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# The Rebalancing Dilemma

Why Quarterly Rebalancing May Destroy Alternative Alpha

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# The Rebalancing Dilemma

## Why Quarterly Rebalancing May Destroy Alternative Alpha

Quarterly rebalancing sounds disciplined. But when applied to portfolios containing alternatives, it can systematically reduce annual return.

In a traditional 60/40 portfolio, quarterly rebalancing forces buy-low-sell-high discipline with minimal friction. Both asset classes are liquid, transaction costs are small, and mean reversion works over short horizons. This logic breaks down completely when alternatives enter the portfolio.

### FOUR WAYS QUARTERLY REBALANCING DESTROYS VALUE

#### The Mechanical Problem

It is challenging to trim a PE fund or farmland holding quarterly. Capital calls arrive on the GP's schedule. Distributions come when companies are sold, not when your model triggers.

#### The Stale Comparison

When equities rise 15% but private NAVs report flat (because marks lag), the model says equities are overweight. The advisor sells a liquid winner based on a stale comparison.

#### Vintage Disruption

PE returns are heavily vintage-dependent. Rebalancing logic that cuts commitments after strong vintages or increases after weak ones does the opposite of what endowments prescribe.

#### Illiquidity Premium Erosion

The entire point of alternatives is patient, long-duration capital. Quarterly rebalancing introduces short-duration thinking into a long-duration allocation.

### THE RIGHT APPROACH

- 1 Set ranges, not point targets.** A 20% alternative target becomes 15-25%. Only act when the boundary is breached.
- 2 Rebalance sleeves independently.** Equity/bond split rebalances quarterly. The alternative allocation is reviewed annually.
- 3 Use commitment pacing.** If alternatives are underweight, increase the next vintage commitment. If overweight, reduce it.
- 4 Accept NAV lag as a feature.** Comparing stale private marks to daily-priced public assets may create false signals. Don't trade on them.
- 5 Report holistically, act selectively.** Show the total portfolio. But make clear alternatives operate on a different clock.

### THE COST OF GETTING IT WRONG

**30-100+bps**

Estimated annual drag from quarterly rebalancing of mixed portfolios

**12-36 mo**

Rebalancing cycle used by top-performing endowments

**15-25%**

Recommended range (not point target) for alternatives

Trying to force quarterly rebalancing onto a multi-year investment is like harvesting a crop every three months - you destroy the yield.



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