



Invest

Rebalancing Your Investments

Nutritionists talk about “balanced diets,” journalists write articles about the “work/life balance,” and economists discuss “balanced budgets.” Balance also applies to investing. An investment portfolio is in balance when it matches the asset allocation that was originally set for it.

In the Beginning

Asset allocation is the strategy of dividing a portfolio among the various asset classes — stocks, bonds, and cash equivalent investments. An asset allocation should reflect a person’s goals, risk tolerance, and investment time frame.

However, investment values don’t stand still — they change almost every day. So over time, a substantial change, up or down, in one asset class (e.g., stocks, bonds) can have a major impact on a portfolio’s allocation. In other words, portfolios can become unbalanced.

“Rebalancing a portfolio helps keep an investment strategy on track.”

Why Rebalance?

When a portfolio becomes unbalanced, its exposure to investment risk changes. Suppose a portfolio is originally allocated 75% to stocks. But, over time, stock values increased significantly. Instead of representing 75%, stocks now represent 90%

of the portfolio. Since stocks carry more risk than bonds or cash equivalent investments, the current portfolio is invested much more aggressively — and exposed to much more risk — than originally planned.

On the other hand, if the percentage of stocks in a portfolio drops below the desired asset allocation, there is less exposure to risk. There’s also less potential for the portfolio to reach its target goals because it is invested less aggressively than originally planned.

In either situation, rebalancing may be needed to restore the appropriate level of risk in the portfolio.

Rebalancing is also recommended when someone’s investment goals or feelings about risk change. For example, when retirement is a long way off, a person may be very comfortable with a relatively aggressive portfolio that is weighted toward stocks and relatively light on bonds and cash equivalents. But when retirement is not very far away, that same person may want less risk exposure. Rebalancing to



have a smaller portion of the portfolio invested in stocks and a greater portion invested in less risky bonds and cash equivalents will accomplish that.

Getting Back in Balance

There are two ways to rebalance. One is to sell investments in the asset class that has become too large and use the money to buy additional investments in the asset classes that are too small relative to the desired allocation. (This may create a taxable event if the investments are not in a tax-deferred account, such as a retirement account.) The other way to rebalance

is to invest new savings in the underrepresented asset classes until the portfolio is back to its original asset mix.

Rebalancing a portfolio helps keep an investment strategy on track. While it may be hard to move money out of an investment or asset class that's doing very well, the investment markets have a history of ups and downs. An investment that is performing well today may face a rough patch in the not too distant future. Similarly, asset classes that are currently underperforming may be tomorrow's winners.

Beginning: Balanced		After Performance Differences			Rebalancing Back in Balance	
Stocks	75%	Stocks	90%	- 15%	Stocks	75%
Bonds	20%	Bonds	8%	+ 12%	Bonds	20%
Cash Equivalents	5%	Cash Equivalents	2%	+ 3%	Cash Equivalents	5%

This sample allocation is a hypothetical illustration only. In applying any asset allocation model to a person's individual situation, it is important to consider other assets, income, and investments (for example, home equity, other retirement accounts, and savings accounts) in addition to the balance in the investment account.

Source: NPI

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