

Managing Concentrated Stock Positions

A STRUCTURED APPROACH TO MANAGING SINGLE-STOCK RISK

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Wealth is often created through concentration, but preserved through diversification.



Many investors find themselves with a significant portion of their net worth tied to a single stock or a small number of positions. This may come from a successful career, equity compensation, founding a business, or long-term investment success. While these concentrations can represent opportunity, they also introduce risk—often more risk than a client fully intends to take.

At Sunpointe, we address concentrated positions as a multi-pronged framework rather than a single decision point. Focusing on long-term objectives while balancing tradeoffs between risk reduction, tax impact, and liquidity ultimately leads to a thoughtful, customized solution.

This paper outlines the key challenges associated with concentrated positions and highlights several strategies available to address them. While each situation is unique, having a framework helps guide better decision-making over time.

The Challenge of Concentration

What are concentrated positions and how do they arise?

A concentrated position typically refers to a scenario where a single security or a small number of related securities makes up a meaningful portion of an investor's overall net worth. While there is no universal threshold, many practitioners begin to view a position as "concentrated" when it exceeds 10–20% of a portfolio, as the investor's financial outcomes become increasingly tied to the performance of a single company or sector.

Concentrated positions rarely occur by accident. More often, they are the byproduct of success, discipline, or circumstance. For example, a long-tenured employee may accumulate a significant position through equity compensation such as stock options or restricted stock units. Similarly, business owners and founders often build substantial wealth tied to a single enterprise. In other cases, a concentrated position can emerge over time as the result of strong performance—what may have started as a modest allocation grows disproportionately within a portfolio after years of outperformance.

An effective way to manage concentration is often to prevent it from building in the first place. A disciplined rebalancing process involving periodically trimming positions that have grown beyond their intended weight can help maintain diversification over time without requiring a single, high-stakes decision later. While not always possible in cases involving taxes or restrictions, this proactive approach can significantly reduce the need for more complex strategies down the road.



What risks are associated with concentrated positions?

Concentrated positions expose investors to both systematic and idiosyncratic risk. Systematic risk is the broader market risk that cannot be diversified away and affects all investments to some extent. In contrast, idiosyncratic risk, or company-specific risk, is largely avoidable through diversification. When a portfolio is heavily weighted toward a single security, this idiosyncratic risk becomes the dominant driver of outcomes. A negative company-specific event, such as a regulatory issue, earnings disappointment, or industry disruption, can have an outsized impact on overall wealth. This becomes particularly impactful because concentrated positions are often built through stock-based compensation, which is prevalent in industries that tend to experience higher levels of disruption.

In practice, we see the impact of this company-specific risk reflected in higher levels of return volatility. The S&P 500, which represents the broad U.S. equity market, has historically exhibited a standard deviation of around 15%. In other words, annual returns tend to fall within roughly $\pm 15\%$ of the average about two-thirds of the time.

In contrast, the average individual stock typically experiences standard deviations in the range of 25–30%, with some stocks exhibiting volatility as high as 50%. This wider dispersion of outcomes highlights how concentrated positions introduce a much broader range of potential results, both positive and negative.

What factors should I consider when addressing a concentrated position?

Before determining how to address a concentrated position, it is important to first take inventory of the factors at play as well as the desired outcomes. For some investors, the primary concern is volatility or more specifically, downside risk, or the possibility of negative outcomes. For others, it may be tax exposure or the desire to create greater diversification over time. Other factors include behavioral biases tied to familiarity or emotional attachment. This can make objective decision-making more difficult and delay action. Another example of a behavioral risk is tax friction. Many concentrated positions carry significant embedded gains. The tax impact of selling can feel prohibitive, causing investors to delay diversification even when it is economically rational.

Identifying which issues matter most is a critical first step, as it directly influences which strategy, or combination of strategies, makes the most sense. A solution that is effective for reducing risk may not be optimal from a tax perspective, and vice versa.

With that context in mind, it becomes easier to evaluate the tradeoffs of each approach and implement a plan that aligns with the investor's broader financial goals. Now, let's consider some of the most common approaches to addressing concentrated positions.

Selling and Diversifying — The Most Direct Approach

The simplest diversification strategy is to sell shares and reinvest the proceeds into a diversified portfolio. This strategy is ideal for those who do not have a low-cost basis for the position, or if the position is in tax-advantaged account. However, even in the case of low-cost basis, it can still be economically reasonable to immediately sell.

