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Should Your Clients Rebalance Their Portfolios in Today's Markets?

Pros and cons revealed.

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**DISCLOSURE: Please note the views expressed in this article are the author's and do not necessarily reflect the views of the AICPA or the Wealth Management Insider.*

I had a strange experience on the way home from work yesterday. When I first started driving, my car was sloshing through pouring rain. By the time I got off the freeway (seven minutes later), the skies were clear and the sun was shining brightly. Pretty crazy.

Just like the stock market.

This morning, before I had my first cup of tea, the market was down over 100 points. By the time I had lunch, it was up by almost the same amount. And that was only one of many such turnarounds we've witnessed so far this year. The volatility you and I are seeing is really wild by historical standards. I think it's a good time to give you and your clients an update on where I see the economy, the market and the dangers of rushing to rebalance one's portfolio in this environment.

The Bad News

First, I think just about everyone agrees that our economy is contracting. We may or may not actually enter a recession, but I don't think it's all that important. The reality is that the economy is not exactly in a growth mode. Housing prices continue their decline. Unemployment is rising. Oil and gold are getting more expensive by the day. Taken together, this all contributes to higher inflation. While interest rates have been slashed (and they will likely be decreased again), at some point they will have to go up to combat inflation.

These are the facts and they are not pretty.

So with all this bad news, shouldn't your clients rebalance OUT of the stock market now?

The best way to approach this question is to have a historical perspective. Over the past 50 years we've had nine recessions that have lasted 10 months on average. Usually, by the time we acknowledge we were actually in a recession, the worst was over in terms of the stock market. In fact, on average, the market returned over 23 percent in the six months following the mid-point of past recessions. Why? Because the market looks ahead nine to 12 months rather than simply reacting to what is happening today.

This explains why often the most frightening times offer the best opportunities to invest.

Of course I can't guarantee what will happen to investments over the next six days let alone the next six months but the point is, usually when things look worst, it's often the best time to invest.

How Should Your Clients Navigate This Situation?

The most critical success factor for your clients will be their investment strategy and their ability to stick to it. What people often do is "rebalance" out of stocks when they are frightened. While I can certainly understand this tactic, it will cost your clients plenty in the long run.

Think about it. Regardless of how your clients invest, they will look like geniuses some of the time and dummies at other times. Investing in bank CDs has its pros and cons. Investing in bonds has its pros and cons. Investing in real estate has its pros and cons and investing in stocks has its pros and cons.

Make sure your clients have an investment policy that is consistent with their risk tolerance and their financial goals, making sure they stay the course in both good times and bad.

Talk to your clients and make sure that the strategy they are using is appropriate for them over the long run — not just something that helps them sleep at night.

The law of averages works, but it requires long periods of time to work. There is nothing wrong with having a strategy that guides investors in and out of the market. But it must be a strategy that is well articulated and based on facts and historical results. And if your clients use such a strategy they must understand that in very volatile periods, such a strategy may under-perform.

Rebalancing works as part of an overall investment strategy to help your clients reach their financial goals. It may also work as a security blanket to help squeamish investors feel less frightened. Unfortunately, if your clients *do* decide to rebalance their portfolios for short run piece of mind, they take on a greater risk of losing their financial security in the long run.

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Neal Frankle is the author of *Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity*. He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. Send Neal an [e-mail](#) if you would like a free monthly e-newsletter (written especially for CPAs to use with their clients so they make better investments).

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