

# What should I do now?

Answers for today's tough client questions about risk, rebalancing and re-entering the market.

APRIL, 2009

Erik Ristuben, Chief  
Investment Officer/North  
America

Your advice has never been more important than it is now. Use these questions to start client conversations and answer concerns about what's next.

- Should I dial down my clients' portfolio risk?
- Should I rebalance my clients' portfolios?
- How do I get my clients back in the market?

## EXAMINING ISSUES OF RISK AND ASSET ALLOCATION

### Should investors dial down their portfolio risk?

Advisors are asking if they should take a tactical position with clients' portfolios to try to minimize portfolio risk. From an investment perspective Russell does not recommend tactical asset allocation. In our view, you should not tactically reposition a client's portfolio if their long-term investment objectives haven't changed, particularly if they have five years or more before retirement.

For clients who are in retirement or less than five years from retirement, review whether the downturn in the financial markets has materially reduced their portfolio value to a point where the original retirement spending goal is no longer sustainable. If so, we recommend strategic re-allocation to align the client's portfolio with their current circumstances and long-term goals. Alternatively, if the spending goal is not under threat we recommend a thorough review of the portfolio but no material changes to the allocation.

For more information about asset allocation strategies, read the paper titled "*Evaluating Asset Allocation After the Crash*," by Grant Gardner.

### How should I advise investors to get back in the market if they decided to move to cash no matter what?

The goal for these clients is to limit the cost of their actions by applying the minimal response necessary to address their concerns. For some, that may simply mean reducing their equity exposure from 60% to 40% and investing the difference in a conservative allocation of fixed income instruments. Encourage these clients to schedule a move back to equities over the next year. Dollar cost averaging may be a good way to do this. More information on dollar cost averaging can be found in the section below titled "Advising clients who want to re-enter the market."

Please note, dollar cost averaging does not assure a profit or prevent a loss in declining markets and your clients should consider their ability to continue investing during low price levels. Your clients should also carefully consider any tax consequences before making changes to an asset allocation.

---

## OUTLINING REBALANCING STRATEGY DURING MARKET VOLATILITY

**Should investors who remained invested rebalance back to their target allocation despite the current market volatility? If yes, what is Russell's recommendation on how to do it?**

Yes. Russell believes rebalancing is a vital part of portfolio management. Its purpose is to ensure that a portfolio maintains its long-term asset allocation by periodically eliminating deviations in the portfolio's target allocation, which are caused by natural movements of the market. Russell believes that significant deviations from the target allocation create additional and—in most cases—avoidable, unrewarded risk. Rebalancing helps investors stay the course, not shift away from it. It is a mechanical discipline that overrides the negative impact of our behavioral tendencies to be reactive. This discipline is especially important in volatile periods.

Given the current market volatility and liquidity we recommend rebalancing back to the threshold of the lower edges of the portfolio's tolerance bands. For example, if the client's risk target is 60% equity/40% fixed income plus or minus 5% and they are currently at 30% equity/70% fixed income, then go to 55% equity/45% fixed income. We recommend going to the lower bands because it allows portfolio deviation, within reason, from the target allocation but with minimal impact to the risk and return characteristics of the funds. If you have a client that is already at the lower threshold of the bands, stay put. There is no reason to rebalance unless your client's portfolio moves outside of the tolerance band.

**Is Russell's view that fixed income may provide "equity like" returns in the near term? If so, will rebalancing cause a shift from fixed income to equities?**

Based on Russell's forecasting models, we do expect that on a risk-adjusted basis, U.S. investment-grade corporate bonds are likely to provide an opportunity for equity-like returns in the near term. This is because corporate bonds have experienced unprecedented spread widening during the credit crisis versus Treasuries.

We do realize that any rebalancing now is likely to cause you to sell some portion of the fixed income portfolio and buy equities. So our rebalancing recommendation may feel counterintuitive given our near-term outlook for corporate credits. This is because, while we do expect investment-grade corporate bonds to do well, our models also indicate that the expected returns from equities in the relative near term are likely to be higher than those we expect from bonds; the issue is that we expect equity volatility to remain at the elevated levels we have experienced over the last several months. So by rebalancing to the lower edge of your tolerance band, we believe you will be well positioned to take advantage of a potential upturn in both asset classes, while still maintaining your overall portfolio risk characteristics.

