

# Rebalancing strategy

After an unusual year, a thoughtful approach is needed

---

Diversified portfolios achieved strong results in 2024 largely because of exceptional returns from public equity. Consequently, many investors are now likely to be considering a rebalancing trade that would reduce equity exposure in favor of other asset classes.

The decision to rebalance is meant to increase the likelihood of superior performance; it is also a critical risk management tool. The drift away from a strategic allocation may leave a portfolio riskier, less diversified and less efficient. A thoughtful approach can reduce the imbalance and bring down overall risk, while also seeking the most productive uses for capital.

When, and how, to rebalance deserves a thorough examination. Three factors make a thoughtful response particularly important:

- Strong overall equity performance in 2024 masks significant variation across different sectors of the U.S. and international equity markets
- Rich valuations are not limited to equity sectors. Many fixed income sectors are also trading at historically tight credit spreads
- Our recently updated 2025 *Long-Term Capital Market Assumptions (LTCMAs)* can guide a more nuanced and efficient rebalancing across the full spectrum of asset classes

To maintain portfolio efficiency, it may be worthwhile to consider a handful of less traditional rebalancing approaches: First, redeploying capital within the broader equity markets. Second, maximizing the diversification and flexibility of fixed income mandates. And third, looking beyond public markets for the most compelling opportunities.

## Performance was driven by a narrow subset

**Exhibit 1** (next page)—showing the relative performance of stocks and bonds since January 2024—highlights the degree to which equity returns were responsible for investors' positive results in 2024. At the time of writing, large capitalization U.S. equities have risen almost 30%. Meanwhile, fixed income portfolios barely moved, delivering total returns below their average yield over the period. As a result of these exceptional returns, stock and bond allocations have drifted from strategic benchmarks.

## Authors



**Jared Gross**  
Head of Institutional  
Portfolio Strategy



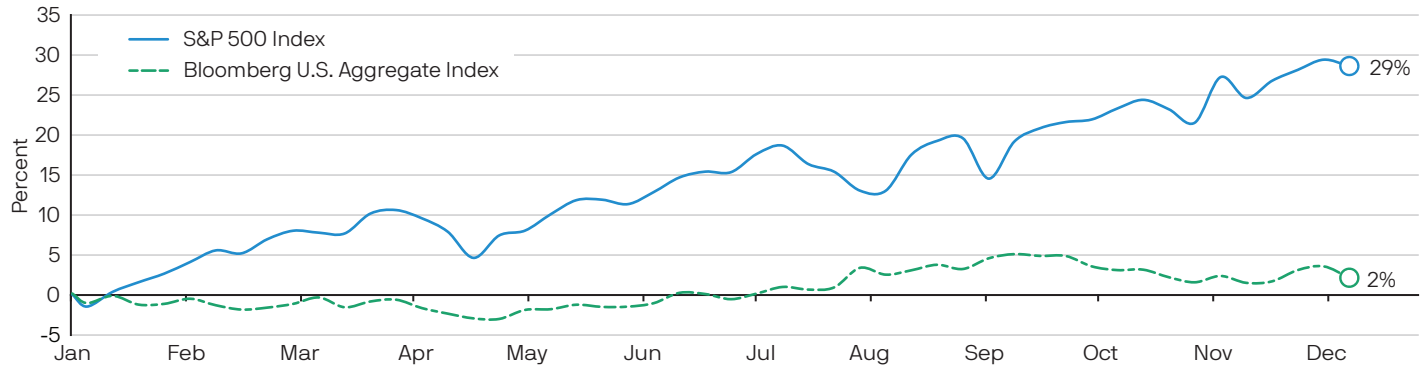
**Kathleen Clum**  
Associate,  
Institutional Portfolio  
Strategy



**Addison Muir**  
Associate,  
Institutional Portfolio  
Strategy

**Exceptional equity returns have moved allocations from strategic benchmarks**

Exhibit 1: 2024 YTD total returns for U.S. stocks and bonds



Source: Bloomberg, J.P. Morgan Asset Management; data as of December 13, 2024.

