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Rethinking the ‘rebalancing’ rule book

Instead of rebalancing portfolios, some pros are staying overweight

By Ian Salisbury

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Like many market pros, Paul Winter usually becomes a seller after a strong year of stock gains. The logic, says the Salt Lake City-based financial adviser: Clients need to “rebalance,” or trim back, their exposure to stocks to keep them from becoming a too big—and too risky—slice of their portfolios.

But even with stocks up 17% over the past 12 months, Winter has tossed out the playbook. “I’m overweight equity, because if I sell, where do I go?” he says.

For many investing pros and their clients, the current environment—a seemingly improving economy and an unusually risky bond market—has forced them to rethink what has long been an Investing 101 strategy. Because bond yields remain at historic lows—the 10-year Treasury pays 1.84%, which is less than inflation’s current 2% rate—many worry any pickup in interest rates could send bond prices plummeting (bond prices and interest rates move in opposite directions). As a result, they are keeping their stockholdings at an elevated allocation.

The big business of 401(k) plans

Investors will soon learn more about the costs of their retirement plans. Many may wonder whether they're getting what they pay for. Ian Salisbury has the details on Markets Hub. (Photo: AP/Lisa Poole)

And while it is unclear just how many investors are skipping their annual rebalancing programs this January, at least one survey suggests financial advisers are sticking with stocks.

According to the Investors Intelligence Advisors Sentiment survey, which polls financial newsletters, advisers who are "bullish" on stocks—which the survey defines as either keeping a heavy stock allocation or buying more stocks—outnumber bears by roughly 2 to 1.

Not everyone is rewriting the rebalancing rules. Rebalancing is "inherently uncomfortable" since it always involves selling winners to buy losers, says San Francisco-based adviser Milo Benningfield. Benningfield says he has made only small adjustments to his rebalancing routine, such as selling large-company domestic stocks before small-company value ones, which he thinks have more room to appreciate. "The whole point of a discipline is to avoid reacting to the markets," he says.

New ways to pay for college

Some families are forgoing pricey student loans in favor of alternative strategies. Photo: AP.

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But many others say they are making bigger tweaks to their strategies. Raymond James chief strategist Jeffrey Saut likes stocks despite the run-up. His reasoning: The recent compromise to avoid the so-called fiscal cliff suggests Washington will be less of an impediment to U.S. economic growth than many feared. At the same time, recent mutual-fund-flow data hint Main Street investors, whose appetite for stock-market risk has been dormant since the financial crisis, may finally be returning.

"Rebalancing is an art form," he says. "I'm a buyer."

At U.S. Trust, a Bank of America unit that caters to wealthy investors, clients are being advised to remain "tactically overweight" in stocks—industry jargon for bullish—while at the same time avoiding Treasurys and top-rated corporate bonds, both of which could be hit if interest rates rise.

Among the alternatives U.S. Trust strategist David Litvack recommends: buying lower credit-quality bonds, such as those rated triple-B by ratings firms. The higher yields on these investments could cushion price declines if interest rates rise. "Plan for inflation," Litvack says.