Rebalancing Your Portfolio

When developing an investment portfolio, the starting point should be determining an appropriate asset allocation, one that is based on your time horizon and risk tolerance. Once the allocation is determined, you can go about the process of selecting investments to implement the plan. However, this does not signal the end of the investment process. Without periodically reviewing your asset allocation and rebalancing when appropriate, your original plan can find itself drifting off in a way you had never intended.

What is Rebalancing

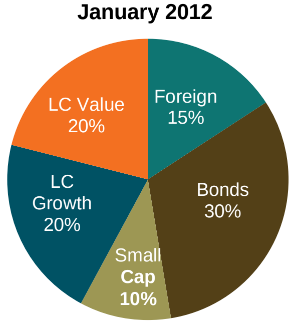
Rebalancing is the periodic adjustment of a portfolio to restore the original asset allocation mix. The need for rebalancing comes from one asset class in a portfolio outperforming another. Not all asset classes provide the same annual return, which is the whole reason for asset allocation in the first place. Over time some asset classes tend to grow or shrink, beyond the allowable range you established in your investment policy statement. When this happens, it is time to rebalance and bring your portfolio back to your original target allocation.

Unfortunately, many investors fail to recognize the benefits of rebalancing a portfolio. These investors view rebalancing as selling off the securities that have done the best and buying more of the securities that have under-performed. In reality, there are advantages to rebalancing.

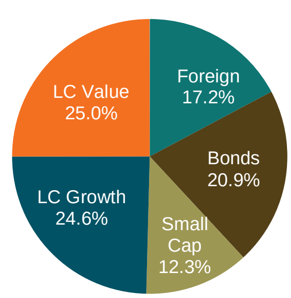
- Ensures that you retain the proper allocation, increasing the likelihood that your portfolio will produce the risk/return characteristics your goals required.
- Provides a built-in “sell high/ buy low” signal that may enhance returns over time.
- Can mitigate the unforeseen risks you encounter when your portfolio drifts from your stated investment policy.

Below is an illustration showing the effect of not rebalancing your portfolio. These charts illustrate how a portfolio would be substantially changed from the original allocation established five years ago. For example, this illustration allocated a portfolio in January 2012 without rebalancing. The large value allocation would have grown by 25% (from 20% to 25%) and the bond allocation would have decreased by 30.3% (from 30% to 20.9%). As you can see, this portfolio has changed from what the investor had originally planned.

January 2012



December 2016



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