Key Questions

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Is It Too Late to Rebalance?

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Like thrills? Then you would have loved the stock market on Monday, January 24, when the Dow Jones Industrial Average sunk by more than 1,100 points in the morning, then rallied in the afternoon to finish the day ahead of where it started.

January 2022 was that kind of month, the worst since the beginning of the pandemic in March 2020. Despite a strong surge on the final day of the month, the S&P 500 fell 5.3 percent in January, the tech-heavy Nasdaq dropped by 9 percent and the Dow finished down 3.3 percent. As we have signaled in previous publications, investors should expect more fluctuations in 2022.

Last year's low level of volatility was abnormal as the Federal Reserve (the Fed) held interest rates near zero to prop up the economy post-pandemic. Now, inflation has risen and the Fed promises to combat it by tightening credit through multiple increases in interest rates in the months ahead.

And this transition may portend some major swings in the market.

So now is a good time, maybe the perfect time some say, to assess what kind of investor you are and how much risk you can stomach. If the ups and downs are causing you too much anxiety, it's never too late to recalibrate and rebalance.

Rebalancing is the process of buying and selling the assets in your portfolio to reach the target allocation set based on your life's circumstances such as your current financial situation, the time left until your retirement and other financial commitments that you have.

Let's say you set a 60/40 ratio as your target portfolio at the beginning of 2021. If you started with $1 million in your portfolio – $600,000 in US stocks and $400,000 in bonds – your portfolio would have appreciated by $166,000 resulting in a ratio of almost 67/33 by the end of the year. More specifically, your portfolio would approximate $774,000 in stocks and $392,000 in bonds.

However, the decline in asset values in January 2022 would have caused your portfolio to decline by roughly $60,000. Note that you'd be ahead by more than $100,000 from January of 2021, and your asset mix would be 65/35 stocks/bonds, which is still above your pre-determined allocation of 60/40. Thus it may not be too late to rebalance.

The bigger takeaway is that if the volatility experienced thus far in 2022 is proving unbearable, use this experience as a time to evaluate risk.

Importantly, asset values can and do fluctuate wildly. However, losses only become actual losses once an asset is sold. So before you sell an asset, you should reassess why you are selling.

Changes in your financial situation may necessitate a need to take action. On the other hand, attempting to protect your portfolio from short-term bouts of volatility thinking you can "time" the market by getting out before it goes down and then jump back in before it goes back up may be unwise.

As such, it's best not to focus on the change from one period to another; rather, look at the absolute value of your portfolio and remember this: Don't let the present undermine your future. Selling merely to make yourself feel better in the short run may deprive you of future investment gains later.

As we continue along this rocky road of 2022, here are some key points to remember:

- The Fed will most likely be raising interest rates and could act aggressively if inflation does not subside. As such, markets will be more volatile this year relative to last.

- Keep an eye on credit markets, yield curves and earnings growth to determine when to be defensive. We will be watching the market closely, and we will keep you apprised of the implications.

- Examine your portfolio regularly, keeping it aligned with your risk tolerance.

- We used only US stocks and bonds to simplify our example, but don't forget to scrutinize other assets as well, including international stocks, real estate, commodities, and possibly other diversifiers such as alternative investments strategies in some circumstances.

Above all, do not overreact. And don't let your anxiety about the present cause you to miss out on opportunities in the future.

For more information, please contact your advisor.

About the Author

As Chief Investment Officer, George Mateyo is responsible for establishing sound investment strategies for private and institutional clients, expanding internal and external research capabilities, and managing the delivery of solid risk-adjusted investment performance.

In previous roles, George spent more than 15 years in investment management and investment consulting, where he acquired firsthand knowledge and insights into the capital markets and the stewardship of investment portfolios for institutional and high net-worth investors.

George received his MBA from the Weatherhead School of Management at Case Western Reserve University and completed additional studies at the London School of Economics.