Seasonality and Rebalancing Your Portfolio

CEMIL OTAR

Asset allocation has the largest contribution to the success of your portfolio. A right balance of ownership (equity) and lendership (fixed income) is essential to optimize the preservation and the growth of your investment.

Over time, different asset classes in your portfolio grow (or shrink) at different times. Sometimes the equity portion of your portfolio grows faster, other times it may be your fixed income portion. It is important to “rebalance” your portfolio periodically. This is done either by cashing in the asset class that had a good run and placing it to other asset classes, or by adding more money to the asset class that is lagging. This way, the asset class balance is brought back to its original proportion.

The question arises: “Knowing what we know about the seasonality, when is the best time to rebalance your portfolio?”

To find an answer to this question, firstly, I created three portfolios:

- Conservative Portfolio:
15% Cash, 40% Fixed Income, 45% Equity
- Moderate Portfolio:
50% Fixed Income, 50% Equity
- Aggressive Portfolio:
25% Fixed Income, 75% Equity

Each portfolio started with $100,000 in March 1982, ended in March 1997, and included following investments:

- Conservative Portfolio:
15% Average Money Market fund
40% Altamira Income fund
25% Trimark Canadian fund
20% Templeton Growth fund
- Moderate Portfolio:
50% Altamira Income fund
30% Trimark Canadian fund
20% Templeton Growth fund
- Aggressive Portfolio:
25% Altamira Income fund
35% Trimark Canadian fund
20% Templeton Growth fund
20% Guardian Enterprise fund

To create a mathematical benchmark, I rebalanced each portfolio each month throughout this 15-year period. Then, I rebalanced each portfolio once a year, at the end of January, then February and so on for each month of the year. I compared the end value for each case to the minimum portfolio value and I noted this as percentage.

Results:

Rebalancing portfolios annually in any of the months of July, August or September increased the portfolio value 2% to 3%. Interestingly, rebalancing during any of these months once a year added more value than rebalancing each and every month.

Rebalancing during January, February, March or April did not improve the portfolio value, only reduced its volatility. Considering that most people contribute to their RSP in January and February (just before the tax deadline), it may be better to invest this money without consideration of rebalancing your whole portfolio. Later on, during the hot summer months, you can rebalance it more effectively.

Cemil Otar, P. Eng., author of “Commission Free Investing: Handbook of Canadian DRIPs and SPPs”, is an independent financial advisor with W. H. Stuart & Associates, Phone (905) 889-7170.