While equity returns normally outpace bond returns, **Exhibit 2A** places 2024’s performance numbers in context by showing their percentile rank in a historical distribution. The S&P 500, which was the standout among broad market benchmarks, delivered performance in the 88th percentile; the U.S. Aggregate Bond Index, in contrast, finished the year with below-average 28th percentile returns (**Exhibit 2B**). A relative performance gap of this magnitude is likely to create a degree of allocation drift that would require a rebalancing.

Indeed, a 60/40 stock-bond portfolio (the S&P 500 and core bonds) has drifted to a 65/35 mix over the course of 2024—a meaningful deviation from the original

allocation and one that leaves portfolios riskier and less diversified. Most investors will experience somewhat different outcomes based on the particulars of their allocation, but the trend should be broadly consistent.

**What level of drift should trigger a rebalancing?**

The logic of rebalancing rests primarily on asset class returns’ mean reversion across time: The greater a sector’s outperformance or underperformance, the more likely it will eventually reverse. By rebalancing back to a strategic benchmark—in effect, selling the winners and buying the losers—the overall portfolio may enjoy superior performance.

**Equity returns were unusually high in 2024, while bond returns were below average**

Exhibit 2A: Percentile rank, 2024 stock returns relative to history (1977–2024)

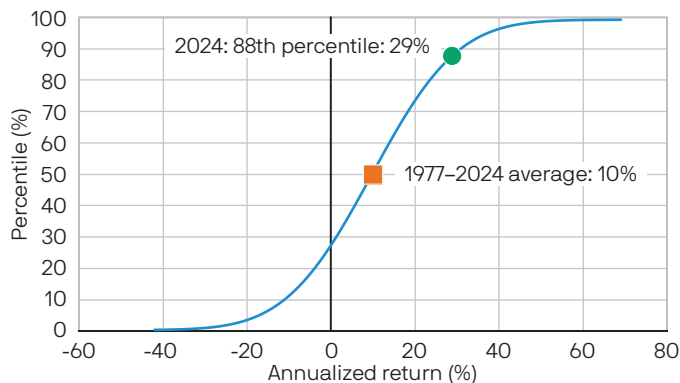
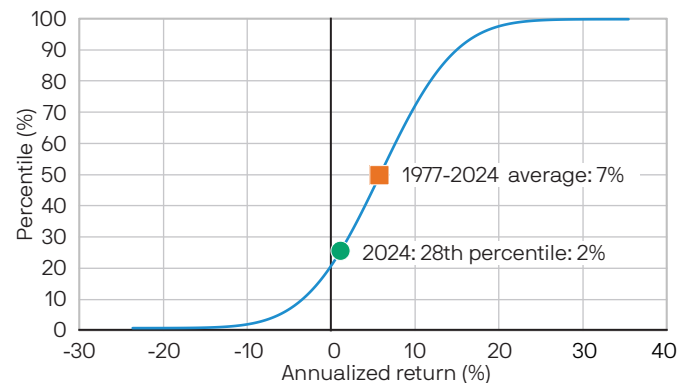


