Rebalancing Your Portfolio

Everyone loves a winner. If an investment is successful, most people naturally want to stick with it. But is that the best approach?

It may sound counterintuitive, but it may be possible to have too much of a good thing. Over time, the performance of different investments can shift a portfolio's intent – and its risk profile. It's a phenomenon sometimes referred to as "risk creep," and it happens when a portfolio has its risk profile shift over time.

When deciding how to allocate investments, many start by taking into account their time horizon, risk tolerance, and specific goals. Next, individual investments are selected that pursue the overall objective. If all the investments selected had the same return, that balance – that allocation – would remain steady for a period of time. But if the investments have varying returns over time, the portfolio may bear little resemblance to its original allocation.

How Rebalancing Works

Rebalancing is the process of restoring a portfolio to its original risk profile.[1]

There are two ways to rebalance a portfolio.

The first is to use new money. When adding money to a portfolio, allocate these new funds to those assets or asset classes that have fallen. For example, if bonds have fallen from 40% of a portfolio to 30%, consider purchasing enough bonds to return them to their original 40% allocation. Asset allocation and diversification are investment principles designed to manage risk. However, they do not guarantee against a loss.

The second way of rebalancing is to sell enough of the "winners" to buy more underperforming assets. Ironically, this type of rebalancing actually forces you to buy low and sell high.

Periodically rebalancing your portfolio to match your desired risk tolerance is a sound practice regardless of the market conditions. One approach is to set a specific time each year to schedule an appointment to review your portfolio and determine if adjustments are appropriate.

Shifting Allocation

Over time, market conditions can change the risk profile of an investment portfolio. For example, consider a hypothetical portfolio that was 50% invested in bonds, 10% in treasuries, and 40% in equity. Over the course of a few years, if the stock portion of the portfolio outperformed the other assets, the hypothetical portfolio may no longer reflect the initial allocation. An adjustment may be needed to reflect the original risk profile. Keep in mind that investing involves risks, and investment decisions should be based on your own goals, time horizon, and tolerance for risk. The return and principal value of investments will fluctuate as market conditions change. When sold, investments may be worth more or less than their original cost. This is a hypothetical example used for illustrative purposes only. It is not representative of any specific investment or combination of investments.

1. FINRA.org, 2025