Rebalancing 101: How to Get Your Portfolio Back on Track – Video Transcript

Welcome to “Rebalancing 101: How to get your portfolio back on track.”

Before we dive into what rebalancing is and how to do it, let’s quickly review the basics of asset allocation.

Asset allocation refers to the mix of asset classes in your portfolio. In the simplest terms, it refers to the percentage of money you invest in each of the three primary asset classes--stocks, bonds, and cash. Typically, you will choose an asset allocation based on your investment goals, time horizon, and tolerance for risk.

Once you choose an asset allocation and begin directing money into your portfolio accordingly, the idea is to leave your allocation alone unless something changes in your personal circumstances or financial situation.

However, checking your portfolio occasionally—for example, every six months or so—is probably a good idea because your asset allocation can change on its own due to market performance.

For example, after a period when the stock market performs particularly well, you might discover that your portfolio is too heavy in stocks. On the other hand, if the stock market has performed poorly, you could have too much money in bonds or cash. When you notice this type of allocation drift, it may be time to rebalance—that is, regain your original asset allocation.

There are two primary ways to rebalance your portfolio. The first, and perhaps quickest, is simply to sell some of the assets in which you have too much money, and use the proceeds to buy more shares in the other asset classes. Although this method of rebalancing may result in tax consequences in a taxable investment account, that’s not the case in a tax-advantaged retirement account, such as an IRA or employer-sponsored retirement plan.

The second way to rebalance is to direct new investment dollars into the underweighted asset class until your target allocation is reached. This method typically takes a little longer, but it generally has no immediate tax consequences for either taxable or tax-advantaged accounts because you’re not selling anything. If you use this method, don’t forget to change your allocation of new investment dollars back to the original mix after your target is reached.

As in other areas of life, when it comes to investing, a little regular maintenance can potentially go a long way toward helping you meet your goals. If you have any questions about rebalancing, consider talking to a financial professional.

All investing involves risk, including the possible loss of principal, and there can be no assurance that any investment strategy will be successful.