Single Stock Risk:
Implications for Individuals and Markets

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Single Stock Risk

“Why Company Stock is a Burden for Many - And Less So for a Few”
Wall Street Journal, November 27, 2001
Single Stock Risk - Background

- Companies (especially large ones) tend to match 401k contributions in company stock
- Individuals often purchase company stock with their own 401k distributions
- SO WHAT! Markets only go up and everybody wins!!!!! WHOOPS…..

Single Stock Risk - Issues

- What can (should) an individual in a highly concentrated 401 portfolio do?
- What implications do these actions have for the market at large?
Single Stock Risk - Implications

- Executives with large portfolios have more flexibility and more tools at their disposal
  - May not be locked up
  - Above $2M, custom hedge packages
- Other employees face difficult challenge
  - Buying puts is expensive
  - Single stock futures
  - Relaxation of restrictions

Single Stock Risk - Implications

- Large, publicly-traded companies tend to match 401k contributions in company stock
  - Concentrations over 80 percent not uncommon
- Throughout the 1990s, these firms enjoyed high P/E multiples so stock matching was “cheap”
  - Fewer shares need to hit a certain dollar target; also saves cash
- Selling pressures on high P/E stocks the other side of the coin
Single Stock Risk - Implications

- Admitted crude analogy
  - Expiration of “lockups” on Initial Public Offerings (IPOs)
- Price pressure on firms with largest concentrations of shares in defined contribution plans
  - Unlike IPOs, however, these companies tend to have very large public floats
- Do employees rebalance with “similar” firms thus offsetting the pressure?

Summary

- Some relief from trading restrictions is likely
  - Companies will balance costs and benefits of having employees worried about concentrated portfolios
  - Threat of regulation
- Employees flooding out of concentrated portfolios will keep selling pressure on large-cap firms
  - Large cap P/E ratios still very high
  - Rebalance with diversifying assets