Position Sizing

How Much Is Too Much in One Holding? — Lesson Explainer

The Concept

Two investors can hold the exact same stock and end up with very different outcomes, purely because of how much of their portfolio they put into it. A 2% position that halves costs 1% of the total portfolio - a 40% position that halves costs 20%.

Position sizing is the decision, made before you buy, of what percentage of your total portfolio a single holding is allowed to occupy. A great company can still be a bad position if it's sized too large.

Two common approaches: a maximum-weight rule (e.g. no single stock over 10%) and a risk-based rule (e.g. risk no more than 1-2% of the account on any one trade's stop-loss distance). Both answer the same question: how much can this one position hurt me if I'm wrong?

Illustrative Example: Same Loss, Different Position Sizes

A $50,000 portfolio holds a stock that drops 30%. The dollar loss depends entirely on the position size going in.

Position Size	Position Value	Loss at -30%	Loss as % Port.
5% Position	$2,500	-$750	-1.5%
10% Position	$5,000	-$1,500	-3.0%
25% Position	**$12,500**	**-$3,750**	**-7.5%**
50% Position	$25,000	-$7,500	-15.0%

Same stock, same -30% move - but the portfolio-level damage ranges from a shrug (-1.5%) to a serious setback (-15%), purely as a function of position size.

5 Things to Know About Position Sizing

1. Conviction isn't a sizing plan - overconfidence is exactly what precedes oversized positions.

2. Sizing rules are set before you buy - deciding the cap after a big gain just rationalizes it.

3. A max-weight rule protects against concentration risk from any one company.

4. A risk-based rule protects against a single trade blowing up an account.

5. Winners can outgrow their cap on their own - that's what rebalancing exists to fix.

4 Things to Check Before You Buy

• Set a max weight in advance - decide your cap before you're attached to a specific idea.

• Know your risk-per-trade - size so a stopped-out trade only costs a small, defined slice.

• Use a calculator, not a gut feel - work backward from risk amount and stop distance.

• Re-check after big moves - a winning position can drift past your cap on its own.

Worth knowing:
this explains the mechanics and reasoning behind position sizing rules using illustrative numbers - it isn't personalized financial advice. Speak to a licensed advisor about what's appropriate for your own portfolio.

Quiz — Answer the questions, then check the key on the next page

1. What is position sizing?

A. Predicting which stock will perform best
B. Deciding when to buy or sell a stock
C. Deciding, before buying, what percentage of the portfolio a single holding may occupy
D. Choosing which broker to trade through

2. In the illustrative example, why did the same -30% move cause such different damage?

A. Because different investors paid different prices for the stock
B. Because the position sizes relative to the total portfolio were different
C. Because some investors used stop-losses and others didn't
D. Because the stock dropped by different amounts for different people

3. What are the two common position sizing approaches described in this lesson?

A. Buy low, sell high
B. Technical and fundamental analysis
C. Long-term and short-term
D. A maximum-weight rule and a risk-based rule

4. Why should sizing rules be set before buying, not after?

A. Deciding the cap after a position is up big just rationalizes letting it run unchecked
B. It's required by law in most markets
C. It has no effect on the outcome either way
D. Brokers automatically enforce sizing rules for you

5. What should you do if a winning position naturally grows past your size cap?

A. Nothing - winners should always be left alone
B. Sell the entire position immediately
C. Treat it as a cue to rebalance, trimming it back toward its target weight
D. Raise the size cap to match wherever the position has grown to

Answer Key

1. What is position sizing?

Correct answer: C. Deciding, before buying, what percentage of the portfolio a single holding may occupy

Position sizing is separate from stock-picking - it's about how much capital any one idea is allowed to control.

2. In the illustrative example, why did the same -30% move cause such different damage?

Correct answer: B. Because the position sizes relative to the total portfolio were different

Same stock, same percentage move - but different weights translate that into very different portfolio-level dents.

3. What are the two common position sizing approaches described in this lesson?

Correct answer: D. A maximum-weight rule and a risk-based rule

A max-weight rule caps a position's share of the portfolio; a risk-based rule sizes from your stop-loss distance.

4. Why should sizing rules be set before buying, not after?

Correct answer: A. Deciding the cap after a position is up big just rationalizes letting it run unchecked

Setting the cap in advance removes the temptation to keep raising it because a position is doing well.

5. What should you do if a winning position naturally grows past your size cap?

Correct answer: C. Treat it as a cue to rebalance, trimming it back toward its target weight

This is exactly the drift problem the Rebalancing lesson covers.