



PORTFOLIO CONSTRUCTION

Portfolio Rebalancing, Part 1: Strategic Asset Allocation

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This paper shows that many reasonable rebalancing processes may achieve similar benefits of maintaining a portfolio's risk characteristics, but also that price momentum effects can benefit some processes more than others.

- The authors seek to confirm that rebalancing to target allocations helps to maintain more stable portfolio risk characteristics and improved diversification, and to show that many different methods confer similar long-term risk benefits.
- Rebalancing can be considered an active contrarian strategy when compared to a buy-and-hold benchmark.
- The authors discuss the main considerations when designing a rebalancing process, and use a simple empirical analysis to demonstrate the drivers of relative performance over four decades.
- Asset prices have tended to exhibit trending behavior, and this has favored less-frequent rebalancing schedules or wider tolerance bands, which allow trends to play out between rebalances.

When designing a rebalancing process, investors should balance their tolerance for short-term variations in portfolio weights against their expectation or belief that multi-month price momentum effects will continue in the future. For liquid portfolios, cost considerations may be secondary.

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