Rebalancing Your Account

What rebalancing is and why it is important

Portfolio rebalancing is like a tune-up for your car: it allows individuals to keep their risk level in check and minimize risk. It's also helps you to take advantage of differences in performance among investments in a diversified account by buying low and selling high.

For participants invested in Target Risk Model Portfolios:

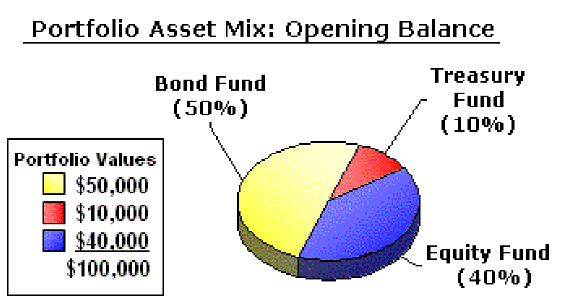
- Rebalancing is done for you; there is no need to do anything

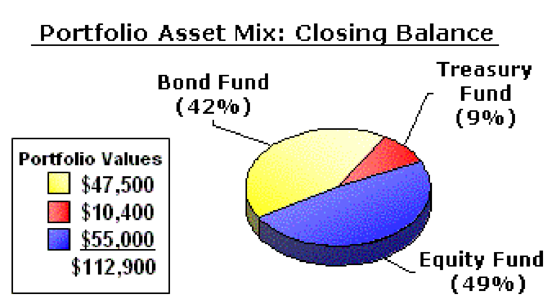
For Do it Yourself Investors, this article covers:

- How to rebalance your account at Ascensus
- How to set up automatic rebalancing

What Is Rebalancing?
Rebalancing is the process of buying and selling portions of your portfolio in order to set the percentage or weight of each asset class back to its original state. In addition, if an investor's investment strategy or tolerance for risk has changed, he or she can use rebalancing to readjust the weightings of each security or asset class in the portfolio to a new asset allocation.

Your asset mix inevitably changes as a result of differing returns among various securities and asset classes. As a result, the percentage that you've allocated to different asset classes will change. The charts below illustrate what happens in a three asset portfolio when, after a period of time, stocks increased 37% in value, the bond fund declined 5%, and the treasury fund increased 4%:





At the end of the year, Bob finds that the equity portion of his portfolio has dramatically outperformed the bond and Treasury portions. This increased the % that he has in the equity fund while decreasing the

% invested in the Treasury and bond funds. In this example, Bob's portfolio is now significantly more risky than Bob originally intended.

An important part of the winning investment strategy is rebalancing the portfolio. Rebalancing is required because the market's movements cause the value at risk of a portfolio to drift -- increasing the danger to the portfolio. Thus, rebalancing is essential to maintaining the plan's desired allocation.

A second reason for rebalancing is that it impacts the risk-adjusted returns of a portfolio -- a well-diversified portfolio will benefit from the differences in performance among asset classes at different times, contributing to lower portfolio volatility. A portfolio that is rebalanced on a regular basis will produce a higher return than the weighted average return of its components. This is often referred to as a "rebalancing bonus," or a "diversification return."

To demonstrate the benefits of rebalancing, Jacques Lussier provided the following example in his book "Successful Investing is a Process."

An investor begins in 1973 with a $100,000 portfolio that is 60 percent stocks and 40 percent treasury bonds. By 2012:

- The S&P returned 9.8% per year.
- Five-year Treasuries returned 7.7%.

Most people would assume that an unrebalanced portfolio would produce a higher return because stocks earned 2.1% more than bonds. Yet:

- An unrebalanced portfolio would have an ending value of $3.2 million (with 77% in stocks).
- A portfolio that was rebalanced annually would have an ending value of $3.6 million

The example demonstrates that when you have assets with both high volatility and low correlation you will have a large "diversification bonus." The greater the volatility of stocks and the lower the correlation of stocks to bonds, the greater the excess performance of stocks must be to compensate for the loss of the diversification benefit gained from rebalancing the portfolio.

This diversification bonus is even greater in portfolios that invest in many different asset classes, such as different types of bonds, small and large cap stocks, international developed market equities, emerging market equities, commodities and real estate. With rebalancing, the differences in performance among asset classes from period to period can lower the volatility and improve returns.

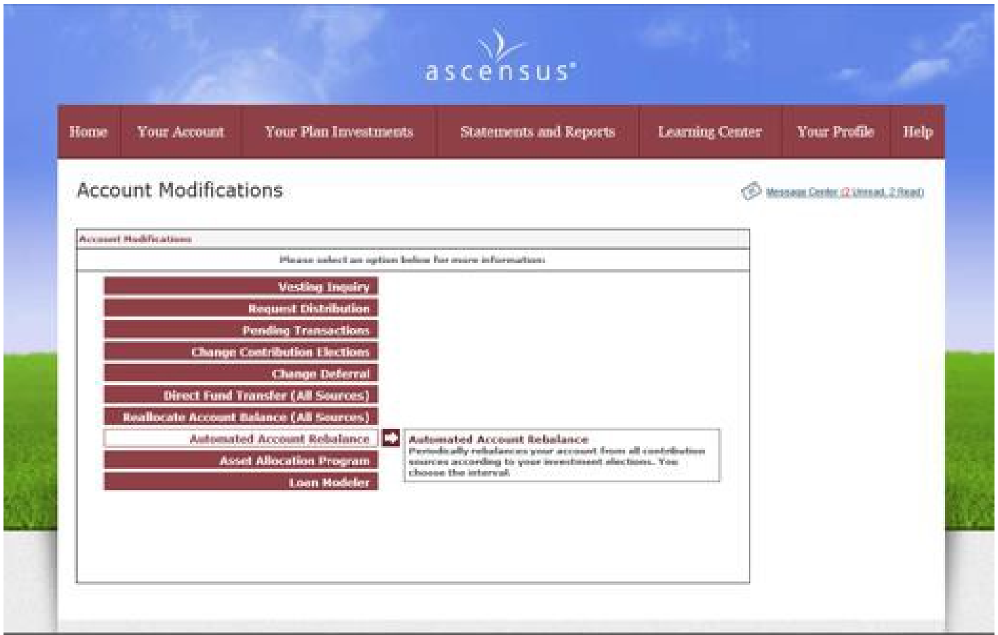
How to Rebalance

If you're invested in a model portfolio, rebalancing is done automatically for you twice a year. Rebalancing occurs on those dates when the percentages in a fund fall above or below a specific threshold, which in this case is 1%.

When you choose your own investments, you need to either set up the automatic rebalance feature, or manually rebalance (one time rebalance) your portfolio. Portfolio management is all about discipline, so we think it is advisable to set up automated rebalancing. Either way, it is recommended that you rebalance with the same frequency that we use for the model portfolios: every six months. Rebalancing more frequently than that can rob you of market momentum and increase frictional costs over time.

How to Set Up Automatic Rebalancing

Log on to the Ascensus website and choose: Your Account>Account Modifications>Automated Account Rebalance



How to Set Up Manual or One Time Rebalancing

Log on to the Ascensus website and choose: Your Account>Account Modifications>Reallocate Account Balances (all sources)