

When to rebalance:

Portfolio strategies for long-term wealth planning



Establishing an appropriate portfolio allocation is key to supporting your long-term wealth building potential. A strategically allocated portfolio can help manage downside risk, support growth potential and stay aligned with your goals over time. Your specific allocation should be based on your investment objectives, risk tolerance, time horizon and overall financial plan. Developing a custom portfolio that makes sense for you takes time and effort, and it's important to ensure your allocation continues to meet your needs over time.

However, many investors mistakenly view the investment allocation process as a one-time event. In reality, it's important to regularly review and rebalance your investments to help ensure they continue to meet your needs as your life evolves.

What is portfolio rebalancing?

Rebalancing is the process of realigning a portfolio back to its target asset allocation by buying and/or selling investments, or by directing new contributions or withdrawals, to help maintain a consistent level of risk. While it may seem counterintuitive to sell assets that have performed well, doing so may help limit allocation drift and keep the portfolio aligned with your risk tolerance and objectives.

Consider the necessity of pruning a hedge: Over time, some branches may grow more quickly than others; without regular trimming and shaping, the hedge becomes uneven, unhealthy and may not look as you intended. However, regular trimming can encourage growth in other areas and may help keep the hedge growing as intended. Similarly, rebalancing allows you to bring your portfolio back to its target allocation, which may help keep it aligned with the direction of your goals.

The potential benefits of regular rebalancing include:

- **Risk management:** Rebalancing helps prevent portfolio weightings from drifting too far from your target allocation, which can help maintain your intended risk exposure. However, it may also involve transaction costs and taxable events, particularly in taxable accounts.
- **Goal alignment:** Rebalancing helps ensure your investment allocation continues to reflect your long-term financial goals and risk tolerance.
- **Disciplined approach:** Regular rebalancing at pre-determined intervals can help you remain disciplined in your investment approach and avoid emotional investment decisions such as chasing investment gains or panic selling during a downturn.
- **Risk/return consistency:** Rebalancing can help manage portfolio volatility and maintain a more consistent risk profile over time. Outcomes vary depending on market conditions, taxes, costs and implementation, and rebalancing may cause a portfolio to lag during strongly trending markets.

Rebalancing strategies

When it comes to rebalancing your portfolio, timing matters. Selling investments can lead to taxes and transaction costs, so you don't want to rebalance too often. However, waiting too long to rebalance could lead to significant asset drift that can expose you to unnecessary risk. Establishing a rebalancing strategy in advance can help you balance the pros and cons of rebalancing while also avoiding emotional decisions during periods of market volatility.

Following are three common rebalancing strategies to consider.

1. **Time-based rebalancing:** Time-based rebalancing involves establishing a set frequency at which rebalancing will occur, most commonly quarterly, semi-annually or annually. This approach can be easy to implement, and it removes emotion from the rebalancing process.

However, more frequent rebalancing can potentially lead to higher transaction costs and capital gains tax exposure. And, during volatile markets, your portfolio allocation could drift significantly between rebalancing, which could result in additional risk exposure.

2. **Threshold-based rebalancing:** Using a threshold-based approach, rebalancing is triggered when an asset class deviates from its target allocation by a pre-established percentage. For example, if your target allocation to equities is 60% and you establish a 5% threshold, you would rebalance when your equity allocation exceeds 65% or drops below 55%.

This approach may lead to fewer trades during stable markets when rebalancing isn't as essential, potentially resulting in lower transaction fees and tax liabilities. It's also more sensitive to market movements, which can result in a more consistent risk profile.

Threshold-based balancing requires ongoing portfolio monitoring, and in volatile markets, it can lead to excessive trading, resulting in increased transaction costs and additional tax liabilities.

3. **Hybrid rebalancing:** A hybrid rebalancing strategy combines elements of both time-based and threshold-based approaches. Typically, it works by setting a time frequency for portfolio reviews but only rebalancing if the portfolio has drifted from its targets by the pre-determined threshold.

Hybrid rebalancing is a commonly used approach because it combines the discipline of a time-based strategy with the risk management and cost effectiveness of a threshold-based strategy. Your advisor can help you establish a rebalancing strategy that makes sense for your unique situation.

Additional rebalancing tips

In addition to establishing the right timing strategy, the following tips may help improve the efficiency of your rebalancing approach.

- **Use new cash flow to achieve your target allocation:** Directing new money to underweighted asset classes may help you avoid the transaction costs and potential capital gains tax exposure of selling off existing assets.
- **Rebalance within your tax-deferred accounts:** Whenever possible, consider rebalancing within your tax-advantaged accounts, such as your 401(k) or IRA, where portfolio transactions generally do not result in current capital gains taxes.
- **Reevaluate with any major life event:** Major life changes—getting married, having a child, nearing retirement—should always trigger a review of your investment allocation and rebalancing strategies. Your advisor can help ensure your portfolio continues to meet your needs as your life and situation evolve over time.
- **Include trusts in your rebalancing review:** It's important to review how personal or charitable trusts fit into your family's aggregate, multi-generational asset allocation. Trusts are often designed with specific goals, time horizons or beneficiaries in mind, but their investments can still drift over time.



How we can help

Keep in mind that the most effective rebalancing strategy is the one you can stick with over time. This may mean implementing a unique approach to navigate the challenges you face. Your wealth advisor can help you establish a portfolio allocation and rebalancing strategy based on your individual circumstances, including your risk tolerance, time horizon and needs. This holistic approach helps ensure your rebalancing strategy aligns with your life goals, not just market changes.

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