Maintaining Balance

"What I dream of is an art of balance."

- Henri Matisse

The need for balance and moderation in life is nothing new. Matisse longed for an art of balance and yoga instructors have been emphasizing balance for thousands of years. In the 21st century we seek serenity and happiness by finding a balance between work and leisure, stopping to smell the roses versus moving at breakneck speed, and achieving harmony between healthy eating habits and the occasional ice cream sundae.

Moderation and balance are important to our financial serenity as well. Balancing your checkbook each month is a good start, but real financial balance also involves diversification, discipline, and an effort to maintain that balance over time.

Diversification

Balance in an investment context must begin with diversification. Having a high concentration in the stock of a single company, a single industry, or even a single country can upset the balance of risks in your portfolio. It may be tempting at times to buy into the media hype around the latest hot technology stock, but the reality is that an investment in one or only a few stocks is risky.

Instead, a more moderate exposure to a large number of stocks representing a wide variety of industries from around the globe, as well as some more conservative investments in high-quality bonds, will subdue the ups and downs in your portfolio and prevent you from being thrown off track by the movements of the market. Decades of economic research have shown that this is a far more fruitful and less volatile way to invest over the long term.

Discipline

The benefits of moderation are easy to see, but the temptation to go to extremes can arise at every turn. Discipline is necessary in order to maintain balance in your finances as your life and the world around you go through their gyrations.

In an investment context, the temptation to move out of balance can arise in any market environment. You often hear about the need to maintain discipline during difficult times such as the global financial crisis of 2008 and 2009, but discipline is equally difficult and important in good times.

For example, global stock markets were very strong in 2016 and 2017, with a total return of 33.7% over those two years. Some investors are tempted to be more conservative after a large rally like this because they want to book their profits or they believe that

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stocks must be "due" for a crash. However, markets are notoriously difficult to forecast, and data shows that stocks are no more likely to fall after making an all-time high than they are after a more subdued period of returns.

In contrast, some investors feel the temptation to take on more risk in good times for fear of missing out. Recent media coverage has focused on leading American technology companies like Amazon, Facebook, Apple, and Google. As these companies gain more power and their stocks continue to soar, the temptation to get in on the action can be powerful.

In an environment like this it is helpful to recall the "Nifty Fifty" stocks of the 1960s such as Xerox, IBM, and Eastman Kodak, and the high-flyers of the 1990s technology boom like AOL, Global Crossing, and WorldCom. All of these companies had their time in the sun, but they came back to earth and made room for the next group of winners. As a well-balanced investor you should own the high-flying technology stocks of today and benefit from their success, but you **must** own them in the context of a well-diversified portfolio so you will be insulated from the likely decline and also be assured of owning the next set of great companies when they come along.

Rebalancing

Balance certainly requires discipline, but discipline does not mean simply staying put. As the market moves from day-to-day and year-to-year, the various assets in your portfolio will move with it. Some assets will rise in value, and as they do they may eventually represent an uncomfortably large portion of your portfolio and your overall wealth. Other assets will decline in value and will become a smaller portion of your assets.

This constant movement in the market will cause your portfolio to be out of balance and it requires you to periodically adjust your portfolio in order to maintain the proper allocation. You should review your portfolio on a regular basis, reduce the positions in the assets that have performed best, and increase the positions in those that have lagged. This process, known in the industry as "rebalancing", will facilitate a buy low, sell high trading process, and it is the best way to ensure that standing still does not cause your portfolio to get out of line.

Maintaining balance and discipline within your portfolio is clearly a worthwhile goal, but it is not easy. The temptation to stray from one extreme to another is always present. In order to achieve balance in your financial affairs, you need to know how to diversify properly and how to keep your discipline when those around you are losing theirs. As Warren Buffett reminds us, "We don't have to be smarter than the rest. We have to be more disciplined than the rest."

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