Do you have any advice on rebalancing my stock portfolio or 401(k)?

Every Sunday, The Star asks local financial experts to respond to readers' questions on consumer and investor issues. If you have a question, please e-mail it to dwight.adams@indystar.com or mail it to: Personal Finance, The Star, P.O. Box 145, Indianapolis, IN 46206-0145.

The normal ups and downs of the stock market can unbalance the portfolio target percentages of even the most meticulous investor. Some experts advise checking your allocations of stocks, bonds, cash or other investments every six months to a year and rebalancing if percentages are more than 5 percent higher or lower than desired. Let members of the Financial Planning Association of Greater Indiana advise you on this matter. Visit their Web site at www.fpagrindiana.org.

Ed Snyder

OAKTREE FINANCIAL ADVISORS

First, we assume you have an investment strategy that includes asset allocation. Asset allocation refers to spreading your assets among different asset classes.

You may have had an original allocation of 70 percent stocks, 25 percent bonds and 5 percent cash. But normal market gyrations often throw a portfolio off balance. If your portfolio is now 60 percent stocks, 35 percent bonds and 5 percent cash, you need to sell some bonds and buy more stocks to bring it back to 70/25/5.

You also should consider taxes.

In 401(k)s, you can rebalance without tax implications. There are several ways to rebalance a taxable account, while trying to work around selling assets with taxable gains.

One way is to put any new investments into the asset category that has fallen behind. Another option is to receive dividends and interest in cash within your account and put the cash toward underweight asset classes. Although you still will owe taxes on the dividends and interest, you won't incur an additional capital-gains tax from selling an appreciated asset.

How often do you rebalance?

I believe a portfolio should be rebalanced whenever its percentage allocations stray significantly from their targets. And how do you measure "significantly"? That's the challenge.

A portfolio targeted at 70/25/5 is not in great need of rebalancing if stocks fall to 68 percent. But if the stocks drop to 60 percent, it likely will need to be rebalanced.

★ **Investment advisor representative and securities and investment advisory services offered through InterSecurities, member of FINRA, SIPC and a registered investment adviser.**

Walter R. Willms

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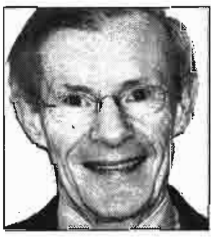

First, I want to review and define the process of rebalancing.

An investment portfolio typically consists of an allocation of stocks, bonds (or mutual funds consisting of stocks and bonds), cash, and possibly other alternative investments. The percentage of each of these assets allocated to the portfolio is based on the investor's age, risk tolerance and objectives. Once the allocation is determined and the investments made, the investments will grow or decrease in value at different rates.

After a period of time, generally six months to a year, the allocations should be checked to determine how near they are to the desired percentage. If the variance is more than about 5 percent, the portfolio may be rebalanced. This is done by selling some of the assets that have performed better and investing this extra money into assets that have lagged. Consistently rebalancing can increase portfolio performance over time.

Periodically, the investor also should check on the quality of the investments to see whether they can be improved, and if so, replace an underperforming investment with a better one.

It may be helpful to consult with a financial professional for assistance in developing a portfolio and selecting investments for each of the assets. With the multitude of stocks and mutual funds in the market, the choices can become very complicated.

★ **Willms is a certified financial planner.**

This concept is not intended as individual investment advice, since personal investment parameters must be carefully reviewed prior to employing any investment strategy.

Dennis J. Meyer

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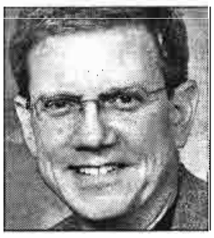

The balancing act of an asset allocation strategy is understanding when, how and why the rebalance occurs.

In a "down market," an investor's original asset allocation may have changed. For example, if stocks have generally decreased in value 35 percent to 40 percent in a year, an initial target allocation of 80 percent stocks and 20 percent bonds and cash a year ago may now be 70 percent stocks and 30 percent bonds and cash.

A rebalancing of this portfolio would require reducing (by selling) the bond and cash holdings by 10 percent, and increasing (through purchases) the stock holdings by 10 percent. The stock/equity holdings in this example may be purchased at a discount from their values of a year ago. (This is called buying low.)

Most 401(k) plans allow for rebalancing online, and some have "target funds" consisting of weighted proportions of mutual funds of different asset categories bundled into one fund, which rebalance themselves via the portfolio managers. These funds usually include a target retirement year within the fund name, such as 2010, 2015, 2020 or 2030. A "2040" retirement fund, for example, would have a longer time frame before the funds are needed and may be allocated more heavily in stock funds. Likewise, a "2010" retirement fund may be allocated more heavily in bonds and cash.

Rebalancing an investment portfolio held outside of a 401(k) requires careful attention to the tax consequences that may be incurred. A rebalance also should involve the expertise of a financial and tax adviser.

★ **Meyer is a certified financial planner.**