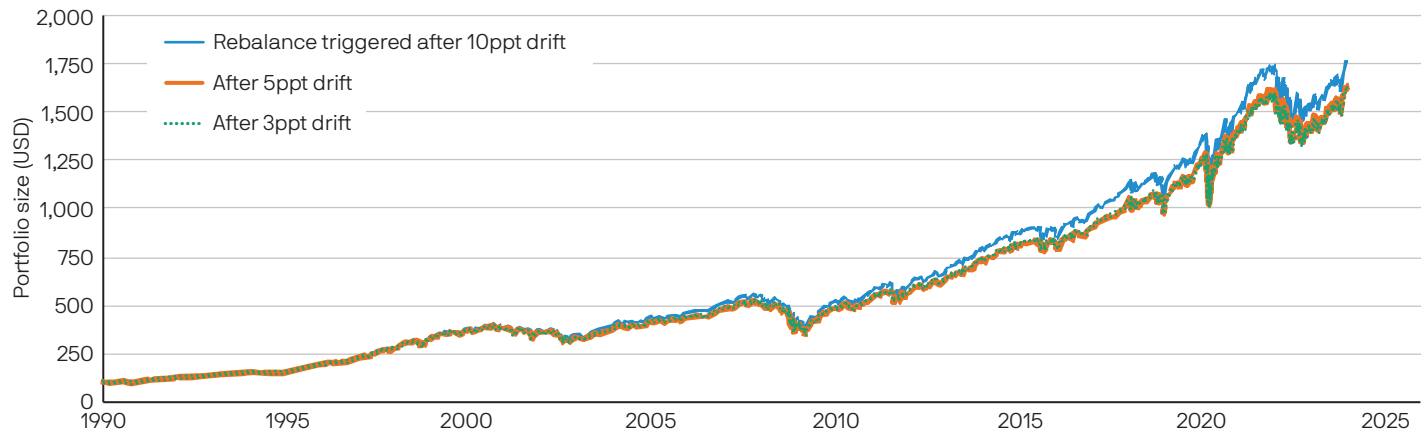
Exhibit 2B: Percentile rank, 2024 bond returns relative to history (1977–2024)



Source: Bloomberg, J.P. Morgan Asset Management; data as of December 12, 2024.

## Rebalancing strategies had modest impacts across time

Exhibit 3: Relative performance of 3%, 5% and 10% rebalancing thresholds (1990–2023)



Source: Bloomberg, J.P. Morgan Asset Management; data as of December 31, 2023. Based on a starting portfolio of \$100 in 1990.

But choosing the best trigger for initiating a rebalancing is difficult: Too small an incremental change and the portfolio will miss out on the compounding of returns (while also bearing transaction costs from more frequent activity); too large an incremental change and the portfolio will miss opportunities to redeploy capital and manage risk. In practice, however, the difference in outcomes can be surprisingly modest. **Exhibit 3** illustrates the historical performance of portfolios that rebalanced between stocks and bonds at 3 percentage points (ppt), 5ppt and 10ppt of incremental portfolio drift (e.g., the 5ppt scenario would trigger a rebalancing at 65/35 or 55/45).

But improving long-term returns is not the only rationale for systematic rebalancing. Another benefit is maintaining an appropriate level of risk across time. The original strategic asset allocation reflects a desired level of overall portfolio return—as well as risk. A portfolio that has drifted towards equity will be riskier than intended in absolute terms; a portfolio that has drifted towards fixed income will be less risky. Rebalancing keeps risk levels aligned with the investor’s objectives over time.

So, the current situation (approximately 5ppt drift) seems adequate to justify action, though perhaps not absolutely critically. Rather than taking no action all, however, a more thoughtful approach can reduce the imbalance and overall risk while also seeking the most productive uses for capital.

### The three-step rebalancing plan

As a starting point, since the equity market’s strong performance has been driven by an unusually narrow portion of the benchmark, the rebalancing discussion can be reframed away from a mechanical shift from stocks to bonds and potentially toward flexibly targeting other equity sectors.

Current market conditions favor:

- 1. Restructuring equity portfolios away from passive large cap allocations to active core, active small and mid-cap, and active global strategies.**

Our latest LTCMA projections suggest that equity may still offer reasonable potential performance, particularly outside of the most highly valued U.S. large cap sector. Long-term (10- to 15-year) U.S. large cap equity return projections in 2025’s LTCMAs have fallen since the previous year’s forecast, but only modestly—to 6.7%, from 7.0% (**Exhibit 4**).

