Ehlen Heldman

ehlenheldman.com

Rebalancing: The Secret to Long-Term Investing Success

Investing isn't just about choosing the right mix of stocks, bonds and other assets, it's also about maintaining the right mix over time. That's where rebalancing comes in.

What is Rebalancing?

Rebalancing is the process of adjusting your investment portfolio to restore its original or target allocation, helping you maintain a well-structured portfolio. When we develop our investment portfolio, we consider several key factors, including risk tolerance, time horizon, financial goals, liquidity needs, tax considerations and the economic outlook. Based on these assessments, we review all investment accounts to determine the optimal asset allocation. Over time, market fluctuations can cause some investments to outperform (or underperform) others, shifting your portfolio's original balance of stocks, bonds and cash.

Why You Need to Rebalance

1. **Manage Risk Exposure**: Your asset allocation is designed for your personal financial goals but as the market often shifts, so does your portfolio balance. If stocks outperform bonds, for example, your portfolio may become more stock-heavy, increasing your exposure to risk. Rebalancing prevents your portfolio from becoming too aggressive or conservative over time.
2. **Maintains Investment Strategy**: Rebalancing helps you sell high and buy low. When one asset class performs well, it's a good time to sell some of those assets and reinvest in underperforming ones. This strategy can help you lock in gains and reduce the chance of being overly exposed to any one investment that may be at risk of a downturn.
3. **Encourages Disciplined Investing:** Rebalancing forces you to sell high and buy low, a fundamental principle of successful investing. It prevents emotional decision-making, such as chasing hot-performing investments or panic-selling during downturns.
4. **Enhances Long-Term Returns:** While rebalancing doesn't guarantee higher returns, it can improve risk-adjusted returns over time by ensuring that your portfolio remains diversified and positioned for steady growth.

How Often Should You Rebalance?

1. **Calendar-Based Rebalancing:** Rebalancing doesn't need to happen every month or even every quarter. Many investors choose to rebalance annually or semi-annually. This approach ensures a regular check-in without excessive trading.

2. **Threshold-Based Rebalancing:** You may also choose to rebalance when your portfolio's asset allocation drifts by a certain percentage, typically 5-10% away from your target allocation. For example, if your 60/40 portfolio shifts to 65/35, you may rebalance to restore the original allocation.
3. **Life Event Rebalancing:** Major life changes such as a new job, marriage, birth of a child or retirement may require a shift in investment strategy. Reviewing your portfolio in response to these events ensures your investments align with your evolving goals.

How to Rebalance Your Portfolio

1. **Selling Overweighted Assets:** As one asset class grows too much, selling a portion and reinvesting in underweighted areas will restore proper allocation.
2. **Using New Contributions:** Direct new investment contributions toward the underweighted assets to rebalance gradually.
3. **Dividend and Interest Reinvestment:** Redirect dividends and interest payments into underperforming assets to help rebalance without selling.

Tips for Success

1. **Automate the Process**: Some investment accounts offer automatic rebalancing features, where the portfolio adjusts itself based on your target allocation or time frequency. This can take the guesswork out of rebalancing and help ensure you stay on track with minimal effort.
2. **Avoid Emotional Decisions**: Rebalancing should be a strategic decision based on your financial plan, not emotional reactions to market fluctuations. Avoid making changes in response to short-term market volatility. Instead, stick to your long-term strategy and rebalance when it makes sense according to your schedule.
3. **Keep Costs in Mind**: Rebalancing can trigger transaction fees or tax liabilities, particularly if you're selling investments that have appreciated in value. Before rebalancing, consider how much these costs may impact your returns, the type of account they are held within, and whether they're necessary to maintain your portfolio's balance.

Rebalancing is essential for keeping your investment portfolio balanced and aligned with your financial goals. It helps keep your investments on track with your financial goals by ensuring that your asset allocation reflects your risk tolerance and the market conditions. By setting a regular rebalancing schedule, reviewing your goals, and staying disciplined, you can maximize the potential of your investments while minimizing unnecessary risk.

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