Should You Be Selling Your Winners?

"It's tough to sell winners and buy laggards, but it's smart."

That is the lesson from MarketWatch's, "Force yourself to rebalance your portfolio."

Good advice. But difficult for most investors to follow.

Human Nature is to Ride the Winners

> *The basic human instinct when an investment gamble has been paying off is to let it ride; rebalancing involves culling winners and putting the proceeds into laggards in order to follow a plan.*

It is hard for investors to sell successful investments and move the proceeds into underperforming areas. But that is the correct strategy much of the time.

Note that I (nor MarketWatch) am not talking about individual (non-diversified) investments like stocks. There are way too many variables that impact individual stock performance and often market leaders can maintain their edge for lengthy periods. Rather, we are talking about markets, as a whole, and asset classes and sub-classes.

Take Emotion Out of Investing

> *That is why, ideally, rebalancing is done unemotionally, based on a schedule set either by how far off-plan a portfolio gets, or by regular calendar intervals. The bigger the portfolio, the more these differences matter, creating more need to rebalance on a scheduled basis; experts note that average investors with moderate portfolios can get away with rebalancing every year or two, or when the portfolio is*

5 to 10% off-target.

Take the emotion out your investment decisions. Adhere to a predetermined fixed plan for reviewing your portfolio. Rebalance as necessary.

As the above quotes states, reviews can be based on how much the actual asset allocation deviates from your target allocation. Or it can result from regular calendar intervals.

Personally, I would factor in the volatility of the portfolio (a.k.a., portfolio risk, portfolio standard deviation). The riskier the portfolio, the greater the frequency of monitoring. I would also review the portfolio in the event of a material event.

A key takeaway from the embedded quote should be: "average investors with moderate portfolios can get away with rebalancing every year or two, or when the portfolio is 5 to 10% off-target." Moderate refers to portfolio investment risk.

The more you rebalance your portfolio, the greater the transaction fees (and potential triggering of taxable capital gains). Your investment goal should be cost minimization, so watch out for too much trading. If you decide to rebalance every month, expenses will impair long-term performance.

As well, the higher your portfolio risk, the greater the acceptable asset allocation variance. The article recommends 5-10%, a good range for moderately risky portfolios like an S&P 500 index fund. But what if your equity allocation consists of small African mining companies? Perhaps they can fluctuate up and down 30% each year. Do you want to be buying and selling the shares every time they get 10% from target allocations? No.

Momentum Investing

Browne, of FundX, follows a strategy of investing in funds *and ETFs that have the hot hand, trying to ride category leaders in the areas that look best*

As a side note, I want to mention momentum investing. Not quite what Browne is doing, but it came to mind when I read the quote.

If you are nimble, perhaps you can take advantage of short term movements. But there are a lot of traders out there playing this game. If you want to trade, trade. If you want to invest for the long-term, might be best to not worry about momentum investing.

I do not like momentum investing, although I will admit to following this path on occasion in my youth.

I do though, to some extent, tactically invest. But I prefer to do so using longer term trends, rather than simple pricing anomalies or short-term movements. And I prefer to utilize diversified investments (e.g., index funds) to take advantage of macro-economic trends, rather than guessing if Apple will continue to outperform over the short-term. Also, for clients, I recommend building a strong overall core portfolio, then utilizing tactical moves to augment the core. Not tactical as a stand-alone strategy.

I would caution readers that tactical asset allocation requires a fair amount of investment expertise and experience. If you wish to go this route, I strongly suggest working with a competent advisor.