Don’t Put All of Your Eggs in One Basket – Place a Yoke on Your Employer Stock

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When we think about all of the types of financial risk we try and minimize, we often overlook the peril of owning too much of our employer’s stock. Often we don’t realize how closely our investment portfolio ties to our cash flow if we are heavily invested in company stock. Point View advocates investors take an accurate measurement of how exposed they are to their company’s fortunes, and if too high, mitigate the risk through diversification.

Why Own the Stock? – We buy our employer’s stock for a multitude of reasons, but the most prevalent is our connection to the company. Becoming an owner ties us more closely to the fruits of our labor and makes us feel like more than a worker. As employees of the company, we are knowledgeable about its products and prospects and feel like experts regarding its future performance. On a psychological level, feeling confident enough to buy your employer’s stock justifies the long hours and dedication you show your employer. In addition, companies often offer discounts to the market value when employees buy stock. These discounts typically range from 5-15%, which makes you feel like you are picking up a bargain.

Ways You Can Accumulate Employer’s Stock:

Employee Stock Purchase Plans (ESPP) – This is a preferable method for many workers as they are able to buy the stock at a discount to the current market price. The purchase method is also easy as it is often done through payroll deduction versus coming up with an additional check. There are no commissions, and you end up dollar-cost averaging your holdings by buying a small amount each pay period.

Restricted Stock Units (RSU) – This is a method commonly used by employers to pay deferred compensation, especially to employees viewed as valuable to the firm. An RSU is a grant of stock in which the employee’s ownership rights are restricted for a vesting period. Once the shares vest, the employee owns the stock outright and may retain or sell the shares. The RSUs are taxed as earned income when vested.

Stock Options – Employers can also award stock options as part of their compensation program. This gives an employee the right to purchase stock at a predetermined price, regardless of its market price at that time. Employees can either execute the option or allow it to expire worthless. Options are taxed as earned income when exercised.

401K and Employer Match – You may also choose to buy employer stock as one of your 401K options. Although less common today, check and see if your employer uses its stock to fulfill its matching contribution to your 401K.

Independent Purchase – Nothing prohibits you from buying more of what you think is a good thing in your own brokerage account or traditional IRA.

What Could Go Wrong? – Having a sizable proportion of your net worth invested in your company's stock leaves you exposed in several ways. First, your company's paycheck provides life's essentials – food, housing, education and leisure. Your company also likely provides other essential benefits such as healthcare and life insurance. If your employer falls on hard times, staff reductions are a risk you need to consider. Should you lose your job, and along with it your income stream and healthcare, you may need to rely on your savings and investments. It is reasonable to believe that if your company is struggling enough to have to reduce staff, its stock price is also likely suffering. Here comes the second whammy, a falling investment portfolio and 401K just when you need the cushion. Better to have diversified your assets into a mix of stocks and bonds than to let your employee stock ownership eat up a large share of assets. Employees at Enron, Tyco, and Lehman learned this lesson the hard way as they saw their retirement savings wiped out at the same time they lost their jobs. In the Enron case alone, almost 58%, or $1 billion, of employees' 401K assets were invested in Enron stock as it fell 98.8% during 2001.

How Much Stock Should I Own or Rather How Much is Too Much? – While there is no hard and fast number for the right allocation, investors are particularly vulnerable when the allocation exceeds 10-20% of their net worth. Step back and view how much exposure you would invest in any one stock that you don't have personal experience with. That number is likely 2-5% of your portfolio.

Evaluate How Much You Own – Be sure to include direct holdings, options and restricted stock, employee stock plan purchases, company matches as well as pension fund holdings. In addition, take a look at mutual funds you hold for correlation as they may also have investments in your employer's stock. Many investors didn't know how exposed they were to technology in 2000 and financials in 2008 until both their personal and mutual fund holdings saw simultaneous double digit declines.

How Do I Reduce Holdings in an Efficient Way? – Once you know where you stand, begin the diversification process. Reduce holdings systematically and with discipline, and don't try to time the market. Consider the tax consequences of any sales you make. Make sure you change your contribution rates for employee stock plans and your allocation in the 401K plan. Redirect funds to stocks and bonds not correlated, either through industry, geography or product line, to your company.

Know Restrictions for Buying and Selling – There are restrictions on buying and selling company stock. Blackout periods are common, often tying to the time period when earnings are about to be reported. These periods often freeze your account and can last from a few days to weeks. The risk is the blackout can coincide with the fall of the company's stock as it did at Enron. That stock declined more than 35% during a pre-scheduled two week blackout.

Know Your Company's Prospects Outside of Your Cubicle – You are invested in your company's fortunes in many ways, both financial and emotional. Take control of your destiny by understanding your employer's present position and future outlook. Read the annual reports (10-Ks), quarterly reports (10-Qs) and press releases. Study analyst reports and industry perspectives to understand how the company is positioned. This way you can make a reasonable estimate of what you think the short and long-term potential is for the company’s stock price. Don’t just listen to your employer’s opinion; make your own informed one. But, however informed your opinion is, don’t own so much employer stock that a missed forecast imperils you financially.