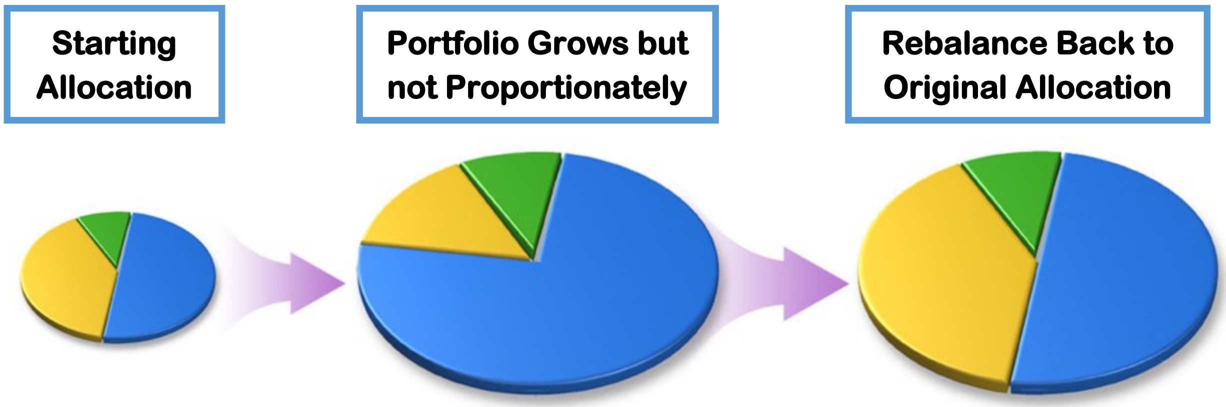
Revisiting Rebalancing

Rebalancing is an overlooked and underappreciated investment strategy. We like to rebalance our portfolios typically once or twice a year. It is a simple yet valuable tool that warrants a closer look.

The illustration bellow shows how rebalancing works to bring our portfolio back to its original allocation.



As illustrated when we rebalance we bring our investment allocation back to the risk level that we targeted originally to meet our goals. The “Blue” investment had grown to a point where it made up a much larger portion of our portfolio. Likewise the “Yellow” investment now makes up a much smaller percentage of the portfolio while the “Green” investment remained about the same. By rebalancing we are going to SELL some of the Blue investment and BUY some of the Yellow. This in theory is selling our winners and buying our losers. While everyone says they want to sell high and buy low this strategy automatically forces us to do just that.

A good example of this would have been during the market crash of 2008. Nobody wanted to buy stocks after 2008 but if we had rebalanced after 2008 we would have been buying stocks (Yellow) which had dropped precipitously and selling other assets (Blue). As we know stocks came roaring back over the following five years and by buying more at the bottom we could have captured a much greater portion of the gains. Conversely at the end of 2014 we would have been selling stocks as their tremendous gains outstripped other assets.

We will be rebalancing your portfolios over the coming weeks. The illustration above is an extreme example of what rebalancing looks like while in practice the changes are much more subtle. When you see multiple trades on your statements or reports this is likely from rebalancing. Rebalancing takes the emotion out of our investment decision, it brings us back to our original investment allocation and ultimately reduces our risk of becoming non-diversified.

Today the assets that have underperformed the greatest are International Stocks, Emerging Markets and Energy. While Bonds and U.S. Stocks have faired better. I hope you find this helpful. If you have any questions or concerns please contact me.

Warm Regards,

Steve