MONTHLY NEWSLETTER

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Why Regular Rebalancing Makes Sense

Your investment portfolio may be off-kilter, and you may not even know it.

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"With the new day comes new strength and new thought"

-Eleanor Roosevelt

Is 80% of your portfolio held in equities? Perhaps it is without you realizing it. You could invite this risk, and others, if you go too long without rebalancing your portfolio.

Some investors stick with the same asset allocation in their investment portfolios (and retirement accounts) for decades: they "set it and forget it." The longer the initial (target) asset allocation goes unreviewed, the greater the potential divergence between the target allocation and the actual allocation.

Just how off-kilter can a portfolio become without rebalancing? Some research from the respected financial analytics firm Ibbotson Associates provides an answer. Looking back, a portfolio with a 50/50 split between equities and fixed-income investments in 1926 would have had 96.7% of its assets held in equities and 3.3% in fixed-income vehicles by 2010 without rebalancing. Even a portfolio with only a

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10% stake in equities in 1926 would have become 76.3% equities by 2010 with the same inattention.[1]

While these examples use an 85-year window of time, the lesson is clear. Inattention allows style drift: a shift away from the stated investment policy for the portfolio. (Heavier weighting in equities over time also implies increased volatility for the portfolio.)

What factors should lead you to rebalance? The first factor is the passage of time. You may wish to rebalance your investments every six or twelve months or just as needed in response to changing market climates. The other factor is variance. You may want to rebalance when the percentage of assets held in each asset class varies notably from the target allocation.

What should you rebalance? You can rebalance the percentages of assets held in various asset classes, or your investment choices within an asset class. (You can do both if you wish.)

In a bull market, having a greater percentage of your invested assets in equities than you would ideally intend may work out well. In a flat or down market, it may hurt your return.

Getting away from your defined long-run investment strategy can potentially impact your entire financial and retirement plan. Rebalancing gives you a chance to put your portfolio back on track.

Citations.

1 - thebalance.com/rebalancing-your-investment-portfolio-357128 [11/8/17]

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