

# Maintain your balance

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Investments can behave differently over time, which means your portfolio's allocation could stray from your initial objectives. However, by rebalancing periodically, together we can help ensure your portfolio is properly allocated to investments that align with your comfort with risk and help you meet your financial goals.

## Designed with a purpose

When you developed your financial strategy, your Edward Jones financial advisor helped build a portfolio with an asset allocation — the amount invested in different equity and fixed-income asset classes — that aligned with your goals and risk tolerance. We pay close attention to asset allocation because it's been shown to be the key determinant of how a portfolio's return varies over time.\*

Additionally, combining asset classes that perform differently or are more likely to move in opposite directions can help manage the risk of a portfolio. Over time, as markets move, your portfolio's allocation can change from what you originally intended, which also changes its risk profile. Because proper diversification is crucial, review your portfolio's asset allocation regularly and rebalance when needed.

## What you need to know

- The asset allocation of your portfolio should be designed purposefully based on your goals and comfort with risk.
- Rebalancing can help:
  - Keep your portfolio's risk exposure aligned with your comfort with risk
  - Take the emotion out of investment decisions
  - Provide the potential for improved risk-adjusted returns
- If you don't rebalance actively, the market can do it for you, which can be a painful process.

\* "Determinants of Portfolio Performance II: An Update," Gary P. Brinson, Brian D. Singer and Gilbert L. Beebower, *Financial Analysts Journal*, 1991.

## Rebalancing methods

**Calendar rebalancing** - As its name implies, calendar rebalancing is done at regular intervals, such as monthly, quarterly or annually. For example, if you chose annual rebalancing, your portfolio would be realigned to its original allocation once a year.

**Threshold rebalancing** - Using this method, you'll rebalance your portfolio when an asset class strays from its target allocation by a certain amount or threshold. For example, suppose you establish your initial asset allocation at 65% stocks and 35%

bonds. If you set a 5% threshold for rebalancing, you'll restore your portfolio to the original 65/35 split when the stock portion rises above 70% or falls below 60%.

Which method is better? The main benefit of rebalancing is to prevent your portfolio from wandering too far from its objectives and taking on too much risk — which could happen at any time of the year. That's why we favor threshold rebalancing. However, we believe either method is preferable to not rebalancing at all.

## Why rebalance?

### 1. Keep your portfolio aligned with your comfort with risk

How can rebalancing help you manage risk? Suppose you began investing in 1993 with a portfolio weighted 65% in stocks and 35% in bonds, an allocation that aligned with your goals and comfort level with risk.

### Portfolio allocation to stocks without rebalancing

Starting allocation — 65% stocks/35% bonds

■ Actual percentage in stocks ■ Desired percentage = 65%



Source: Morningstar Direct, Edward Jones calculations; 1/1/1993-12/31/2022. Stocks represented by the S&P 500 TR USD Index. Bonds represented by the Bloomberg US Aggregate Bond TR USD Index. An index is unmanaged and is not available for direct investment. For illustrative purposes only, this portfolio is not available for investment. All performance data assumes reinvestment of interest and dividends back into the indexes. Diversification and rebalancing do not ensure a profit or protect against a loss. Past performance does not guarantee future results.

If your stock allocation changes over time, your portfolio would have different return and risk characteristics. While a larger allocation to stocks may increase return potential, it also comes with higher risk.

The chart on Page 2 shows how much your stock allocation would have increased if you never rebalanced your portfolio. If you never rebalanced, the percentage of your portfolio allocated to stocks would have increased to more than 80% at times, which also means too much risk based on your objectives. A portfolio with an 80% allocation to stocks would make more sense for clients with higher returns and risk objectives than a portfolio with a 65% allocation. Remember that your portfolio should be designed with your goals and comfort with risk in mind.

Rebalancing your portfolio regularly could have helped prevent this overweighting in stocks and kept the risk exposure aligned with your risk tolerance. It also would have helped reduce the impact of the declines on your portfolio, when the market essentially rebalanced for you. Proactively rebalancing your portfolio would also have taken advantage of the upturn in 2009 by adding to stocks when you would have been underweight. That's because rebalancing works both ways.

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## Why rebalance?

### 2. Take emotion out of asset allocation decisions

The graphic below shows that how we feel does not necessarily align with the future performance of the markets. When consumer confidence is low, we tend to have a negative outlook, such as in 2003 and 2008. But stock prices were also low, and future returns ultimately tended to be higher. The opposite has also been true, like in 2000, when confidence (and the markets) were at highs.

On average, stocks returned 13.89% per year following a consumer confidence reading of 66 or lower. When consumer confidence and stock prices were higher, future returns tended to be low, averaging 5.01% per year following consumer confidence readings of 110 and higher. Investors' emotions caused them to chase performance, overreacting to market conditions and, ultimately, buying high and selling low.

Rebalancing runs counter to our emotions. It can force us to reduce some of our winners and add to asset classes that have underperformed. We like buying when the markets are up because we feel good; we sell when the markets are down because we're worried. You can help avoid this bad habit by establishing an automatic rebalancing program.

With a rebalancing program in place, you can sell a percentage of assets that, because of significant price appreciation, have taken on a larger percentage of your portfolio than you had originally intended. At the same time, you can buy underweight asset classes whose performance may have lagged but now may be poised for recovery. In short, you'll be keeping the asset allocation of your portfolio in proper alignment with your goals and risk tolerance, which may also allow you to take advantage of market opportunities.

