

# PORTFOLIO REBALANCING

## What is portfolio rebalancing

Portfolio rebalancing is a concept that closely ties in to strategic asset allocation (SAA). While SAA refers to the blueprint for a portfolio designed to meet the client’s long-term financial goals, rebalancing refers to keeping the actual portfolio in line with the SAA over time. As underlying markets perform differently or a portfolio experiences regular cash flows (in or out), the asset allocation of a portfolio will move away from the original strategic asset allocation (SAA). Rebalancing is the process of buying and selling assets in order to reset the portfolio weight of each asset class back to the original targets. Advisers play an active role in portfolio rebalancing. They set tolerances around the strategic weights and monitor clients’ portfolios, rebalancing the portfolio when these limits are breached.

Rebalancing can be a more granular exercise. There are also underlying allocations within asset classes that need to be monitored and managed to maintain a consistent investment strategy through time. For example, the sector mix within an equity portfolio should not be allowed to drift too far from the mix of the target benchmark. An equity portfolio biased towards technology stocks might perform very differently to a portfolio with a utilities bias.

## Why rebalance?

As the portfolio mix moves away from the strategic asset allocation, its performance will differ from that of the target portfolio. These misweights are a source of volatility (or risk) to the portfolio relative to the long-term target. The more the portfolio is allowed to drift from the SAA, the higher this risk to the portfolio becomes.

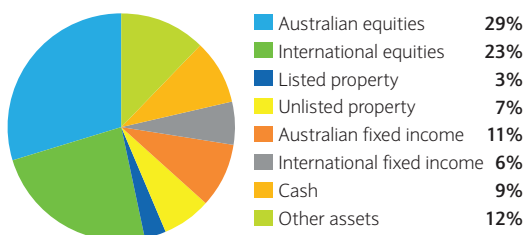
Deciding on whether to rebalance a portfolio back to SAA weights requires a trade-off between the benefits of rebalancing (or the risks of not rebalancing) versus the transaction costs and complexities of doing so. In other words, if rebalancing can be achieved cheaply and simply, then an adviser might have tight tolerances around asset-class allocations and keep the portfolio close to the SAA at all times. Conversely, investing in illiquid investments or products with complex or costly operational procedures will make portfolio rebalancing costly and more difficult, and the costs incurred may not justify regular rebalancing.

## How can rebalancing be implemented?

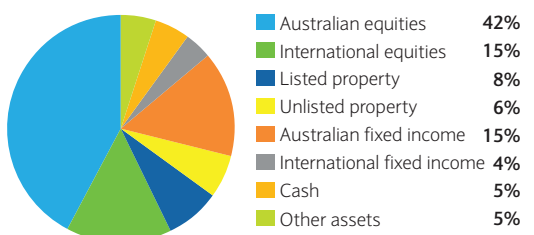
Portfolio rebalancing is most effective when it can be implemented quickly, simply and cost-effectively, therefore controlling portfolio risk without significant cost. Effective rebalancing is therefore best achieved using products that offer access to broad asset classes matching target asset allocation exposures, which can easily be bought and sold.

ETFs provide exactly this – simple, liquid, diversified and cost-effective exposures to a wide range of regions, countries and sectors. ETFs have therefore become a popular rebalancing tool for retail and wholesale investors globally, allowing portfolio allocations to be kept within acceptable tolerances at all times with operational ease.

Strategic Asset Allocation



Client Portfolio



## Client case study – David and Pam

- **Age:** 50s
- **Portfolio:** 90% Australian, 10% international
- **Interests:** travel without the children
- **Goal:** rebalance portfolio back to long term asset allocation

### Meet David and Pam

David and Pam have a diversified portfolio, with 90% exposure to Australian assets and 10% to international investments. Their financial adviser has scheduled a meeting to discuss rebalancing their portfolio.

### Factors important to their decision:

- **Timing:** they want to rebalance their portfolio as soon as possible
- **Cost:** They do not wish for this to be an expensive exercise
- **Diversification:** As they get older they are more conscious of diversifying away certain risks

### Working with a financial adviser

Their adviser schedules a meeting to discuss rebalancing their portfolio. After reviewing the current weightings, David and Pam decide to sell down their Australian equities exposure to repurchase listed property and international equities.

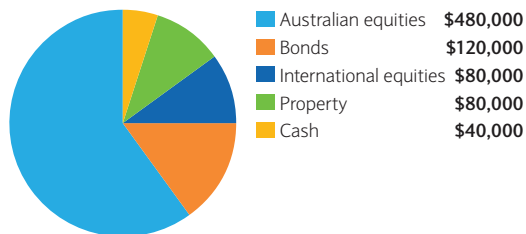
Their adviser recommends a managed fund for the property exposure, and exchange traded funds for their additional international allocation. By purchasing three iShares ETFs they can gain diversified global exposure that correlates almost perfectly to the iShares MSCI All-Country World Index:

- 47% allocation to iShares MSCI EAFE (ASX: IVE)
- 42% to iShares S&P 500 (ASX: IVV)
- 11% to iShares MSCI Emerging Markets (ASX: IEM)

When told this solution will cost 0.277% per annum, David and Pam are surprised that buying international equities can be so inexpensive. They instruct their adviser to sell some Australian equities and to purchase the managed fund for property exposure and ETFs for their international exposure.

Their adviser can keep David and Pam fully invested during the \$30,000 rebalance from Australian equities to international equities, given both execute on the ASX through the normal T+3 settlement cycle.

### David and Pam's SAA

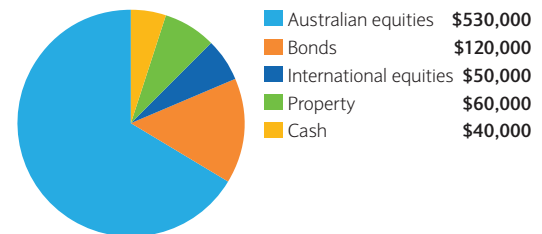


PORTFOLIO DRIFT



REBALANCING

### Current Portfolio



## The outcome

### Good for the client:

- ✓ Rebalancing was faster than they expected
- ✓ The international equity allocation was much cheaper than expected
- ✓ They achieved broad international diversification across both developed and emerging markets

### Good for the adviser:

- ✓ Client is happy with the solution
- ✓ Brought the client's risk profile back in line with expectations
- ✓ Differentiated the business by utilising best international and domestic investment products

For more information visit [iShares.com.au](https://www.ishares.com.au) or call 1300 iShares (1300 474 2737)

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