IntoView™

Bringing clarity to issues on your mind™

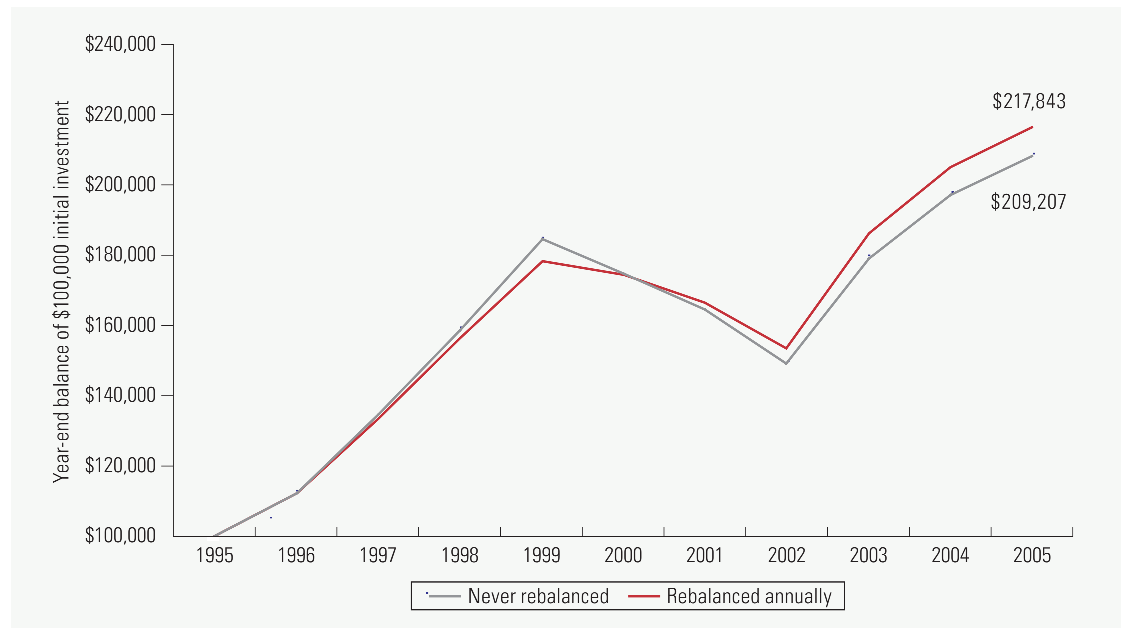
Buy low, sell high: It's easier than you think

By periodically rebalancing your portfolio back to its target asset allocation, you can help reduce your portfolio's risk. Not having to predict market movements may also help you sleep better.

It's an old investment maxim: Buy low, sell high. The problem, of course, is that you don't know if the current price of an asset is low or high relative to its future price until after the fact. But there's a simple way to take the guesswork out of the equation. Periodically rebalancing your portfolio back to its target asset allocation forces you to sell asset classes that have run up in price and buy asset classes that have become cheap relative to others.

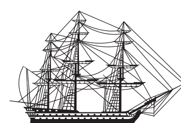
The ten years through 2005 illustrate both the drawback and the benefit of rebalancing. A portfolio that was rebalanced annually would have lagged one that was never rebalanced during the equity bull market of the late 1990s, but the rebalanced portfolio would have come out ahead during the subsequent bear market and recovery. Rebalancing can reduce upside potential, but it also helps mitigate downside risk. The latter may be more important when you consider that it takes a 100% return to make up for a 50% loss.

> In a volatile period, rebalancing reduced risk and enhanced return



Source: Vanguard.

The portfolios were originally weighted 48% U.S. stocks, 12% international stocks, and 40% investment-grade U.S. bonds using the following indexes as proxies: Dow Jones Wilshire 5000 Index, MSCI EAFE Index, and Lehman Brothers Aggregate Bond Index. Past performance does not guarantee future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index. All investments are subject to risks, including the possible loss of principal. Diversification does not ensure a profit or protect against a loss in a declining market. This hypothetical illustration does not represent any particular investment.



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Steps in developing a rebalancing strategy

1. **Set an appropriate target asset allocation.** Before you can even begin talking about rebalancing, you need a target allocation that's appropriate for your objectives, time horizon, and risk tolerance.
2. **Weigh the costs of rebalancing.** Depending on the assets, the type of account, and the method of rebalancing, there might be trading costs and tax consequences. The costs of frequent rebalancing could offset the benefits.
3. **Set a schedule or trigger for rebalancing.** Whether semiannually, annually, or biennially, choose a set schedule to rebalance your portfolio. Alternatively, you can set a "trigger" as to when to rebalance—for example, if your current allocation differs from your target allocation by more than 5 percentage points. Or, better yet, do a combination of the two: Review annually, rebalancing only if the deviance exceeds 5 percentage points.
4. **Decide on a method of rebalancing.** There's more than one way to rebalance. You can make new contributions to the asset class that's underweighted relative to your target allocation. To meet living expenses, retirees might draw down from the overweighted asset class. You can also redirect income from one asset class to another. Consider, too, that large-scale rebalancing might be better restricted to your tax-advantaged accounts to limit tax consequences.
5. **Avoid buyer's remorse.** Rebalancing is meant to reduce risk, not necessarily enhance returns. Because it's essentially a contrarian strategy—you are reallocating assets from "winners" to underperformers—there will inevitably be periods when relative performance will lag. It helps to remember that the important thing is not to beat the market, but to achieve your financial goals.

Talk with your advisor to develop asset allocation and rebalancing strategies that are appropriate for your individual situation.

For more information on mutual funds or exchange-traded funds (ETFs), contact your financial advisor to obtain prospectuses and ETF product descriptions. Investment objectives, risks, charges, expenses, and other important information are contained in these documents; read and consider them carefully before investing.

Mutual funds are subject to market risk. Foreign investing involves additional risk, including currency fluctuations and political uncertainty. Investments in bond funds are subject to interest rate, credit, and inflation risk.

Investors cannot invest directly in an index.

Investment Products: Not FDIC Insured • No Bank Guarantee • May Lose Value

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FAIVREB 102006