# Consumer confidence and stock market performance

(4/30/1967 - 12/31/2022)



Sources: FactSet, The Conference Board, Bloomberg and Edward Jones calculations. Past performance is not a guarantee of future results. Further distribution prohibited without prior permission. The Dow Jones Industrial Average (Dow) is an unmanaged index and is not meant to depict an actual investment. Figures do not include fees, commissions or expenses, which would have a negative impact on investment results. Annualized % change in the DJIA calculated using 1 year forward looking returns. Consumer Confidence is a survey conducted by the Conference Board measuring consumer optimism or pessimism with respect to the economy in the near future. The Conference Board is a not-for-profit research organization for businesses that distributes information about management and the marketplace. It is a widely quoted private source of business intelligence.

## Why rebalance?

### 3. Provide the potential for improved risk-adjusted returns

While the primary goal of rebalancing is to help keep your portfolio's asset allocation and risk aligned with your objectives, having a rebalancing strategy in place could also help improve return potential and smooth out volatility over time relative to a non-rebalanced portfolio, especially in a market where the leading types of investments frequently change.\* That said, outperformance should not be your objective — you should work to ensure your performance, risk and asset allocation are all aligned with your financial goals.

\*Rebalancing cannot guarantee a profit or protect against a loss.

### Issues to consider when rebalancing

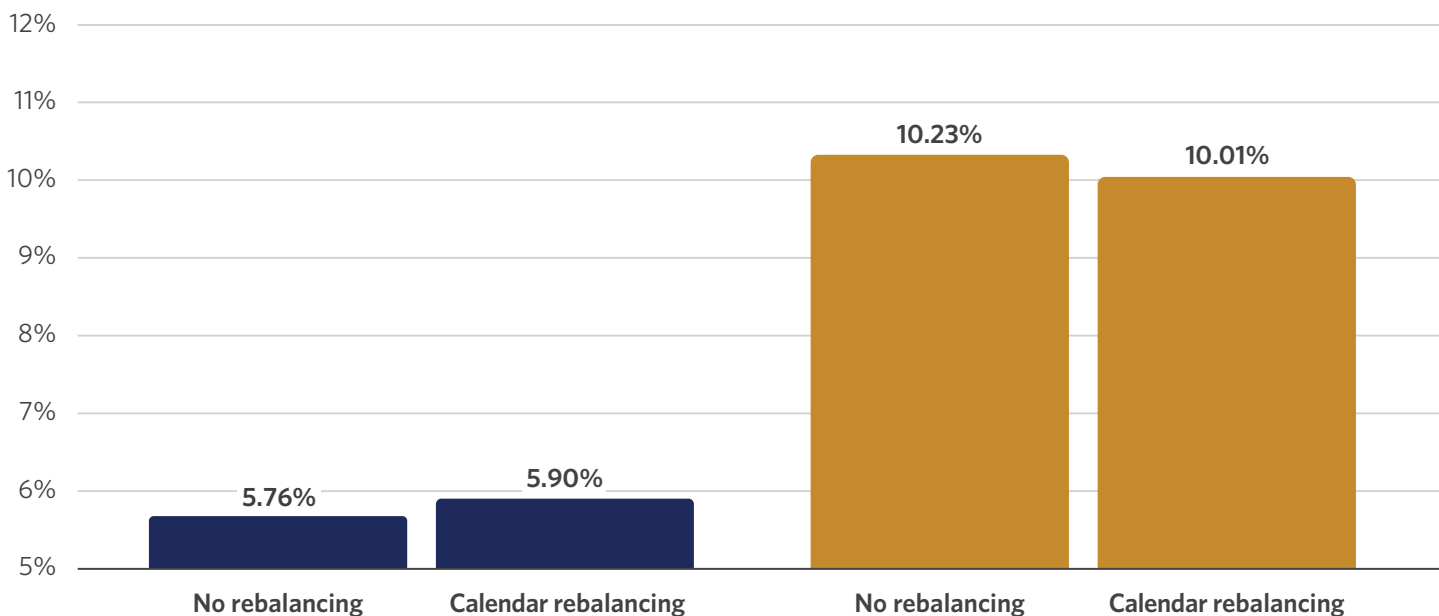
If rebalancing has all these benefits, why not do it anytime your portfolio deviates slightly from your stated risk tolerance? Because there are trading costs, and you could owe taxes from selling overweighted assets (in a taxable account).

But taxes should not be the key driver of the rebalancing decision. Essentially, you'll want to rebalance when the increased risk to your portfolio (due to the overweighted positions) outweighs the trading costs and potential tax ramifications associated with it.

## Rebalancing can help manage risk

Rebalancing vs. not rebalancing — Starting allocation 65% stocks/35% bonds

■ Annualized total return ■ Risk



Source: Morningstar Direct, Edward Jones calculations; 1/31/2000–12/31/2022. Stocks represented by the S&P 500 TR USD Index. Bonds represented by the Bloomberg US Aggregate Bond TR USD Index. An index is unmanaged and is not available for direct investment. For illustrative purposes only, this portfolio is not available for investment. All performance data assumes reinvestment of interest and dividends back into the indexes. For calendar rebalancing, we rebalanced back to the starting allocation annually. Calculations do not include the impacts of trading, liquidity, costs, fees or taxes a client can experience when investing, which would lower performance results. Diversification and rebalancing do not ensure a profit or protect against a loss. Past performance does not guarantee future results.

## Take action

Rebalancing your portfolio can help you work toward your long-term goals without straying too far from your initial asset allocation and comfort level with risk. In addition to helping take the emotion out of investing, it also can help smooth volatility and provide the opportunity for better risk-adjusted return potential over time.

So, has your portfolio become out of alignment? This may mean you need to add money to an underweight investment or sell some of an overweight investment and reinvest those funds. Your portfolio was designed to help meet your long-term goals, and it's important that your allocation still aligns with these goals to keep you on track.

Automatic rebalancing and asset allocation do not guarantee a profit or protect against loss.

