Rebalancing my portfolio

Market movements can alter the asset allocation and risk profile of your portfolio so you need to monitor your portfolio regularly.

What is rebalancing?
Rebalancing refers to the process of realigning your portfolio’s asset allocation. It aims to reduce the risk of your portfolio by bringing it back in line with your strategic asset allocation mix.

Market movements can alter the asset allocation and risk profile of your portfolio. For example, rising share prices may leave you with too many individual stocks and too few other investments, while falling prices can reduce your overall level of share holdings.

How do I rebalance my portfolio?
There are a number of ways you can rebalance your portfolio. These include:

- reinvesting dividends – if you don’t participate in a dividend reinvestment plan, you can invest any dividends you receive in your transaction account into the asset classes that are underweight
- investing new cashflow – direct your future super contributions into the underweight asset classes
- transferring funds from your other investment options – switch funds from the investment options you are overweight into those that are underweight
- taking profits – take profits from outperforming securities and reinvest them into underweight sectors

Sometimes it can be more cost-effective to rebalance your portfolio using new cashflow or dividends rather than selling assets. Selling assets can incur transaction costs and capital gains tax.

Example – Asset allocation targets

Many investors set a target, or benchmark, weighting so they know how much of their portfolio they should invest in each asset class. In this example, market movements have increased the weighting to shares to above the target allocation and reduced the weighting to fixed interest and cash to below the target weighting.

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Target asset allocation %</th>
<th>Current asset allocation %</th>
<th>Difference %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian shares</td>
<td>40</td>
<td>50</td>
<td>+10</td>
</tr>
<tr>
<td>International shares</td>
<td>20</td>
<td>25</td>
<td>+5</td>
</tr>
<tr>
<td>Property</td>
<td>15</td>
<td>15</td>
<td>0</td>
</tr>
<tr>
<td>Total growth assets</td>
<td>75</td>
<td>90</td>
<td>+15</td>
</tr>
<tr>
<td>Fixed interest</td>
<td>15</td>
<td>5</td>
<td>-10</td>
</tr>
<tr>
<td>Cash</td>
<td>10</td>
<td>5</td>
<td>-5</td>
</tr>
<tr>
<td>Total income assets</td>
<td>25</td>
<td>10</td>
<td>-15</td>
</tr>
</tbody>
</table>

How often should I rebalance my portfolio?
When you set up your portfolio it is worthwhile deciding how much you are willing to let your asset allocation shift from your targets before taking action. Many investors set a ‘trigger point’ at which they will rebalance their portfolio to bring it back in line with their asset allocation targets. For example, some investors might rebalance when their portfolio shifts by 5% or 10%.

Other investors rebalance their portfolios at regular time intervals. This could be monthly, quarterly or annually. It is important to remember that rebalancing can have cost and tax impacts, so it is best not to overdo it.

Some investors may be tempted to leave their portfolio particularly when the asset classes they are overweight are performing strongly. This can have negative long-term repercussions if markets correct and investors find themselves with too much invested in the more volatile asset classes.

What does overweight and underweight mean?
Overweight is when your holdings in a particular asset class are above the target or benchmark weighting. You are underweight an asset class if your actual asset allocation falls below your target weighting.

For more information on target weightings, read our asset allocation fact sheet.
Using Exchange Traded Funds to rebalance your portfolio

Exchange Traded Funds (ETFs) can be an efficient way to rebalance your portfolio. You can buy ETFs in the asset classes you are underweight to bring your portfolio’s asset allocation back into balance. Often this can be a much quicker and lower cost way to implement your rebalancing strategy than buying or selling direct shares or other investment options.

Mary has an investment portfolio of $100,000 with a target asset allocation of 60% in Australian shares and 40% in cash. Market movements over the last year have shifted Mary’s asset allocation so she now has 50% of her portfolio invested in Australian shares and 50% in cash.

Mary decides to bring her portfolio back into balance by investing $10,000 in an Australian shares ETF.

Quick reference

- market movements can alter the asset allocation and risk profile of your portfolio
- decide on your rebalancing strategy when you set up your portfolio
- direct your dividends, cashflow or funds from other investment options into asset classes you need to invest more in
- ETFs can be a low-cost, efficient way to rebalance your portfolio
- rebalancing can be complex so seek assistance from a professional financial adviser

Seek advice before you invest

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