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Is it time to be tactical?

William Schneider, Managing Director

With a backdrop of the financial meltdown of 2007 – 2009, the idea of *tactical asset allocation* (TAA) is once again gaining traction. The siren song is almost irresistible. “Get out to avoid losses, and then hop back in to catch the gains.”

We want to believe. *Behavioral Finance* shows that investors hate losses two or three times more than they regret missing an equal amount of gain (financially, an identical impact). Brokers and money managers promote their TAA products, and new, back-tested, models always seem to work so well. But the problem is that academic research finds no evidence that TAA can consistently add value; you simply have to be right too often.

So, our answer to the above question is, “No. It’s never time!”

A Better Approach

Having said that, it is time to employ a robust rebalancing overlay. When asset returns run to extremes, either up or down, it is important to have a discipline to rebalance back to targets. It is human nature to lock up when markets move to extremes. We either become greedy or fearful and fail to pull the trigger. Maybe from an evolutionary standpoint it makes sense; (if you see a saber toothed tiger and freeze maybe he won’t see you). But, from a financial perspective, it can be hazardous to your health.

For example, a hypothetical institution with approximating 60% equity and 40% fixed income* and \$100 million in assets as of 12/31/2008 would have had \$121.5 million as of 9/30/09 if they did NOT rebalance. If they rebalanced back to targets on March 1, their asset value became \$123 an additional \$1.5 million! Precision is not required. If the rebalance occurred on either February 1 or on April 1, 2009, the ending values became \$122.3 million. These are still additional gains of \$800,000! Of course, no rebalancing overlay will be profitable in a steadily falling market.

Current clients know that our proprietary model, the Portfolio Engineer™ provides such discipline. As you may recall, the Portfolio Engineer™ triggers a rebalance only when the risk and return of the entire portfolio (rather than an individual asset class) have made a statistically significant change. We believe this approach has resulted in: unchanged risk posture, higher returns, and fewer transactions than other rebalancing strategies. Required disclaimer: past performance is no guarantee of future results.

If you’d like to learn more about the Portfolio Engineer™, contact your DiMeo Schneider consultant or Bob DiMeo at (312)853-1000.

*40% Global Bonds, 30% U.S. Equity, 20% MSCI EAFE; 10% MSCI Emerging Markets