Understanding Rebalancing

First Ascent Asset Management

What is Rebalancing?

Let's say the target asset allocation of your portfolio is 60% stocks and 40% bonds. As markets rise and fall, your portfolio could drift away from that target allocation. **Rebalancing is the process of buying and/or selling holdings to return the portfolio to its target allocation.** This maintains the risk/return characteristics of your portfolio.

Why Rebalance?

It may seem counterintuitive to sell assets that are performing well and purchase assets whose returns are lagging, but there are good reasons for doing so.

- **Risk control.** Assume the stock market rises in value and the percentage of stocks in your portfolio moves to 70% instead of your 60% target. As the percentage of stocks increases, so does the potential for larger declines in portfolio value. Rebalancing lowers this risk.
- **Rational decision making.** Assume the stock market declines in value and the percentage of stocks in your portfolio is now 50%. Rebalancing causes you to automatically purchase stocks when they are "on sale" and it might be difficult emotionally to make those purchases.
- **Consistency.** The table below shows the year-to-year performance of a variety of asset classes, including US and global stocks and US and global bonds. It also shows the performance of a 60% stock/40% bond portfolio that combines these asset classes (the orange boxes).

Annual Returns By Asset Class

1997–2019

'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	Avg.
U.S. equities 31.29%	U.S. equities 23.43%	EM equities 60.88%	Comm. 31.84%	REITs 12.65%	Comm. 25.91%	EM equities 58.81%	REITs 30.85%	EM equities 32.85%	REITs 35.22%	EM equities 39.39%	U.S. bonds 5.24%	EM equities 78.51%	REITs 28.48%	REITs 8.69%	EM equities 18.22%	U.S. equities 33.51%	REITs 30.38%	REITs 2.52%	U.S. equities 12.68%	EM equities 31.06%	Cash 1.86%	U.S. equities 30.84%	REITs 9.37%
REITs 31.29%	60/40 16.22%	Global stocks 29.27%	REITs 26.38%	U.S. bonds 8.44%	Global bonds 16.53%	Global stocks 40.41%	EM equities 26.68%	Comm. 21.36%	EM equities 29.93%	Comm. 16.23%	Global bonds 4.79%	Global stocks 40.44%	EM equities 18.88%	U.S. bonds 7.92%	REITs 17.77%	Global stocks 15.76%	U.S. equities 12.58%	U.S. bonds 0.44%	EM equities 11.77%	Global stocks 27.41%	U.S. bonds –0.08%	REITs 25.84%	U.S. equities 8.77%
60/40 14.17%	Global stocks 15.43%	Comm. 24.35%	U.S. bonds 11.63%	Cash 4.09%	U.S. bonds 10.26%	REITs 35.92%	Global stocks 20.93%	Global stocks 15.78%	Global stocks 26.93%	Global stocks 15.85%	Cash 1.80%	REITs 29.15%	U.S. equities 17.28%	Global bonds 5.51%	Global stocks 17.04%	60/40 15.02%	U.S. bonds 5.85%	U.S. equities 0.40%	Comm. 11.40%	U.S. equities 21.19%	Global bonds –1.58%	Global stocks 21.80%	60/40 6.91%
U.S. bonds 9.65%	Global bonds 13.71%	U.S. equities 23.56%	Cash 5.96%	Global bonds 1.57%	REITs 3.61%	U.S. equities 31`.64%	U.S. equities 12.62%	REITs 11.96%	U.S. equities 15.72%	Global bonds 9.48%	60/40 –22.22%	U.S. equities 28.76%	Comm. 16.83%	U.S. equities 1.08%	U.S. equities 16.44%	REITs 2.47%	60/40 5.42%	Cash 0.03%	REITs 8.60%	60/40 16.16%	REITs –4.57%	EM equities 20.40%	EM equities 6.30%
Cash 5.24%	U.S. bonds 8.69%	60/40 14.66%	Global bonds 3.18%	EM equities –2.80%	Cash 1.70%	Comm. 23.93%	60/40 11.90%	60/40 6.12%	60/40 14.13%	60/40 8.91%	Comm. –35.65%	60/40 22.55%	60/40 11.18%	Cash 0.08%	60/40 11.77%	Cash 0.05%	EM equities 1.24%	60/40 –1.18%	60/40 6.72%	Global bonds 7.84%	U.S. equities –5.17%	60/40 19.68%	U.S. bonds 5.13%
Global bonds 3.79%	Cash 5.05%	Cash 4.74%	60/40 –4.07%	60/40 –6.14%	60/40 –6.33%	60/40 23.74%	Global bonds 9.27%	U.S. equities 6.08%	Global bonds 6.64%	U.S. bonds 6.97%	U.S. equities –37.04%	Comm. 18.91%	Global stocks 10.69%	60/40 –0.17%	Global bonds 4.59%	U.S. bonds –1.97%	Global bonds 0.56%	Global bonds –3.51%	Global stocks 4.73%	REITs 5.07%	60/40 –5.58%	U.S. bonds 8.87%	Global stocks 5.02%
Global stocks –1.07%	REITs –16.50%	U.S. bonds –0.82%	U.S. equities –10.89%	U.S. equities –10.97%	EM equities –7.04%	Global bonds 12.51%	Comm. 9.15%	Cash 3.00%	Cash 4.76%	U.S. equities 5.59%	REITs –37.17%	Global bonds 6.93%	U.S. bonds 6.58%	Comm. –13.32%	U.S. bonds 4.32%	Global bonds –2.27%	Cash 0.03%	Global stocks –4.29%	U.S. bonds 2.75%	U.S. bonds 3.63%	Comm. –12.99%	Global bonds 7.19%	Global bonds 4.36%
Comm. –3.39%	EM equities –18.39%	REITs –4.43%	Global stocks –15.76%	Comm. –19.51%	Global stocks –15.29%	U.S. bonds 4.10%	U.S. bonds 4.34%	U.S. bonds 2.43%	U.S. bonds 4.33%	Cash 4.74%	Global stocks –45.52%	U.S. bonds 5.93%	Global bonds 4.57%	Global stocks –14.31%	Cash 0.07%	EM equities –4.28%	Global stocks –3.39%	EM equities –15.40%	Global bonds 2.14%	Cash 0.84%	Global stocks –14.61%	Comm. 5.44%	Cash 2.12%
EM equities –16.36%	Comm. –27.03%	Global bonds –5.17%	EM equities –27.94%	Global stocks –19.77%	U.S. equities –20.86%	Cash 1.07%	Cash 1.24%	Global bonds –4.49%	Comm. 2.07%	REITs –16.40%	EM equities –53.33%	Cash 0.16%	Cash 0.13%	EM equities –18.42%	Comm. –1.06%	Comm. –9.52%	Comm. –17.02%	Comm. –24.70%	Cash 0.27%	Comm. 0.75%	EM equities –14.76%	Cash 2.25%	Comm. 0.08%

