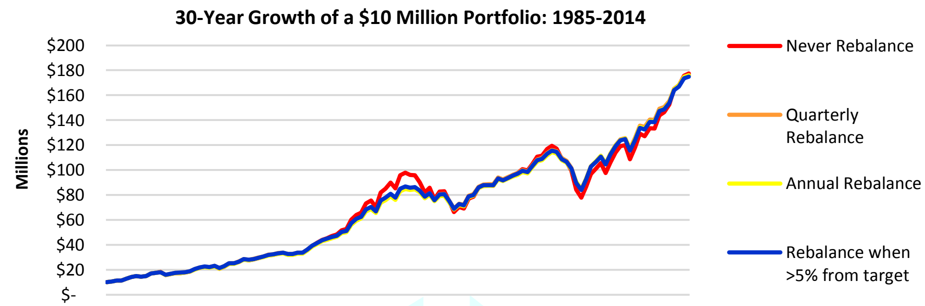
MARKET MICROSCOPE: The Importance of Rebalancing a Portfolio

Having a plan that regularly rebalances an investment portfolio back to its target allocation can improve the investor experience over long periods of time.

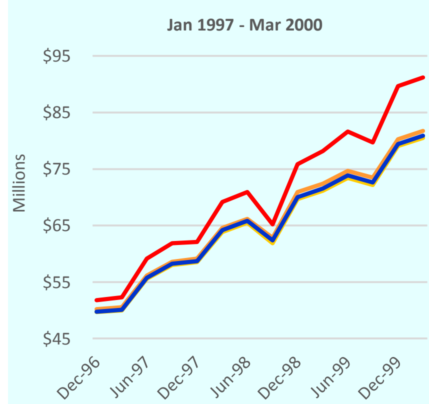
To illustrate, consider a portfolio that starts out with 60% invested in stocks (70% in the S&P 500 Index, 30% in the MSCI EAFE Index) and 40% invested in bonds (represented by the Barclays Aggregate Bond Index). The following table shows the return and volatility of that portfolio over the past 30 years if an investor never rebalanced the portfolio, and then compares that data to several different methods of rebalancing:

	30-Year Return	30-Year Standard Deviation	Risk-Reward Ratio	Rebalances In 30 Years	Final Stock Allocation	Final Bond Allocation
Never Rebalance	9.81%	***11.04%***	0.89	0	***79.2%***	***20.8%***
Quarterly Rebalance	9.86%	9.22%	1.07	120	60.0%	40.0%
Annual Rebalance	9.88%	9.21%	1.07	30	60.0%	40.0%
Rebalance When > 5% From Target	9.87%	9.29%	1.06	15	61.8%	38.3%

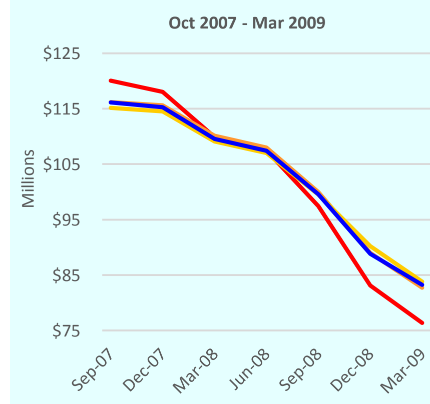


The 30-year return of each rebalanced portfolio is slightly higher than the portfolio that never rebalanced, but more importantly the portfolios that regularly rebalanced experienced significantly less volatility. Note that the reduction in volatility is roughly the same regardless of the method of rebalancing used.

If an investor never rebalances it also creates the potential for ever-larger drawdowns as the portfolio strays farther from its target allocation over time.



	Cumulative Return
Never Rebalance	76.0%
Quarterly Rebalance	62.8%
Annual Rebalance	62.1%
Rebalance When > 5%	62.5%



	Cumulative Return
Never Rebalance	-36.4%
Quarterly Rebalance	-28.8%
Annual Rebalance	-27.2%
Rebalance When > 5%	-28.3%

The bottom line is that *HOW* you rebalance a portfolio doesn't matter as much as having a rebalancing plan and *STICKING TO IT*!

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