at once.”

And there are ways to do that—we’re going to go through them.

Eric

And I think the other part of this conversation is taxes. From a historical perspective, our tax system dates back to the 1913 amendment—

Patti Brennan

Here’s our history buff. Eric should be a history professor—go ahead, Professor.

Eric

Well, history provides context.

If you think about the tax code, it actually favors investment income. Capital gains are taxed at lower rates than income from labor.

If you earn \$500,000, you’re paying 35% to 37% in income tax. But capital gains may be taxed at 15% up to a certain threshold.

So in many ways, the best way to build wealth is through investing—the tax code gives you a pretty favorable deal.

Patti Brennan

It’s a great incentive.

You’re investing in real companies—diverse businesses across the U.S., Europe, and around the world. Some will do really well, some won’t—and that’s okay.

Over time, you’re still going to do well. Maybe not every time, but over time.

That's the beauty of asset allocation—aligning your capital with what you need it to do. Because your money is a means to an end.

Eric

We want to make sure it lasts to the end.

Patti Brennan

Exactly. Knock on wood—we've never failed at that.

Eric

And once we get to a point of consensus—where someone recognizes the risk and is open to addressing it—we can approach it strategically.

Because we're always trying to minimize taxes while finding the best overall outcome.

That's where different tax lot methodologies come into play.

Patti Brennan

Yes—we've got LIFO. Why don't you walk through the options?

Eric

When you're selling a concentrated position, it's usually done gradually.

Most people acquired shares over time, meaning each batch has a different cost basis.

So the goal is: how do we generate the most dollars with the least tax?

If the stock has risen over time, you might use LIFO—last in, first out—selling the most recently acquired shares with the highest cost basis.

Or you can use specific identification, where you cherry-pick the most favorable lots.

There are also optimization tools—like “minimize tax” or “maximize loss”—where the system automatically selects the best shares to sell based on tax efficiency.

It's a thoughtful way to scale out of a position.

Patti Brennan

Exactly. Because every share may have a gain, you want to choose the most favorable ones to sell—and in some cases, even sell shares at a loss to offset gains.

Eric

Right. And there's one more factor to consider—mortality risk.

If someone bought a stock decades ago and is now in their 80s, there's the step-up in basis.

So before making changes, you have to consider cash flow needs *and* estate planning. That step-up can be a powerful way to transfer wealth without embedded taxes.

Patti Brennan

And while gifting shares sounds appealing, the recipient takes on your original cost basis—so they don't get that step-up benefit. The same applies to many trusts.

That's why it's so important to look at the full picture:

- Reduce risk
- Optimize taxes
- Manage cash flow
- Align with your estate plan

It's not just about the portfolio—it's about everything working together.