Maintain Your Balance

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What You Need to Know

- » The asset allocation of your portfolio should be designed purposefully based on your goals and comfort with risk
- » Rebalancing can help:
  - Keep your portfolio's risk exposure aligned with your comfort with risk
  - Take the emotion out of investment decisions
  - Provide the potential for improved risk-adjusted returns
- » If you don't rebalance actively, the market can do it for you, which can be a painful process

Investments can behave differently over time, which means your portfolio's allocation could stray from your initial objectives. However, by rebalancing it periodically, you can help ensure your portfolio is properly allocated to investments that align with your comfort with risk and help you meet your financial goals.

Designed with a Purpose

When you developed your financial strategy, your Edward Jones financial advisor helped build a portfolio with an asset allocation – the amount invested in different asset classes, such as stocks and bonds – that aligned with your goals and risk tolerance. We pay close attention to asset allocation because it's been shown to be the key determinant of how a portfolio's return varies over time.*

Given the strong performance of the stock market since 2009, your portfolio's allocation to stocks may be higher than you originally intended, changing its risk profile. Because proper stock/bond mix is critical, review your portfolio's asset allocation regularly and rebalance when needed.

Rebalancing Methods

Calendar rebalancing – As its name implies, calendar rebalancing is done at regular intervals, such as monthly, quarterly or annually. If you chose annual rebalancing, for example, your portfolio would be realigned to its original allocation once a year.

Threshold rebalancing – Using this method, you'll rebalance your portfolio when an asset class strays from its target allocation by a certain amount, or threshold. For example, suppose you establish your initial asset allocation at 65% stocks and 35% bonds. If you set a 5% threshold for rebalancing, you'll restore your portfolio to the original 65/35 split when the stock portion rises above 70% or falls below 60%.

Which method is better? The main benefit of rebalancing is to prevent your portfolio from wandering too far from its objectives and taking on too much risk – which could happen at any time of the year. That's why we favor threshold rebalancing. However, we believe either method is preferable to not rebalancing at all.

*Brinson, Gary P., L. Randolph Hood, and Gilbert L. Beebower. 1986. "Determinants of Portfolio Performance." *Financial Analysts Journal*, Vol. 42, No. 4 (July/August 1986): 39–44.

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MAKING SENSE OF INVESTING

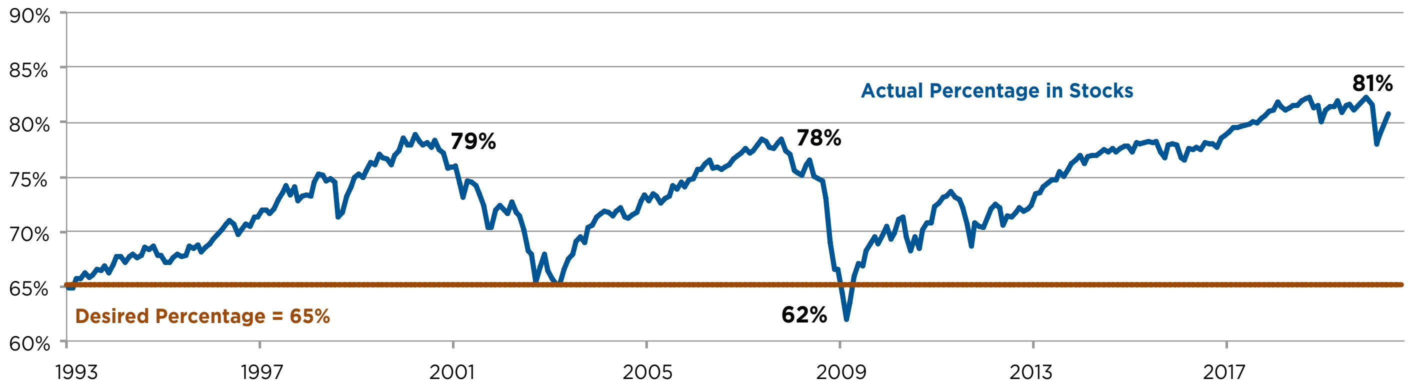
Why Rebalance?

1. Keep Your Portfolio Aligned with Your Comfort with Risk

How can rebalancing help you manage risk? Suppose you began investing in 1993 with a portfolio weighted 65% in stocks and 35% in bonds, an allocation that aligned with your goals and comfort level with risk.

