The Milwaukee Company Wealth Management

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Portfolio Rebalancing Is A Crucial Risk-Management Tool For Investors

In a world laden with economic, financial and political hazards, regular portfolio rebalancing remains a critical risk-management tool for investors, says Andrew Willms, president and chief executive officer of The Milwaukee Company, a wealth management firm in Thiensville, Wisconsin.

“For most individuals, periodically adjusting the allocations of stocks, bonds and other asset classes is an essential strategy to keep a lid on excess risk,” he says.

Simple in concept and easily implemented, rebalancing has proven to be an effective method to manage an investment portfolio so that it continually aligns with an investor’s objective, risk tolerance, time horizon and other characteristics that are unique to every individual. The basic idea is to avoid a dangerous build-up of risk within a portfolio.

“If we could predict the future we wouldn’t need to rebalance,” explains Willms. “The next-best thing is regularly rebalancing a portfolio to avoid extreme results.”

The core idea with rebalancing is selling a portion of assets that have performed well in the recent past and redeploying the proceeds to corners of the portfolio that have been relatively weak. Although any one rebalancing event may not be optimal, over medium- and long-term horizons this strategy provides a time-tested tool to smooth returns and minimize risk.

“The critical factor is consistently rebalancing through time,” advises Willms. “Sometimes it’s tempting to think that you know more than the market and so you forgo rebalancing. But for most investors, that’s usually a mistake.”

Because every investor is different, the particulars of a rebalancing plan should be customized for the individual and her portfolio. Basic variables to consider for designing a rebalancing plan include deciding how frequently to rebalance, choosing parameters that will trigger a rebalancing event and selecting assets for the portfolio.

There are no standard designs, however, because different investors have different objectives and risk tolerances. But even a simple rebalancing plan tends to be better than nothing.

“The closest thing to a universal rule with rebalancing: ignore it at your own peril,” says Willms.

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