

It might be time to rebalance portfolio

You need faith, patience and discipline to survive the global stock market upheaval of the past several months. However, there are things you can do right now to reduce risk, generate tax savings, and better position your investments to participate in markets that may be undervalued.



Gary Brooks

Two pieces of wise investment management – rebalancing your portfolio and tax-loss harvesting – deserve attention today.

Rebalancing is a form of risk management and a way to enhance your returns. I'm not aware of two elements that investors want more of in any market environment. Managing risks, taking only those that you expect to be compensated for, might produce better returns than the average investor experiences.

Rebalancing also keeps your assets aligned with your original investment strategy. It may be counterintuitive, but rebalancing dictates that you sell what has recently performed the best and invest in what has been out of favor.

Market movement this year has likely dictated a substantial drift away from your investment strategy of a year ago. Your mix of stocks, bonds and cash might now represent an entirely different, and usually unintended, approach to pursuing your goals. Imagine that entering 2008 you had determined that the mix of assets best aligned with your goals was a

balanced blend of 60 percent stocks and 40 percent bonds. Drastic market declines this year would have shifted your portfolio makeup closer to 45 percent stocks and 55 percent bonds. This represents a change from being balanced with a tilt toward long-term capital appreciation to a much more conservative mix of assets with lower long-term return expectations.

The least risky time to get into equities is when the market is working out of a steep bear decline. If your goals and time horizon are roughly the same as they were a year ago, rebalancing back to a target mix of assets aligned with those goals should be a growing priority.

To keep rebalance activity from creating tax consequences, you can do as much of the rebalancing as possible in your 401(k) or individual retirement account. Alternatively, you can work back toward an intended investment balance by funneling new contributions to only your investments that have fallen below their intended weight in your portfolio.

A byproduct of rebalancing in today's market conditions is the ability to harvest losses in taxable accounts and utilize them as deductions against ordinary income at tax time.

To realize losses smartly, you need to:

- Understand the cost basis of each taxable holding to identify the size of the current loss.

- Be selective about which assets with losses to sell. You shouldn't sell an investment that has a stronger likelihood of participating in a market recovery than an alternative.

- Determine how much loss harvesting to do. Losses in excess of \$3,000 must be carried over and applied to future tax returns.

As part of loss harvesting and rebalancing, you might benefit from repositioning assets into more tax-efficient investments. You can also wisely locate the most tax-inefficient investments (income-generating bonds, stocks that pay large dividends) in tax-advantaged accounts such as your employer retirement plan or IRA.

While taxation shouldn't entirely drive your investment choices, it needs to be considered carefully. After all, we can only spend our savings in an after-tax world. A world where it's not what you make but what you keep that is paramount.

Gary Brooks is a certified financial planner and the president of Financial Life Design, a consulting firm in Tacoma. Reach him at gary@yourFLD.com.