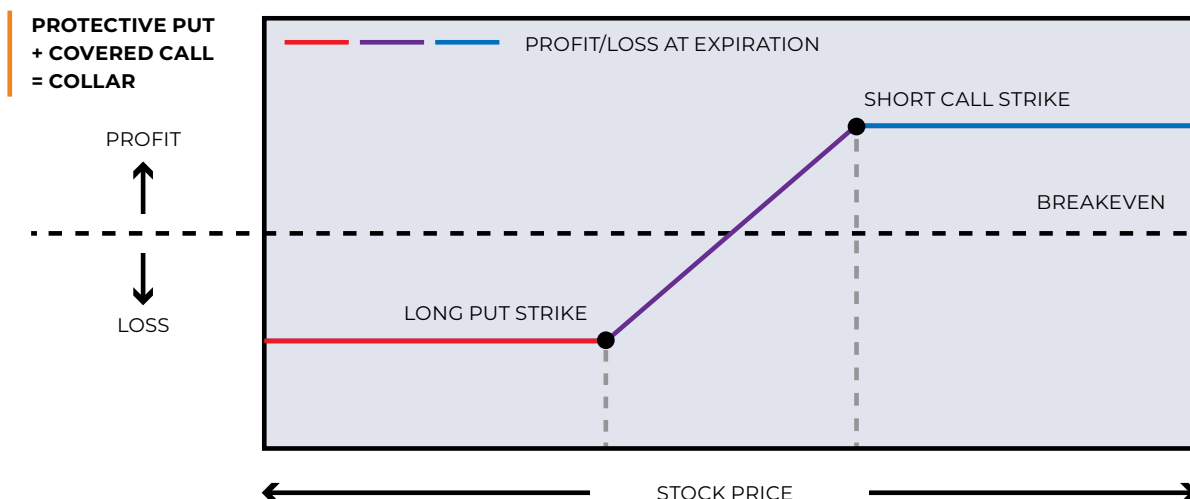
Monte Carlo analysis has demonstrated that even with a zero-cost basis, resulting in maximum tax impact, an individual stock with volatility of 40% will result in expected median outcomes less than that of an investment reflecting a broad market index.¹ That same analysis also indicates that the individual stock has nearly a 40% chance of a negative return after 20 years. This analysis considered two investments that had the same expected return, so in order for the scales to tip in favor of the individual stock, it would have to be expected to outperform the market. In many cases, a disciplined, staged selling program can help manage both market timing risk and tax exposure, while still moving toward a more diversified outcome.

Option-Based Hedging — Downside Protection Strategies

Options can be used to reduce downside risk while allowing an investor to retain ownership of the underlying position. These strategies are often most appropriate for investors who are not yet ready to sell but want to manage near-term risk exposure.

Two of the most common approaches are protective puts and collars. A protective put establishes a floor value by providing downside protection if the stock declines. A collar builds on this by combining a protective put with a covered call, which helps offset the cost of the hedge but also limits potential upside.

The next natural step in this approach is to use this concentrated position, now hedged with a protective put and collar, as collateral for a loan. The proceeds of the loan can then be used to diversify into other areas in the market. These arrangements are more commonly known as Variable Prepaid Forward (VPF) contracts. While these products have advantages, they can result in tax liabilities at maturity unless they are rolled, which can require large cash outlays. There is also the risk of maintaining a collar that is too “tight”, or near the market price, that the IRS deems it an economic sale resulting in recognition of capital gains and a tax bill.



¹ Stein, David M. 2001. "Taxes and Quantitative Portfolio Management." In *Developments in Quantitative Investment Models*, edited by Kahn, Ronald N. Charlottesville, VA: Association for Investment Management and Research.

Exchange Funds & Section 351 Strategies — The Tax-Deferral Strategies

For investors highly sensitive to taxes, certain structures allow diversification without immediate recognition of capital gains.

Exchange funds pool assets from multiple investors, each contributing concentrated stock positions. In return, the investor receives a share in a fund, representing a diversified basket of securities, which they can redeem after a required holding period for some of the fund's holdings. These funds generally track common benchmarks such as the S&P 500 or Russell 1000, but they are required to include 20% of illiquid investments, usually private real estate. The lock-up period of 7 years results in less liquidity and early withdrawal can lead to significant fees.