■ U.S. equities ■ 60% equities/40% bonds ■ Cash investments ■ Global stocks ■ Global bonds
■ REITs ■ Emerging markets equities ■ U.S. bonds ■ Commodities

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Source: Vanguard, as of December 31, 2019.

* See "Notes"

The 60%/40% portfolio is not the best performing alternative in any single year, but it is one of the best performing alternatives overall (see column at right) and its performance is very consistent over time.

Notes

Cash is represented by the FTSE 3-Month U.S. Treasury Bill Index. REITs are represented by the MSCI US REIT Index adjusted to include a 2% cash position (Lipper Money Market Average) through April 30, 2009; and MSCI US REIT Index thereafter. U.S. equity is represented by the Dow Jones Wilshire 5000 Index through April 22, 2005; MSCI US Broad Market Index through June 2, 2013; and CRSP US Total Market Index thereafter. Emerging markets equity is represented by the Select Emerging Markets Index through August 23, 2006; MSCI Emerging Markets Index through January 9, 2013; FTSE Emerging Transition Index through June 27, 2013; FTSE Emerging Index through November 1, 2015; FTSE Emerging Markets All Cap China A Transition Index through September 18, 2016; and FTSE Emerging Markets All Cap China A Inclusion Index thereafter. U.S. fixed income represented by Bloomberg Barclays U.S. Aggregate Bond Index through December 31, 2009, and Bloomberg Barclays U.S. Aggregate Float Adjusted Index thereafter. Global fixed income represented by Bloomberg Barclays Global Aggregate ex-USD Float Adjusted RIC Capped Index (USD Hedged). Global equity is represented by the Total International Composite Index through August 31, 2006; MSCI EAFE + Emerging Markets Index through December 15, 2010; MSCI ACWI ex USA IMI Index through June 2, 2013; and FTSE Global All Cap ex US Index thereafter. Commodities are represented by the Bloomberg Commodity Index. Composite 60/40 portfolio's equity allocation consists of 60% U.S.-domiciled stocks and 40% non-U.S. domiciled stocks; bond allocation consists of 70% U.S.-domiciled bonds and 30% non-U.S. domiciled bonds.