Time for a portfolio tune-up

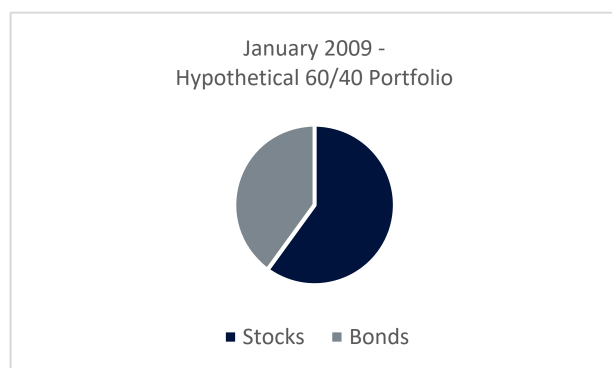
We all strive to strike the right balance in our lives, whether it's balancing work and family obligations or vowing to spend more time at the gym than at happy hour events. Just as we struggle to find the right mix to meet the demands of our personal and professional responsibilities, we may also need to realign our investments occasionally. Determining the right mix of investments in a portfolio is arguably the single most important decision an investor can make. What defines "right" depends on your personal goals, risk tolerance, and time horizon. Historically, major equity and bond markets have delivered positive returns for investors who follow a patient, long-term strategy. However, to realize those potential long-term benefits, investors often have to navigate through periods of short-term uncertainty. An undisciplined approach to investing, particularly during volatile market conditions, can potentially throw our portfolios out of alignment with our long-term goals. Fortunately, it is typically easier to rebalance our investments than it is to strike the perfect balance in our lives.

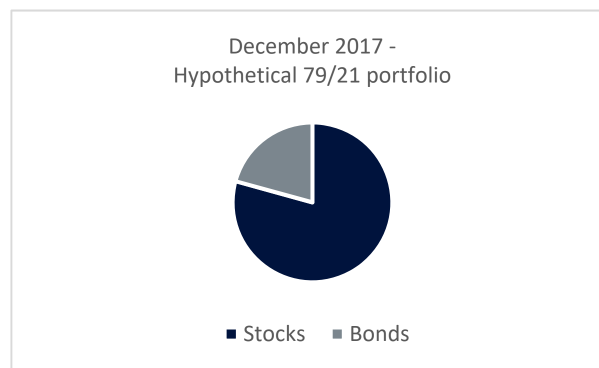
What is rebalancing?

Think of rebalancing as conducting routine maintenance on your portfolio, just like a tune up for your car. Over the course of the year, the market value of each security within your portfolio earns a different return, resulting in a different portfolio allocation than when you started the year. Rebalancing is the act of bringing the allocations back to what you originally set out. It often requires selling investments that have experienced a gain and buying investments that did not perform as well. Now, it can be hard to convince yourself to sell the "winners", but doing so reflects one of the basic principles of investing wisdom: "buy low, sell high." The primary goal of rebalancing is to manage risk: it helps keep your portfolio mix in sync with your tolerance for risk.

Why should I rebalance?

Let's use a simple example of owning 60% stocks and 40% bonds in your portfolio. If stocks rise 10% and bonds rise only 2.5% over the year, your portfolio will be misaligned from where you began, because it will now consist of 62% in stocks and 38% in bonds. To bring your portfolio back in line with your investment target, you should sell 2% of your stocks and buy 2% more in bonds.*





Now let's use an example from the present for that same 60/40 portfolio, using the S&P 500 total return index for U.S. stocks and the Barclays Aggregate bonds index for core U.S. bonds, respectively. Let's say the

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last time you decided to rebalance this portfolio was during the bear market in January 2009. Since then, the relative performance of these investments has caused some big changes to the portfolio mix you initially selected. The hypothetical portfolio depicted in the pie chart shows how U.S. stocks went from 60% of the portfolio in January 2009 to 79% at the end of December 2017, while the proportion of U.S. bonds went from 40% to 21% during the same time.

The equity allocation increased nearly 32% during the period from January 2009 through December 2017, which is not uncommon to see after extended periods of investing during bull markets. Rebalancing may also prevent being overweight stocks or bonds at or near market tops. While there is nothing wrong with having more stocks in a portfolio, that decision should be a result of your planning process and not driven entirely by the markets. The challenge for investors is that more stocks come with more risk, and adding risk to a portfolio may cause investors to derail from the course they originally set out on.

How should I rebalance?

Rather than letting market movements dictate your investment mix, it may make more sense to rebalance your holdings periodically or when your portfolios shift a set amount from your target. Rebalancing annually or semi-annually, or setting a threshold of 5%-10% deviation from the target mix, are typically considered valuable investing practices. The frequency of rebalancing and the target mix can be tailored to your needs, making it easier to stick to a plan. It’s also important to put aside short-term market forecasts when rebalancing your portfolio. Otherwise, you may find yourself tempted to time the market – or afraid to take any action at all – because you are waiting for something to happen over which you have no control.

Bottom Line

Given the uncertainty in today’s markets, this is an opportune time to review the allocation you originally set out. Investing certainly requires patience for the long term, and a disciplined approach can help create value beyond the cyclical trends of the market. Like tuning up your car for that beautiful spring ride, mitigating some of the risks in your investment portfolio during a bull market is a good practice to help you stay aligned with your goals.

**It’s important to note that rebalancing does not ensure a profit or protect against loss in declining markets. Additionally, investors should be aware that there may be costs associated with rebalancing, such as commissions, purchase and redemption fees.*

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