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HOW UNINTENDED RISK MAY BE CREEPING INTO YOUR PORTFOLIO

THOUGHT LEADERSHIP PERSPECTIVES

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THE STOCK AND BOND MARKETS HAVE HAD SPECTACULAR RETURNS SINCE THE TROUGH OF THE MARKET ON CHRISTMAS EVE 2018.

The stock market (S&P 500) is now up 44.7% and the bond market (Bloomberg Barclays US Aggregate Bond Index) is up 9.6%. While investors have no doubt enjoyed these returns, they should be aware of the potential for an unintended, and potentially unwanted, consequence of strong markets.

The high levels of returns can dramatically change the asset allocation of a portfolio, and, in this case, add significant equity risk. For example, a simple two asset portfolio that was 60% large cap US stocks and 40% US bonds on December 24, 2018, would have become 66.4% equity and 33.6% fixed income if the investor had reinvested dividends and not made any other trades in the portfolio. Based on the 2020 J.P. Morgan Long-Term Capital Market Assumptions:

The original portfolio had an expected standard deviation (risk) of 8.4% and the current portfolio has a standard deviation of 9.4%. As a result, the market moves have added 11.9% more risk to your portfolio.

MARKET IMPACT ON HYPOTHETICAL \$1,000,000 PORTFOLIO

	December 26, 2018		January 17, 2020	
	Portfolio Value	Percent of Portfolio	Portfolio Value	Percent of Portfolio
Fixed Income	400,000	40.0%	438,268	33.6%
Equity	600,000	60.0%	867,965	66.4%
Total	1,000,000		1,306,233	
Expected Risk	8.4%		9.4%	

*Index return data from Morningstar Direct. | Expected Risk based on 2020 J.P. Morgan Long-Term Capital Market Assumptions.

READJUST TO TARGET ALLOCATIONS QUARTERLY

At Fairman Group Family Office, we recommend investors rebalance their portfolio back toward the original allocation target at least quarterly, or more often if market movements have created a significant deviance from the target.

Morningstar research has shown that rebalanced portfolios have better risk adjusted returns than un-rebalanced portfolios, but that there is no conclusive evidence as to the most optimal rebalancing schedule.

The rebalancing process:

- Maintains the targeted risk profile of the portfolio
- Is a systematic methodology that generally buys low and sells high
- Provides discipline to the investment process
- Has the potential for reduced portfolio drawdowns

Rebalancing a two asset portfolio for a non-taxable investor is a relatively simple process, but the more realistic scenario of a diversified investor that has taxable, tax deferred, and tax free assets could add significant complexity to the rebalancing process. The investor will have to balance the potential of a

taxable capital gain versus the benefit of maintaining the portfolio's asset allocation closer to the target. There may be other complicating factors such as the need to replace a manager or strategy, required minimum distributions from an IRA, and needs for client liquidity.

Ultimately, rebalancing can feel like a puzzle where getting all of the pieces into place requires a combination of both art and science to account for multiple competing factors. It can; however, be an important contributor to an investor achieving and maintaining the balance between risk and reward that they desire.

AT FAIRMAN GROUP FAMILY OFFICE, WE HELP CLIENTS BUILD APPROPRIATE, DURABLE PORTFOLIOS SPECIFIC TO THEIR SITUATION, AND THEN CONTINUOUSLY MONITOR AND REVIEW THEM WITH CLIENTS TO MAKE SURE THEY REMAIN ON TARGET. WE WOULD BE HAPPY TO DISCUSS YOUR SITUATION. PLEASE LET US KNOW IF YOU WOULD LIKE US TO REVIEW YOUR PORTFOLIO.

ABOUT FAIRMAN GROUP FAMILY OFFICE

Fairman Group Family Office is a fee-only financial planning firm, located in Chesterbrook, PA, offering financial planning, investment advice, tax preparation and tax planning services to individuals and families in the greater Philadelphia area since 2002. We are a fiduciary who serves you with skill, care, prudence and diligence through a disciplined and integrated process. We do not sell products or insurance and do not accept commissions, referral fees, loads/12b-1s, trails, or any other compensation from outside sources. Investment advisory services are offered through The Fairman Group LLC. The Fairman Group LLC is registered with the Securities and Exchange Commission under Section 203(c) of the Investment Advisers Act of 1940.