What to Do After a Strong 2017? Rebalance

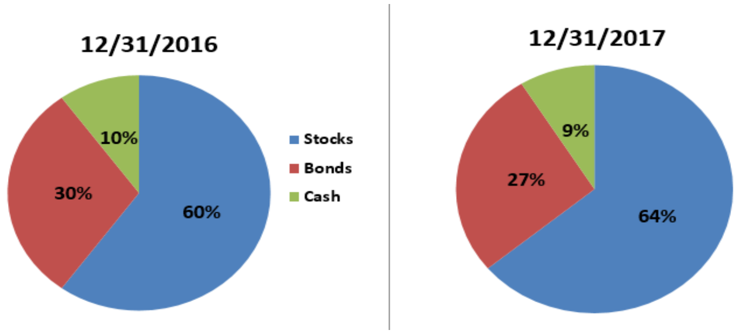
The current bull market is in its ninth year, the second longest in history. The run-up -- capped by an exceptionally strong 2017 -- has left many portfolios heavily weighted in equities and possibly ripe for rebalancing.

The major stock benchmarks all saw double-digit gains in 2017, adding to their already impressive gains since 2009, and leaving many a portfolio overweighted in equities.

By now, you have probably received year-end statements for your investment accounts and retirement plan. If your investments include a large share of stocks or stock funds, the news was probably good. In fact, 2017 was a banner year for stocks in general. The S&P 500 increased by 19% for the year, the Dow Jones Industrial Average gained 25%, and the NASDAQ Composite increased an impressive 28%. Growth and value stocks both did well, while large, mid and small cap indices all saw double-digit gains.[1] This strong performance adds to an already solid bull run -- the second longest in history. From the start of 2009 to the end of 2017, the Dow Jones Industrial Average increased approximately 180%, the S&P 500 almost 196%, and the NASDAQ Composite an impressive 338%.[2]

Market analysts are at odds as to where the market will go from here. But they do agree on one thing: such a run-up is likely to leave many a portfolio heavily weighted in stocks. For many, it could be a good time to rebalance.

Portfolio Drift 2017[3]



A portfolio initially composed of 60% stocks, 30% bonds and 10% cash at the end of 2016 would have seen the stock portion grow to 64% by the end of 2017, due to the outperformance of stocks. Portfolio drift can be even more significant over longer time periods. A portfolio with the same allocations and initially purchased at the end of 2008 would have seen the equity portion grow to 80%, and the bond and cash portions shrink to 16% and 4%, respectively.[3] That's why many advisors recommend rebalancing at least once a year to help restore your original asset mix or target allocation.

Different Ways to Rebalance

There are two ways to rebalance. The first is to direct a larger percentage of your new contributions to the asset class that's lagging and therefore not in line with your long-term plan. In a workplace retirement plan, for instance, you could simply bump up your bond and cash portions until your target is restored. Another way is to sell investments in the asset class that's doing well -- in this case stocks -- and buy investments in the classes that did not perform as well. Keep in mind that rebalancing a portfolio may create a taxable event if done outside a tax-deferred account.

Although you may be reluctant to sell investments when their values are rising, remind yourself that you chose your asset allocation to reflect your risk tolerance, time horizon, and investment objectives. If your current allocation is out of sync with these, then it may be time to rebalance. In fact, now may also be a good time to revisit your target allocation. Is it still in keeping with your current circumstances? If not, realign it to fit your current objectives and rebalance accordingly. Also consider your risk exposure. A portfolio too heavily weighted in equities carries greater risk and is likely to take a bigger hit should stock prices head south.

How much longer the current bull run will last is anyone's guess. But you can take steps to make sure your portfolio stays aligned with your goals.

[1]Source: DST Systems, Inc. Growth stocks represented by the S&P 500 Growth Index, Value stocks by the S&P 500 Value Index, large-cap stocks by the S&P 500 Index, midcap stocks by the S&P 400 Midcap Index, and small-cap stocks by the S&P 600 Small Cap Index. Past performance is no indication of future returns. Your results will differ.

[2]Source: Yahoo Finance. Price only.

[3]Source: DST Systems, Inc. Stocks represented by total returns of the S&P 500. Bonds are represented by the Bloomberg Barclays U.S. Aggregate Bond Index and Cash by Bloomberg Barclays U.S. Treasury Bill 1-3 Month Index. Past performance is no indication of future returns. Your results will differ.