## ADVISING CLIENTS WHO WANT TO RE-ENTER THE MARKET

**How do I get my clients back in the market if they're holding cash?**

Advise clients to start with a fully-diversified all-bond portfolio with an overweight to corporate credits and then agree on a systematic investment strategy to get them back into equities by moving a certain percentage of their portfolio into equities at regular monthly intervals over a 6-month period. A familiar way to think of this is "dollar cost averaging" (DCA).

**Why use dollar cost averaging (DCA) as a re-entry strategy?**

DCA is a technique designed to reduce market risk through the systematic purchase of securities at predetermined intervals and set amounts. Instead of investing assets in a

---

lump sum, the investor works his or her way into a position by slowly buying smaller amounts over a longer period of time. The genius of this is that it makes it easy to get over the psychological barriers of investing in down markets, when stocks are cheap. For your clients, dipping their toe gently into the stock market using a DCA-like strategy might be the only way they are willing to buy stocks at all. We believe clients are better off using this systematic approach than doing nothing.

Carefully consider any tax consequences before making changes to your clients' asset allocation. Dollar Cost Averaging does not assure a profit or prevent a loss in declining markets, and you should consider your clients' ability to continue investing during low price levels.

#### How do I dollar cost average back into a diversified equity portfolio?

Once you have your clients in an all-fixed portfolio, you can begin the process of systematically moving them back into a diversified portfolio with equity exposure over a six-month time period.

In order to begin a dollar-cost-averaging plan, do these three things:

1. Decide exactly how much money you can consistently move to equities each month. Make certain that the portfolio can sustain the same amount every month or the plan will not be as effective.
2. Select the investments that you want the client to hold for the long term, preferably five to ten years or longer.
3. At monthly intervals, invest that money into the security or securities you've chosen for the client.

#### *An Example of Dollar Cost Averaging*

Let's assume an investor decides to purchase \$1,000 worth of XYZ Corp. at the same time every month for four months. In this example, we'll also assume that the stock first declines in value, but then rallies strongly.

Date	Price/Share	Shares	Cost
Jan. 1st	\$20	50	\$1,000
Feb. 1st	\$15	66.66	\$1,000
Mar. 1st	\$10	100	\$1,000
Apr. 1st	\$18	55.55	\$1,000
Total:		272.22	\$4,000
Avg. Price Per Share:			\$14.69

As you can see in the table above, using a DCA strategy the investor would have purchased 272.22 shares for a total of \$4,000. His/her average price per share for this period would have been just \$14.69 (calculated as follows:  $\$4000 / 272.22 = \$14.69$ ). With the stock ending at \$18 at the end of this period, the investor's total position would now be worth \$4,900 (calculated as follows:  $272.22 \text{ shares} * \$18 = \$4,900$ ).

By comparison, if the investor had decided to invest \$4,000 in shares of XYZ Corp. all at once at the beginning of this period, then he/she would have purchased 200 shares at a price of \$20 per share.

---

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

These views are subject to change at any time based upon market or other conditions and are current as of the date at the top of the page.

The information, analysis, and opinions expressed herein are for general information only. Nothing contained in these materials is intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

Bond investors should carefully consider risks such as interest rate, credit, repurchase and reverse repurchase transaction risks. Greater risk, such as increased volatility, limited liquidity, prepayment, non-payment and increased default risk, is inherent in portfolios that invest in high yield ("junk") bonds or mortgage backed securities, especially mortgage backed securities with exposure to sub-prime mortgages.

Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.

As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns. Rebalancing your portfolio may create tax consequences on the taxable portion.

Although stocks have historically outperformed bonds, they also have historically been more volatile. Investors should carefully consider their ability to invest during volatile periods in the market.

Historical impact of asset allocation drift may not be indicative of future asset allocation drift.

Russell Investment Group, a Washington, USA corporation, operates through subsidiaries worldwide, including Russell Investments, and is a subsidiary of The Northwestern Mutual Life Insurance Company.

**Russell Financial Services, Inc., member FINRA, part of Russell Investments.**

Copyright © Russell Investments 2009. All rights reserved.

First used April 2009. Revised June 2009. RFS 09-1880