## J.P. Morgan Asset Management's 10- to 15-year forecasts for major asset classes

Exhibit 4: 2024 vs. 2025 Long-Term Capital Market Assumptions

	Compound return 2025	Compound return 2024	Change
<b>EQUITY</b>			
U.S. large cap	6.7%	7.0%	-0.3%
U.S. mid cap	7.0%	7.6%	-0.6%
U.S. small cap	6.9%	7.2%	-0.3%
AC world equity	7.1%	7.8%	-0.7%
Euro area large cap	8.5%	9.7%	-1.2%
Japanese equity	9.0%	9.3%	-0.3%
Emerging markets equity	7.2%	8.8%	-1.6%
<b>FIXED INCOME</b>			
U.S. cash	3.1%	2.9%	0.2%
U.S. intermediate Treasuries	3.8%	3.9%	-0.1%
U.S. long Treasuries	4.3%	5.2%	-0.9%
U.S. aggregate bonds	4.6%	5.1%	-0.5%
U.S. securitized	4.9%	5.3%	-0.4%
U.S. inv grade corp bonds	5.0%	5.8%	-0.8%
U.S. high yield bonds	6.1%	6.5%	-0.4%
<b>ALTERNATIVES</b>			
U.S. core real estate	8.1%	7.5%	0.6%
U.S. value-added real estate	10.1%	9.7%	0.4%
Global core infrastructure	6.3%	6.8%	-0.5%
Global core transport	7.8%	7.7%	0.1%
Direct lending	8.2%	8.5%	-0.3%
Private equity	9.9%	9.7%	0.2%
Diversified hedge funds	4.9%	5.0%	-0.1%

Source: J.P. Morgan Asset Management; data as of September 30, 2024.

2. A targeted reallocation to active fixed income strategies that have the flexibility to move across a broad spectrum of market sectors, active core, core plus, income and multi-sector.

Underlining this point is the LTCMAs' declining long-term bond return forecast: U.S. core bond return expectations have declined to 4.6% in 2025 from 5.1% in 2024 (**Exhibit 4**). Fixed income offers an attractive level of current yield but may not be inexpensive enough to justify being the sole destination for the portfolio's capital.

3. Seeking improved returns elsewhere in the allocation, including in private markets—some of which have seen a marked improvement in forward expectations.

Long-term expected returns are higher for numerous other asset classes that could serve as potential destinations for capital in a rebalancing.

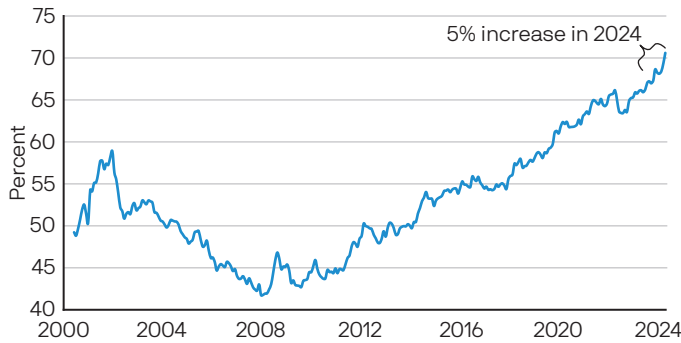
### The cure for market concentration: diversification

Not all equities are equally responsible for the past year's strong returns: As U.S. equity markets outperformed the rest of the world, global benchmarks became more heavily tilted to U.S. markets (**Exhibit 5A**); as large cap companies outperformed the broader U.S. market, the S&P 500 outpaced other sectors (**Exhibit 5B**) and within large caps, a few dominant technology firms generated the largest gains—further concentrating the benchmark (**Exhibit 5C**). Investors risk missing these key elements of the story if they view 2024's portfolio drift purely as a matter of stocks vs. bonds.

Given the relatively narrow sources of equity outperformance in 2024, a number of positive steps can be considered to redistribute risk within the equity portfolio itself. Most of these involve an incremental shift away from passive equity strategies that have become more concentrated and momentum-driven, and towards active strategies across the broader market.

