

Rebalancing Your Portfolio

By Steve Gilbertson

Many people are of the opinion that, once they have picked their investment allocation for their portfolio, their work is done. While it is true that it is unnecessary (and often detrimental,) to micromanage your portfolio, it is still beneficial to periodically tweak your portfolio to make sure that it is still in line with your desired allocation. Neglecting this important step can be a significant roadblock in reaching your retirement goals.

Because different types of investments grow at different rates (depending on market conditions, level of risk, etc.,) it is likely that, over time, the investment allocation of your portfolio will get “out of whack” from your original allocation. For this reason, it is prudent for individuals to periodically “rebalance” their portfolios to bring them back in line with their original asset allocation mix.

For example, consider the following hypothetical scenario: If you originally chose a mix of 70% stocks and 30% bonds, a strong stock market and a relatively weak bond market could, over the course of a few years, transform the allocation to 90% stocks and 10% bonds. Because of this skewed allocation, the portfolio would have a much higher level of risk-exposure and volatility than was originally intended. Rebalancing, then, is clearly a necessary action in making sure that your portfolio is still in-line with your risk tolerance and investment objectives. What’s more, because you are selling some of the over-performing investments and buying more of the under-performing investments, you are, in essence, buying low and selling high.

Generally, it is recommended that you rebalance your portfolio once a year, particularly if any of your investments are off-kilter by more than 4 – 5%. There are a couple of different ways to do this, depending on the type of account:

- 1) **For tax-deferred accounts (such as your 401(k) or your IRA)** - Rebalance by simply shifting assets among your current holdings to your target allocation. Because the account is tax-deferred, you will not incur taxes on these transfers
- 2) **For taxable accounts** - Rebalance by adding new contributions to under-weight investments within the allocation. This will allow you to avoid paying taxes from the rebalancing process.

Either method of annual rebalancing is fairly easily accomplished, and considering the positive effect that it can have on meeting investment objectives, it is well worth the effort.

If you have questions regarding this topic or would like to discuss rebalancing your investment portfolio, please contact Steve Gilbertson at sgilbertson@bryton.com, 515.223.1601.