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"Helping you Determine your Financial Future"

BFA

Rebalance Your Portfolio!

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Market timing is the strategy of making buy or sell decisions of stocks or other financial assets by attempting to predict future market price movements. In other words, buy when the market is low and sell when the market is high. It sounds simple when described that way, but Andrew Lo of Massachusetts Institute of Technology calculates that a market timer switching between the S&P 500 and Treasury bills would have turned a $1,000 investment into $14,000,000,000,000 from 1926-2002. With that kind of return, why would anyone want to invest our small accounts?

What can we take from this? Investors should have a written plan with regard to how their portfolios are allocated and managed. I believe that the only way to buy low and sell high is to rebalance a diversified portfolio of funds on a periodic basis. Rebalancing is a technique that professional investors use to ensure that a portfolio remains efficiently diversified. It is not complicated; since market segments change at different rates, the percentage of stocks and bonds will change over time. Rebalancing simply involves periodically checking the allocation of the different types of investments in your portfolio, then bringing them back to your desired percentages.

Rebalancing reduces the volatility and riskiness of your portfolio, it can also often enhance your returns. For example; you decide the appropriate allocation is 60% stock and 40% bonds. If stocks advance over the course of time so your allocation is 70% stock and 30% bonds, you will have a more risky portfolio than you chose. Rebalancing would have you sell stocks and buy bonds so your allocation returns to 60/40. Doesn't sound too hard? The hard part is when stocks drop to 50% of your portfolio and bonds rise to 50%. No one wants to sell their safe bonds and buy stocks after they have dropped. But by systemic rebalancing, that is what you need to do.

The right response to a fall in the price of one asset class is never to panic and sell out. Rather you need the long-term discipline and personal fortitude to rebalance. The lower stock prices go the better the bargains for the long term investor.

How often should you rebalance? Stocks and bonds tend to have some momentum, continue to move in the direction they are going. You don't need to rebalance too often. Generally speaking, once a year is enough. Personally if my overall allocation is ±5% out of balance, (e.g. 60% stocks go to 65%) I will rebalance back to my desired allocation. The criteria you use can vary with the comfort level you have, the important thing is to have a trigger and follow it. Keep emotions from ruling your decision making and you will result in the largest market return possible over the long term.

Buck Financial Advisors provides independent, commission-free financial advice for people from all walks of life. When you or someone you know needs help, Buck Financial Advisors is there. See www.buckfinancial.com for more information.

Charles Buck CFP®

Merry Christmas and Happy New Year

Ask the CFP®

Q. My husband participates in his employer's 401K plan; can either of us have an IRA?

A. Although there are restrictions for the deductibility of a Traditional IRA if you participate in an employer retirement plan, anyone can have an IRA . If one of you is an active participant, then the person who is the active participant has their deductibility phased out for income between $89,000 and $109,000. The other spouse may have a deductible IRA if the total income is between $167,000 and $177,000. The limits above refer to a married couple filing jointly. Although you need earned income to make a IRA contribution, if married, it may be your spouse's income.

For a Roth IRA, the only restriction is that your income is below the $167,000 to $177,000 phase-out range.

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