Portfolio Allocation to Stocks without Rebalancing

Balanced Toward Growth Portfolio Objective: Starting Allocation – 65% Stocks/35% Bonds



Morningstar Direct & Edward Jones calculations;1/1/1993–12/31/2020. Balanced toward Growth and Growth Focus Portfolio Objectives consist of the following, respectively: Barclays Gbl Agg Ex U.S. Index (2%), Barclays U.S. Agg Bond Index (27%), Barclays U.S. HY 2% Issuer Cap Index (4%), Barclays U.S. Trsy Bellwethers 3Mon Index (2%), FTSE NAREIT All Equity REITs Index (4%), MSCI EAFE Index (13%), MSCI EM Index (4%), Russell 2000 Index (3%), Russell Mid Cap Index (7%), S&P 500 Index (30%), MSCI EAFE Small Cap Index (3%), S&P GSCI Index (1%). The portfolio shown is a hypothetical illustration. Investor performance will vary. All performance data assumes reinvestment of dividends. Past performance is no guarantee of future results. Investment indexes are unmanaged and are not available for direct investment.

The chart above shows how much your stock allocation would change if you never rebalanced your portfolio – which also means too much risk based on your objectives. If you never rebalanced, about 80% of your portfolio would have been in stocks during 2000 and 2008 – just before major market declines.

Rebalancing your portfolio regularly could have helped prevent this overweighting in stocks and kept the risk exposure aligned with your risk tolerance. It also would have helped reduce the impact of the declines on your portfolio, when the market essentially rebalanced for you. Proactively rebalancing your portfolio would also have taken advantage of the upturn in 2009 by adding to stocks when you would have been underweight. That's because rebalancing works both ways.

Two Different Portfolios

A portfolio with 80% in stocks may make sense for clients with higher return and risk objectives – however, this certainly is a different portfolio, with different return and risk characteristics, relative to the initial 65/35 portfolio, as highlighted below. While the differences may not seem that dramatic, remember that your portfolio should be designed with your goals and comfort with risk in mind, which we discuss on the next page.

Portfolio Objective	Balanced toward Growth	Growth Focus
Stock/Bond Allocations	**65% Stocks/ 35% Bonds**	**80% Stocks/ 20% Bonds**
Expected Return	5.0% to 7.0%	5.5% to 7.5%
Expected Risk*	11%	13%
Best 12-month return	43%	51%
Worst 12-month return	-34%	-40%

Source: Morningstar Direct & Edward Jones calculations; 1993–2018. Balanced toward Growth and Growth Focus Portfolio Objectives consist of the following, respectively: Barclays Gbl Agg Ex U.S. Index (2%, 1%), Barclays U.S. Agg Bond Index (27%, 15%), Barclays U.S. HY 2% Issuer Cap Index (4%, 2%), Barclays U.S. Trsy Bellwethers 3Mon Index (2%, 2%), FTSE NAREIT All Equity REITs Index (4%, 6%), MSCI EAFE Index (13%, 15%), MSCI EM Index (4%, 4%), Russell 2000 Index (3%, 4%), Russell Mid Cap Index (7%, 9%), S&P 500 Index (30%, 37%), MSCI EAFE Small Cap Index (3%, 4%), S&P GSCI Index (1%, 1%). The portfolio shown is a hypothetical illustration. Investor performance will vary. All performance data assumes reinvestment of dividends. Past performance is no guarantee of future results. Investment indexes are unmanaged and are not available for direct investment.

Why Rebalance?

2. Take Emotion Out of Asset Allocation Decisions

The graphic below shows that how we feel does not necessarily align with the future performance of the markets. When consumer confidence is low, we tend to have a negative outlook, such as in 2003 and 2008. But stock prices were also low, and future returns ultimately tended to be higher. The opposite has also been true, like in 2000, when confidence (and the markets) were at highs.