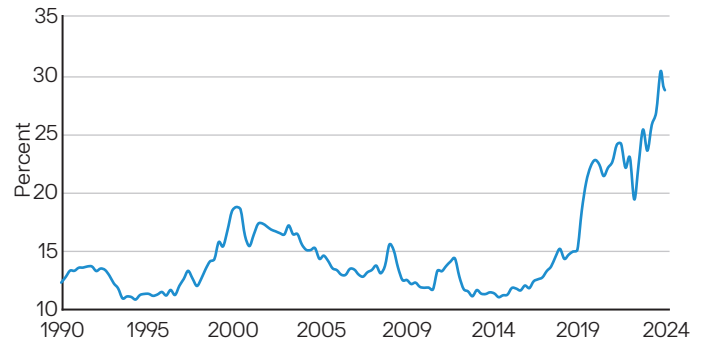
**Only a fraction of equities were responsible for 2024's returns**

**Exhibit 5A: U.S. equities as a share of MSCI World Index market capitalization**



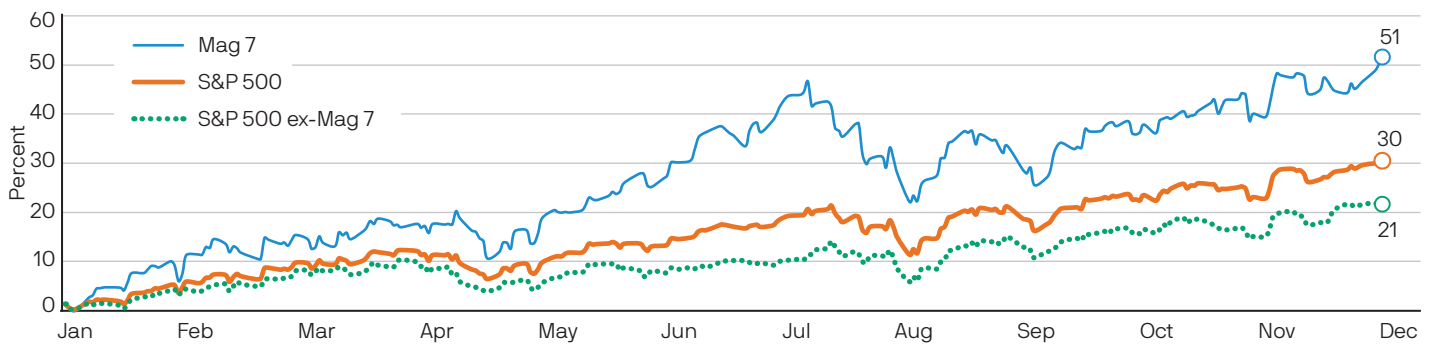
Source: Bloomberg, J.P. Morgan Asset Management; data as of November 29, 2024.

**Exhibit 5B: Market cap, 7 largest U.S. companies as share of S&P 500 market cap**



Source: FactSet, J.P. Morgan Asset Management; data as of September 30, 2024.

**Exhibit 5C: S&P 500 and Magnificent 7 cumulative total return (2024)**



Source: Bloomberg, J.P. Morgan Asset Management; data as of December 4, 2024.

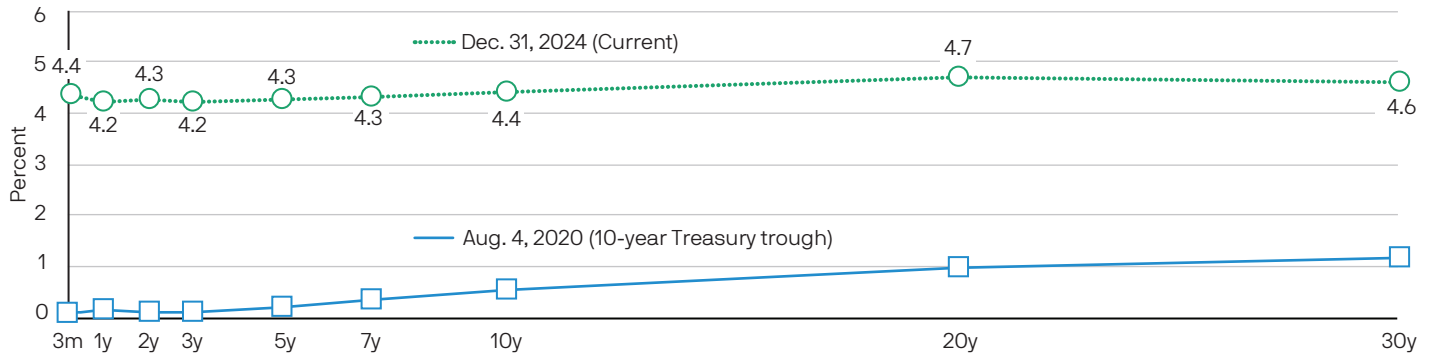
For instance:

