

# Rebalancing Diversified Portfolios

After you have gone through the exercise of determining a suitable asset allocation for your portfolio; you have examined volatility risk tolerance, investment objectives and time horizon; you have evaluated appropriate investment vehicles to construct a portfolio close to a prescribed asset allocation model using mutual funds, UITs, money managers and/or individual securities and determined which account type to use to implement your solution; you have defined and implemented an appropriate asset allocation; it is time to discuss your plans to stay true to your asset allocation strategy through regular rebalancing.

Adhering to a disciplined rebalancing plan not only helps ensure your investments remain in a suitable mix; it also removes the inclination to make emotional decisions based on short-term market movements. Rebalancing from investments in asset classes that have been in favor into investments in asset classes that have been out of favor in the more recent past also reinforces the principals of buying low, selling high and locking in gains.

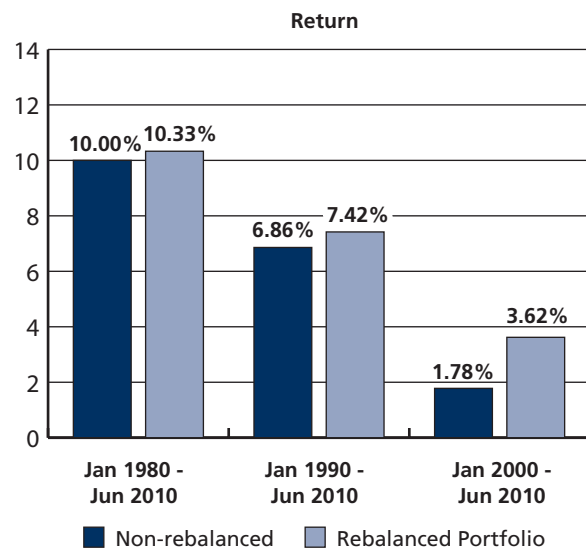
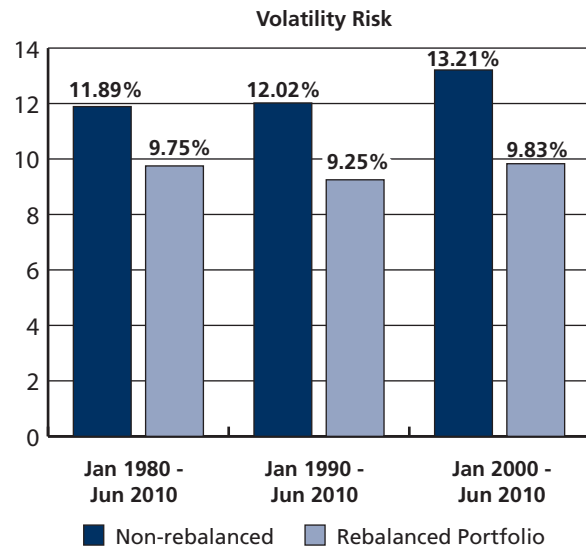
## REBALANCING VS. NOT REBALANCING

The results show regular rebalancing adds value in the form of lower volatility of returns compared to not rebalancing, regardless of the approach used.

This chart compares the volatility risk and return of portfolios rebalanced to those not rebalanced beginning at three different time periods. In all three portfolios, the rebalanced portfolio had a lower volatility risk than the non-rebalanced portfolio. For instance, the rebalanced portfolio beginning January 1990 had a volatility risk of 9.25%, which is only 76.9% of the 12.02% volatility risk of the non-rebalanced portfolio. Although rebalancing was able to help reduce the portfolio volatility risk, the tradeoff was a slight impact in returns. For example, the rebalanced

portfolio beginning January 1990 had a return of 7.42%, compared to the 6.86% return of the non-rebalanced portfolio.

## Volatility Risk And Return Versus Non-rebalanced Portfolios



Source: RBC Wealth Management Advisory Research based on RBC Model Portfolio #3. Rebalanced portfolio is annual.



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## *Rebalancing Diversified Portfolios, continued*

### **REBALANCING HELPS REDUCE YOUR PORTFOLIO'S VOLATILITY**

We believe rebalancing should be considered by every investor, as it is relatively easy to restore a portfolio to its original asset allocation mix.

Because each client situation is different, we consider several different approaches to rebalancing. For instance, tax-sensitive clients would likely adhere to a less frequent rebalancing approach than a client with a large portion of their investable assets in qualified or tax-deferred accounts. Institutional clients with an Investment Policy Statement may have strict thresholds related to the diversification requirements of their target asset allocation and may need to adopt a more disciplined threshold-rebalancing plan.

Decisions may also include whether the rebalancing should be calendar-based or threshold-based and if the rebalancing should be on a quarterly, semi-annual or annual basis. As part of the wealth management process, it is important to have this discussion with your Financial Advisor.

Regardless of the approach used, the results show regular rebalancing adds value in the form of lower volatility risk compared to not rebalancing. Regardless of your financial objectives and volatility risk tolerance, the major benefit of periodic risk management is a potential reduction in portfolio volatility.

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