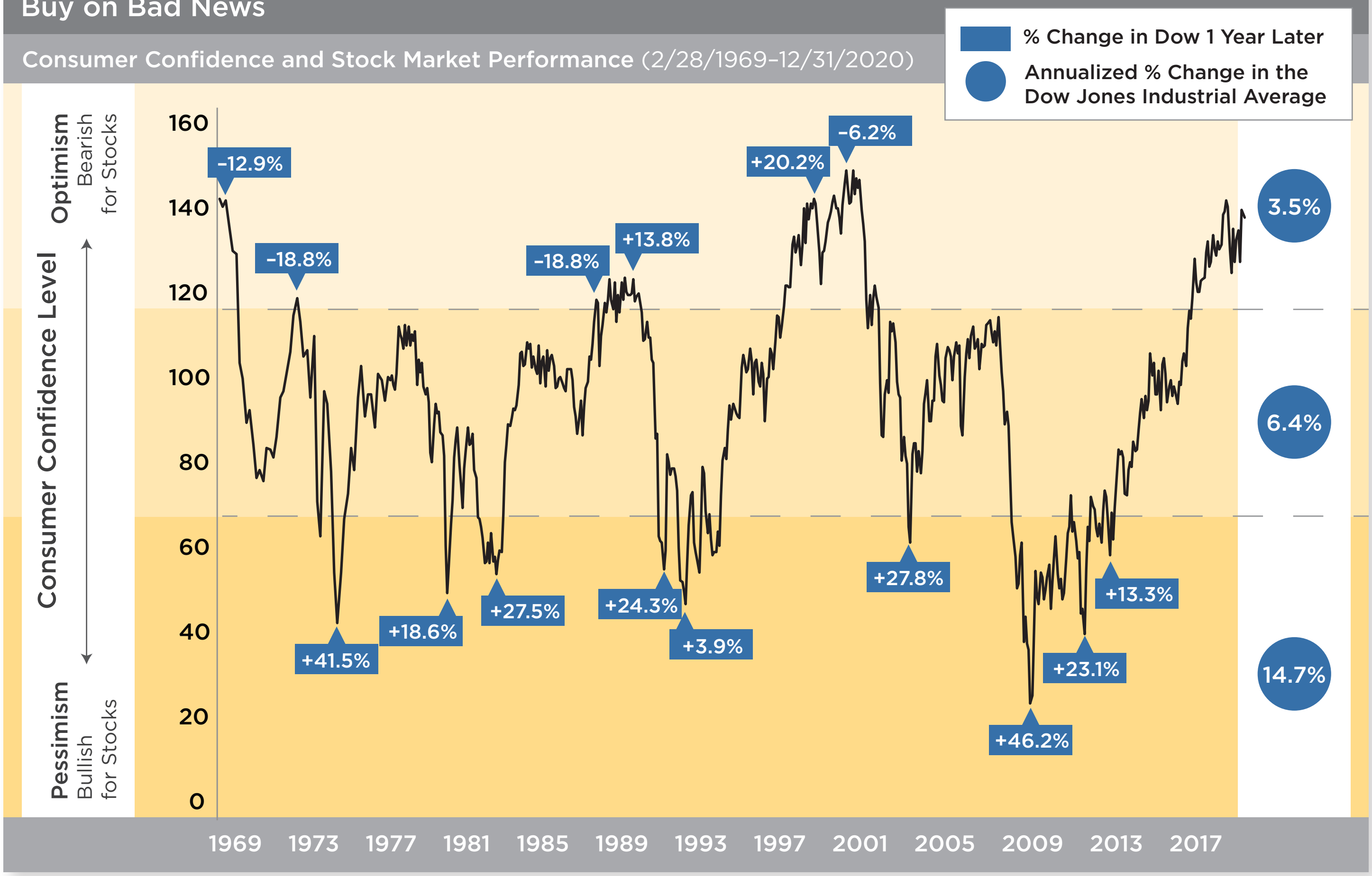
On average, stocks returned 14.7% per year following a consumer confidence reading of 66 or below. When consumer confidence and stock prices were higher, future returns tended to be low, averaging 3.5% per year following consumer confidence readings of 110 and above. Investors' emotions caused them to chase performance, overreacting to market conditions and, ultimately, buying high and selling low.

Rebalancing runs counter to our emotions. It can force us to reduce some of our "winners" and add to asset classes that have underperformed. We like buying when the markets are up because we feel good; we sell when the markets are down because we're worried. You can help avoid this bad habit by establishing an automatic rebalancing program.

With a rebalancing program in place, you can sell a percentage of those assets that, because of significant price appreciation, have taken on a larger percentage of your portfolio than you had originally intended. At the same time, you can buy underweight asset classes whose performance may have lagged but now may be poised for recovery. In short, you'll be keeping the asset allocation of your portfolio in proper alignment with your goals and risk tolerance, which may also allow you to take advantage of market opportunities.

