Commentary

The rebalancing act: Coaching clients to stay focused

Vanguard | 30 June 2014

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'It's time to rebalance your portfolio.' As an adviser it's probably not the first time that you're bringing this up. The seemingly contrarian exercise of rebalancing can sometimes encounter resistance from clients, which may become more acute as clients hesitate at the notion of reallocating assets into bonds in the current low-interest-rate environment.

Coaching clients to tune out the noise

In a world where information is churned out faster than it can be consumed, clients can find justification for just about any decision to veer off their investment paths or, worse yet, to abandon their investment plans.

Advisers serve as an important line of defence against the noise. By framing client conversations around portfolio risk and the role diversification plays as one of the best defences against unexpected market volatility, advisers can help clients focus on their long-term objectives, so they don't lose sight of the importance of sticking to their target asset allocations.

Best practices for portfolio rebalancing

It is worth revisiting a Vanguard research paper Best practices for portfolio rebalancing, published in mid-2010. The paper clearly explains why periodic rebalancing of a portfolio is critical and discusses why rebalancing is challenging for many investors - particularly after markets have moved sharply up or down.

It describes that it may seem counterintuitive for investors to rebalance portfolios by selling their best-performing assets and committing more capital to underperforming asset classes. "However, historically, significant rebalancing opportunities into equities have occurred after strong negative market events."

The analysis indicates that there isn't an optimal rebalancing strategy that fits all clients. Real-world constraints of taxes, transaction costs, and the dedication of resources such as time are factors that can help determine which strategy might be more suitable for a client. While some clients face stricter constraints than others, you usually can minimise transaction costs by using a portfolio's cash flow, such as dividends, interest payments, realised capital gains, or new contributions, for rebalancing. You can use this cash flow to readjust asset allocations as imbalances occur, reducing the frequency of rebalancing events and, accordingly, any affiliated costs.

As a rule of thumb, portfolio monitoring on an annual or semi-annual basis and rebalancing when asset allocations exceed thresholds of 5% usually work for most broadly diversified portfolios. The recent equity market movements offer a good opportunity to proactively check in with clients to discuss long-term portfolio strategies such as rebalancing.

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