

## A BALANCING ACT

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Many of our clients understand the potential benefits diversification can provide when constructing an investment portfolio. However, it is important to remember that this well-diversified portfolio can easily lose balance. A portfolio's structure is designed around the investor's investment objective. This objective is based on the client's risk tolerance and goals. With this in mind, the portfolio is designed in part, by setting a percentage or allocation for each type of individual position comprising the portfolio. As time passes, these positions within the portfolio will change causing the original allocation to change as well. These changes affect both the risk exposure of the account as well as the performance potential. Rebalancing is a simple but extremely important process which helps the original allocation of the portfolio to remain aligned with the client's objective and goals.

### WHEN TO REBALANCE

Two commonly accepted practices are used to determine when to rebalance. The first method tracks allocation by percentage. When an allocation moves beyond a designated variance, say plus or minus 10%, the

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investments are adjusted or rebalanced, back to the original allocation. Another method of determination is based on scheduled intervals. Many investment managers rebalance on a regular schedule, such as every six to twelve months.

### CONSIDER THESE SCENARIOS

To gain a better understanding of the rebalancing process, let's consider a portfolio with a target asset allocation consisting of 60% stocks and 40% bonds. For this example we will assume stocks have performed better than bonds over the course of a year, causing the alloca-



tion to change to 80% stocks and 20% bonds. Through market action alone, the percentage of stocks has increased along with the performance of the portfolio. At this point many investors might focus on short term performance. Hoping to maintain return, consideration is not made toward the increased risk exposure this new allocation has created. However, as we know, markets don't go up forever. With a larger percentage allocated toward stocks, this portfolio is exposed to more risk and higher volatility than originally designed due to a greater exposure on the equity side of the market. A market drop in equities can mean greater losses to this same portfolio than if it had been rebalanced back to the original allocation of 60% stocks and 40% bonds. Although the equities remain a more volatile risk over

bonds, reducing the exposure to 60% can help to limit any losses within the equity allocation.

A lack of consistent rebalancing can expose a portfolio to opportunity risk as well. Let's assume that as time passes, the same 60% stock and 40% bond portfolio experiences an increase in the value within the bond allocation. Due to market conditions, bonds now reflect 60% of the portfolio and stocks 40%. Should the market favor growth in stocks the portfolio will reflect a smaller return than one containing the 60% stock allocation originally intended.

#### A POWERFUL TOOL

As you can see, rebalancing is a tool to help manage an investment portfolio. Used properly it can also provide

opportunity to buy low and sell high. Portfolios are rebalanced through the sale and purchase of the underlying positions. Although the act itself sometimes can feel unnatural, as oftentimes well performing positions are sold to purchase those that have not performed well, it serves to manage risk and create further opportunity within the account.

At Vantage we manage each account based on our client's investment objective and goals. Rebalancing is one of the many tools used by our Investment Managers to maintain the desired asset allocation of the investment strategy. To find out how this tool is applied to your account, please contact your Relationship Manager.

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## VANTAGE NEWS

Get better acquainted with one of our team as they share a little about themselves...

FAVORITE MOVIE King of Kings

FAMILY My two daughters are my best friends.

PAST I became a U.S. citizen at the age of 18.

SURPRISE US I am a twin.

OUTSIDE OF WORK I enjoy playing and laughing with my grandchildren.

AT VANTAGE I love meeting clients and providing great service to them.

ANYTHING ELSE I enjoy reading and writing about our great God.



Maria Saravia  
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