351 Exchange Traded Funds, on the other hand, defer taxation using Section 351 of the Internal Revenue Code. Investors can contribute to a fund manager and receive shares of the ETF in return. However, contributions are required to follow the "25/50 diversification rule." No single security can make up more than 25% of your total contribution, and the top five holdings cannot exceed 50%. This requirement limits how impactful this strategy can be to diversify a concentrated position.

Below is a hypothetical example illustrating the benefits of a tax-deferral strategy:

Liquidating & Diversifying

Original investment: \$10,000

Current value: \$100,000

Unrealized gain: \$90,000

Sell & reinvest (assuming **24%** tax), **7 years** at **10%**:

$(\$100,000 - (\$90,000 * .24)) * (1.1^7) \sim \$152,800$

Cost Basis = \$100,000, if needing to liquidate:

$\$152,800 - (\$52,800 * .24) \sim \$140,000$

Exchange / 351 ETF — Tax Deferred

Original investment: \$10,000

Current value: \$100,000

Unrealized gain: \$90,000

Utilize an Exchange Fund or 351 ETF:

7 years at 10% > ~\$195,000

Cost Basis = \$10,000, if needing to liquidate:

$\$195,000 - (\$185,000 * .24) \sim \$150,600$

Tax drag savings: ~\$10,600

Direct Indexing and Long/Short Strategies — The Gradual Approach

With direct indexing, a diversified portfolio is constructed to track the performance of a broad market index using individual securities. As certain holdings decline in value, they can be sold to realize losses and replaced with similar securities to maintain market exposure. These realized losses can then be used to offset gains generated as the concentrated position is gradually liquidated. In addition, proceeds from the sale of the concentrated position can be reinvested into the direct indexing portfolio, establishing positions at a higher cost basis and creating additional opportunities for tax-loss harvesting over time.

While sophisticated investors have been using tax-loss harvesting strategies like direct indexing for decades, a more recent innovation involves adding long/short investing to these strategies to help manage the tax impact associated with reducing a concentrated position.

A long/short strategy follows a similar objective, but incorporates both long and short positions within the portfolio. Because of this structure, there is often a greater ability to generate realized losses that can be used to offset gains, though results can vary depending on market conditions and positioning.

However, these strategies introduce additional complexity. They typically involve higher costs, require active management, and may be more difficult to unwind once implemented. Despite these considerations, they can be appropriate for investors seeking a more gradual, tax-aware transition away from concentration and who are comfortable with the added complexity.

Putting It All Together

Concentrated positions are often a byproduct of success. But without a clear plan, they can introduce unintended risk over time. The key is not simply deciding whether to act, but developing a strategy that reflects your goals, tax considerations, and comfort with risk.

For some investors, the priority is reducing downside exposure. For others, it may be minimizing tax impact, maintaining upside participation, or improving overall diversification. Each of these objectives can lead to a different approach.

A helpful starting point is to evaluate the primary drivers of concern:

- What level of downside risk is acceptable—and over what timeframe?
- How sensitive is the investor to realizing taxable gains?
- How important are liquidity and flexibility?
- Are there behavioral factors influencing the decision to hold or delay action?

Framing the decision around these issues allows for a more targeted evaluation of available strategies. Rather than searching for a single solution, investors can align the approach to the specific problem they are trying to address, while balancing the tradeoffs each option presents.

At Sunpointe, we focus on helping clients clearly define these priorities so the strategy chosen reflects the outcome they are trying to achieve. If you're evaluating a concentrated position or thinking through how to manage one more effectively, we'd welcome a conversation. You can learn more about our approach or connect with our team at www.sunpointeinvestments.com.

Strategy Overview

Strategy	Primary Objective	Tax Impact	Complexity	Liquidity	Tradeoffs
Sell & Diversify	Immediate risk reduction	Realizes gains	Low	High	Tax cost, timing decisions
Option-Based Hedging (Collars/Puts)	Downside protection	N/A	Medium	High	Cost, capped upside
Exchange Funds / 351	Tax deferral + diversification	Deferred	Medium	Low (lockups)	Limited flexibility
Direct Indexing / Long-Short	Gradual, tax-aware diversification	Actively managed	High	Medium	Complexity, financing fees, difficult to unwind

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