



NORTHSTAR

FINANCIAL
PLANNING INC

DECEMBER 2004

603.681.0435

Smart investors adjust their target allocations to reflect major changes in their personal financial circumstances (not changes in the markets)!

IS YOUR INVESTMENT PORTFOLIO 'OFF-BALANCE'?

Rebalancing a portfolio involves establishing a disciplined strategy to readjust the mix of assets. Smart investors start by establishing an initial asset allocation, assigning percentages of the portfolio to assets such as stocks, bonds and cash, as well as other classes of investments such as real estate and commodities. The allocations are further broken down by subclasses, such as different types of stocks (growth, value, large cap, smaller cap, International) and bonds (short-term, longer term, foreign, TIPS, mortgage).

The target allocations should be appropriate

for each investor's investment goals and financial circumstances, as well take in account an intangible factor- we call it the "comfort level" - with certain types of investments. Someone older with no children and nearing retirement, for example, will likely have a different mix than a family in its early accumulation years. Smart investors also readjust the target allocations to reflect major changes in their personal financial circumstances (but not changes in the markets).

Why rebalance just because a portfolio no longer matches its original allocation?

Why not just let the winners' ride—especially if the market's going up? Because if you don't bring the portfolio allocation back to match your strategy, you increase the risk that you won't achieve your investment goals! Say you had 55 percent in stocks and 45 percent in bonds in 1995. Unless you rebalanced along the way, by the end of 1999, that mix might have become "unbalanced"—say, 80 percent in stocks and





NORTHSTAR

FINANCIAL
PLANNING INC

DECEMBER 2004

603.681.0435

Our retainer clients will receive a report shortly after the New Year titled "Current vs. Target Allocation" showing how far off target their portfolio is and what we recommend to bring things back into balance.

only 20 percent in bonds.

You know what happened next. This stock-heavy portfolio, especially if it was loaded of tech stocks, suffered more when the stock market declined steeply over the next three years than it would have had it maintained its original 60/40 balance through periodic rebalancing. Now let's look at your portfolio now.

Large-cap stocks (represented by the S&P 500) are on track to gain around 7-8% this year on top of a 28% return last year. The tech-oriented NASDAQ has climbed 14% on top of a staggering 50 percent in value in 2003, and en-

ergy has returned over 25 percent. Many international stocks and bonds did well (*helped by a currency conversion "kicker" from the falling value of the US greenback*), as did gold and other commodities. Meanwhile, bonds prices kept pace with interest rate changes; bonds with 3-10 year maturities are up 3%, long bonds up 8% and high-yield bonds up 10%, the latter on top of a soaring 29 percent in 2003!

What impact did market changes have on your portfolio? How much have they altered your original asset allocation? How much did they alter the mix, and should some of the investments be rebalanced?

Our retainer clients will receive a report shortly after the New Year titled "Current vs. Target Allocation" showing how far off target their portfolio is and what we recommend to bring things back into balance. As an example, let's say your target portfolio was 50 percent equity, with appropriate allocations to various subcategories such as large-cap, small-cap, growth, value and international mutual funds and stocks. Another 30 percent was in bonds (long-term, intermediate, short-term and junk) and 10 percent in





NORTHSTAR

FINANCIAL
PLANNING INC

DECEMBER 2004

603.681.0435

real estate and energy as diversifiers.

Let's also assume that balance is still right for your needs.

Now calculate your current portfolio mix. Have large caps grown disproportionate to other categories of stock? Perhaps of the 30 percent you had in bonds, 5 percent was in junk bonds. But after their superb performance over the last four years you find they now represent ten percent! What if the junk bond market stumbles in the 2005? Then the portfolio will take a bigger hit because you're too heavy in them.

Remember the lesson painfully learned back in 2000–2002 when too many portfolios got

way out of balance due to the “dot com” wild run up in tech and growth stocks.

At Northstar, we rebalance our client's portfolios throughout the year when any shift away from the target asset allocation is more than five percent. To rebalance, consider directing future investment funds into those underrepresented categories until they are back in balance.

You also can readjust by selling off some of the overrepresented assets (the winners) and buying the underrepresented (the losers). This counter-intuitive discipline forces you to sell high and buy low.

We find that rebalancing is one of the hardest aspects of being a successful investor and an area where as objective and disciplined professional advisors, we can add great value to our clients.