- Reducing security and sector concentration around the highest valuation equities, such as the “Magnificent 7” stocks, by pivoting from a passive large cap equity strategy to an active U.S. core manager
- Employing a long/short strategy (such as a 130/30<sup>1</sup>) to allow a more effective expression of positive and negative views, relative to a benchmark that has become highly concentrated
- Reallocating across the broader U.S. equity market with active small/mid cap equity or active value strategies
- Addressing the growing concentration in U.S. markets by redeploying capital from passive global (ACWI) to an active global strategy that has the discretion to deploy capital to the best opportunities regardless of geography

<sup>1</sup> A generic descriptor for equity strategies that employ a permanent structural allocation to active short positions, allowing the overall portfolio to benefit from negative security-level performance while maintaining broad risk characteristics similar to the benchmark.

### High quality fixed income is once again offering meaningfully positive yield

Exhibit 6: U.S. Treasury yield curve, 2020–2024



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management; data as of December 31, 2024.

### The relative merits of fixed income

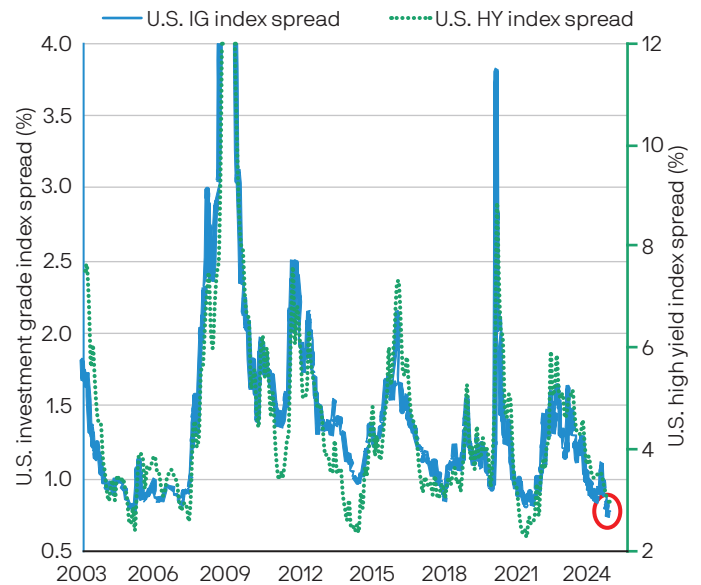
The shift to higher interest rates has revived fixed income’s traditional role as a source of yield and diversification in portfolios, leaving it well-positioned to absorb rebalancing flows. Inflation has declined significantly and Treasury bonds are once again offering a positive real yield at all points along the curve (Exhibit 6). Equally important, should an unexpected event spook investors and generate a “risk-off” flight to quality, bond prices once again have room to appreciate—offsetting possible losses elsewhere in the portfolio.

Beyond the Treasury market, the story becomes a bit more complex. Other credit sectors, such as investment grade and high yield corporate bonds, are trading at spreads at or near all-time tight levels (Exhibit 7).

The prevailing dynamic in credit may reflect strong fundamentals but it also leaves limited room for further upside and makes active management particularly important to avoid exposure to downgrade or default risk. Active managers with the skill to move across the broader markets may find better value in less traditional fixed income sectors, including securitized credit, where a complexity premium is a key driver of returns and credit risk is more limited (Exhibit 8).