Buy on Bad News

Consumer Confidence and Stock Market Performance (2/28/1969–12/31/2020)



Sources: Ned Davis Research, Inc., The Conference Board, Bloomberg and Edward Jones calculations. Past performance is not a guarantee of future results. The Dow Jones Industrial Average (Dow) is an unmanaged index and is not meant to depict an actual investment. Figures do not include fees, commissions or expenses, which would have a negative impact on investment results. Consumer Confidence is a survey conducted by the Conference Board measuring consumer optimism or pessimism with respect to the economy in the near future. The Conference Board is a not-for-profit research organization for businesses that distributes information about management and the marketplace. It is a widely quoted private source of business intelligence.

Why Rebalance?

3. Provide the Potential for Improved Risk-adjusted Returns

While the primary goal of rebalancing is to help keep your portfolio's asset allocation and risk aligned with your objectives, having a rebalancing strategy in place could help improve return potential and smooth out volatility over time relative to a non-rebalanced portfolio, especially in a market where the leading types of investments frequently change.* That said, outperformance should not be your objective – you should work to ensure your performance, risk and asset allocation are all aligned with your financial goals.

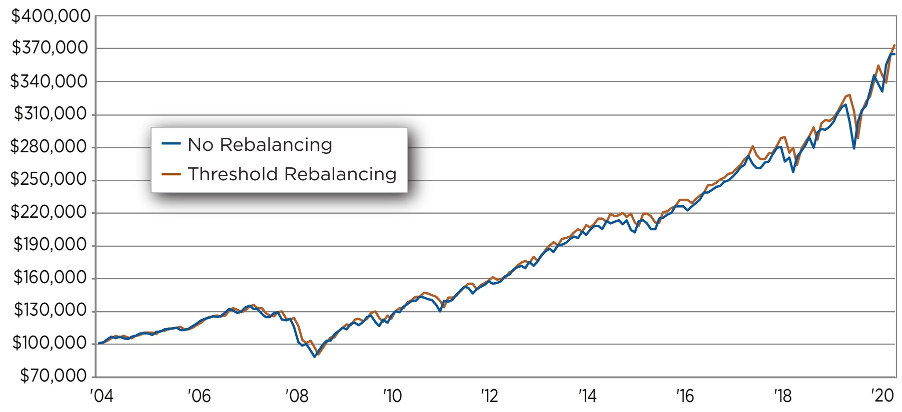
Issues to Consider When Rebalancing

If rebalancing has all these benefits, why not do it anytime your portfolio deviates slightly from your stated risk tolerance? Because there are trading costs, and you could owe taxes from selling overweighted assets (in a taxable account). But taxes should not be the key driver of the rebalancing decision. Essentially, you'll want to rebalance when the increased risk to your portfolio (due to the overweighted positions) outweighs the trading costs and potential tax ramifications associated with it.

*Rebalancing cannot guarantee a profit or protect against a loss.

Balanced toward Growth Portfolio Objective

Rebalanced vs. Non-rebalaced



	No Rebalancing	Threshold Rebalancing
Annual Return	8.3%	8.1%
Risk (Standard Deviation)	10.5%	9.5%

Morningstar Direct & Edward Jones calculations; 8/31/2004–12/31/2020.. Balanced toward Growth Portfolio Objectives consist of the following: Barclays Gbl Agg Ex U.S. Index (2%), Barclays U.S. Agg Bond Index (27%), Barclays U.S. HY 2% Issuer Cap Index (4%), Barclays U.S. Trsy Bellwethers 3Mon Index (2%), FTSE NAREIT All Equity REITs Index (4%), MSCI EAFE Index (13%), MSCI EM Index (4%), Russell 2000 Index (3%), Russell Mid Cap Index (7%), S&P 500 Index (30%), MSCI EAFE Small Cap Index (3%), S&P GSCI Index (1%). The portfolio shown is a hypothetical illustration. Investor performance will vary. All performance data assumes reinvestment of dividends. Past performance is no guarantee of future results. Investment indexes are unmanaged and are not available for direct investment.

Take Action

Rebalancing your portfolio can help you work toward your long-term goals without straying too far from your initial asset allocation and comfort level with risk. In addition to helping take the emotion out of investing, it also can help smooth out volatility and provide the opportunity for better risk-adjusted return potential over time.

So, has your portfolio become out of alignment? This may mean you need to add money to an underweight investment or sell some of an overweight investment and reinvest those funds. Your portfolio was designed to help meet your long-term goals, and it's important that your allocation still aligns with these goals to keep you on track.

Automatic rebalancing and asset allocation do not guarantee a profit or protect against loss.