### Corporate credit spreads are trading near all-time tight levels

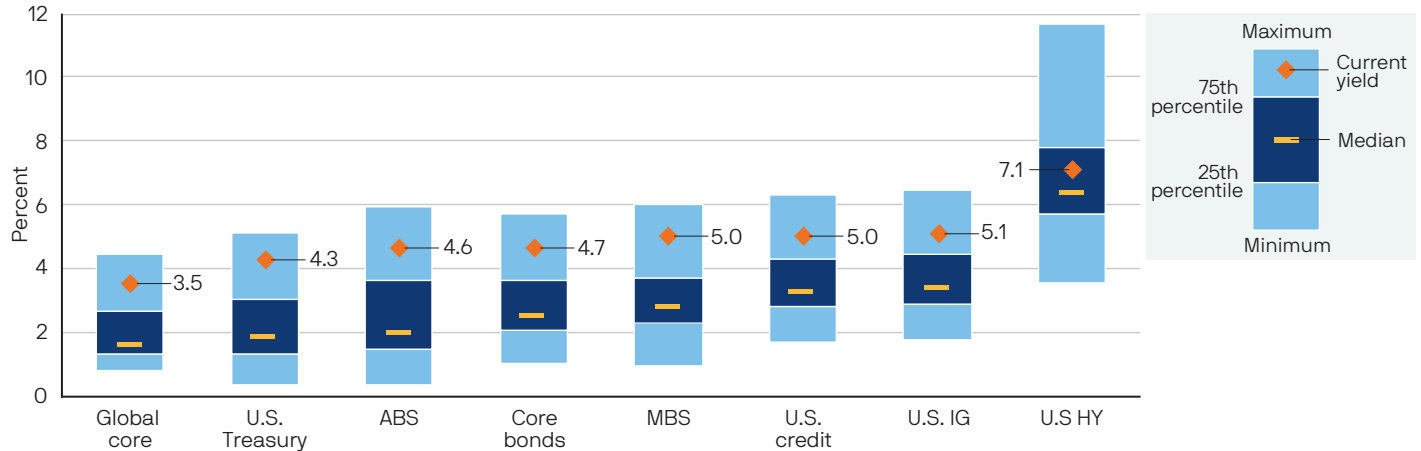
Exhibit 7: Corporate credit spread history



Source: Bloomberg, J.P. Morgan Asset Management; data as of December 6, 2024. IG Index reflects daily spreads and HY Index reflects monthly spreads.

### High quality fixed income sectors exhibit elevated yields vs. recent history

Exhibit 8: Yield-to-worst across fixed income sectors (2014–2024)



Source: Bloomberg, J.P. Morgan Asset Management; data as of December 13, 2024.

### Zooming out to capture the full opportunity set

Simply shifting from stocks to bonds makes sense within the confines of a 60/40 portfolio, but in the real world, investors make use of a much broader opportunity set. Rebalancing should reflect this breadth whenever feasible—particularly when there is limited evidence that a major asset class is positioned to rebound after underperforming. A useful framework is to examine our updated LTCMAs for other investing options that are expected to improve returns without increasing either price volatility or illiquidity risk.

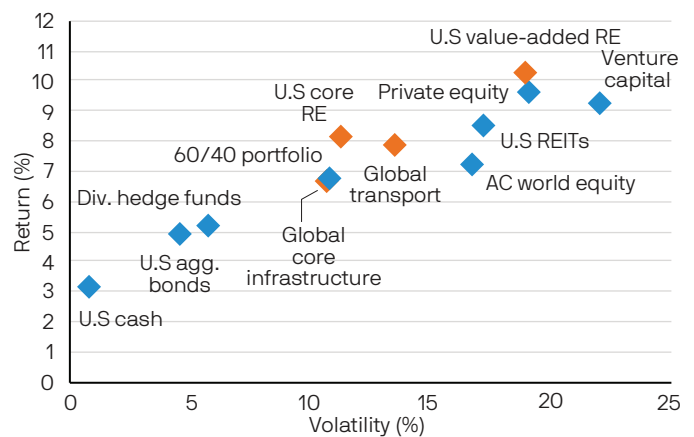
One broad sector that appears to be compelling is core real assets, comprising real estate, infrastructure and transportation. These categories are projected to deliver returns close to or in excess of equities, with risk much closer to that of fixed income (**Exhibit 9**). Core real assets also tend to offer moderate liquidity and a high degree of distributable income, preserving allocation flexibility and helping to avoid the denominator effect.<sup>2</sup>

<sup>2</sup> The denominator effect is the unintended increase in the percentage of a portfolio’s illiquid alternative assets, often to levels in excess of strategic allocation targets, which results from a sell-off in public markets.

Real estate appears particularly advantageous: Across the full spectrum of asset classes included in 2025 Long-Term Capital Market Assumptions, core real estate had the largest year-over-year increase in projected 10- to 15-year annualized returns, rising from 7.5% to 8.1%. Value-add real estate has the highest projected total return, at 10.1%.

### U.S. real estate, infrastructure and transport are expected to offer attractive risk-return

Exhibit 9: J.P. Morgan Asset Management 2025 LTCMA forecast, risk and compound 10-year expected returns



Source: J.P. Morgan Asset Management; data as of September 30, 2024.

## **Conclusion: It's time for thoughtful rebalancing**

Investors seeking to optimize rebalancing programs in today's market should look beyond simply mechanically replacing stocks with bonds, and make use of a broader opportunity set informed by current forward-looking return assumptions.

In today's highly concentrated equity market, investors may add value by reallocating capital within their equity allocations. Transitioning from passive to active is one powerful tool to offset benchmark-level concentration within the U.S. market. Shifting from the U.S. to an active global or international strategy could help distribute capital even more broadly.

Reducing an overweight to equity, which remains a focus, should reflect the insights contained in the recently updated LTCMAs. Value can be found across the broader spectrum of markets, including in extended fixed income sectors and core real assets, which offer particularly compelling opportunities to derisk while preserving potential returns.

---

## J.P. Morgan Asset Management

277 Park Avenue | NY 10017

---

The views contained herein are not to be taken as advice or a recommendation to buy or sell any investment in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit and accounting implications and determine, together with their own financial professional, if any investment mentioned herein is believed to be appropriate to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields are not reliable indicators of current and future results.

**Long Term Capital Markets Assumptions (LTCMA) DISCLOSURE:** All estimates are in U.S. dollar terms. Given the complex risk-reward trade-offs involved, we advise clients to rely on judgment as well as quantitative optimization approaches in setting strategic allocations to all of these asset classes and strategies. Please note that all information shown is based on qualitative analysis. Exclusive reliance on this information is not advised. This information is not intended as a recommendation to invest in any particular

asset class or strategy or as a promise of future performance. Note that these asset class and strategy assumptions are passive only—they do not consider the impact of active management. References to future returns are not promises or even estimates of actual returns a client portfolio may achieve. Assumptions, opinions and estimates are provided for illustrative purposes only. They should not be relied upon as recommendations to buy or sell securities. Forecasts of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. We believe the information provided here is reliable, but do not warrant its accuracy or completeness. This material has been prepared for information purposes only and is not intended to provide, and should not be relied on for, accounting, legal or tax advice.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. Which includes but is not limited to J.P. Morgan Investment Management Inc.

To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our privacy policies at <https://am.jpmorgan.com/global/privacy>.

If you are a person with a disability and need additional support in viewing the material, please call us at 1-800-343-1113 for assistance.

Copyright 2025 JPMorgan Chase & Co. All rights reserved.

PROD-1224-3430364-AM-ALLOCSPOTLIGHT | 0cc6d530-d292-11ef-b97c-55cb39c11bb7