

FRACTIONAL SECURITIES

In this paper we discuss the issues that arise with multi-asset class securities – or fractional securities, as they are sometimes called. We then outline some of the features that a fully-featured portfolio rebalancing tool should provide to solve the problem.

Many securities participate in more than one asset class. For example, Vanguard Balanced Index (VBAIX) holds both bonds and stocks. In some portfolio rebalancing tools it is difficult to assign a multi-asset class security to an appropriate asset class, and to enter trades correctly during rebalancing.

Some rebalancing tools force you to categorize a multi-asset class security as a single asset class, i.e., either a bond or a stock. Either choice introduces error when comparing the client’s actual allocation to the target, and when making trades to rebalance.

If you rebalance manually, each trade for a multi-asset class security requires you to divide the dollar amount among several asset classes. This adds significant time to the rebalancing process and can introduce errors.

A robust rebalancing tool recognizes that fractional securities are common, and it supports features that allow you to manage these securities easily and accurately through all phases of rebalancing.

Defining a Fractional Security

With integrated support for fractional securities, you should be able to assign a security to more than one asset class. You simply list the security as a member of an asset class, and then specify the fraction of the security’s holdings that are invested in that asset class. Repeat for as many asset classes as you need. The rebalancing tool ensures that the fractional percentages add to 100%.

In the example below, the portfolio allocation is divided among three asset classes. The fractional security DGEIX (DFA Global Equity) contributes to all three asset classes: 60% to **Core - II**, 31% to **Core - International**, and 9% to **Core - Emerging Markets**.

Asset Class or Symbol	Fractional %	Target %
Core - II		33.8%
DGEIX	60.0%	
Core - International		19.8%
DGEIX	31.0%	
Core - Emerging Markets		13.9%
DGEIX	9.0%	

Over time, the mix of holdings in DGEIX may change. Support for fractional securities allows you to quickly update the mix by changing the percentages in the Fractional % column.

Reviewing the Client Portfolio

When comparing a client portfolio to the target allocation, the rebalancing tool should automatically assign fractional securities to the appropriate asset classes in the specified proportions. Continuing the example above, if the client holds \$100K in DGEIX, the rebalancing tool assigns \$60K to **Core - II**, \$31K to **Core - International**, and \$9K to **Core - Emerging Markets**.

When you review the results of the portfolio analysis, you should be able to tell at a glance if any of the asset classes are out of balance. The rebalancing tool might display a report like the example below. Actual % for

Core - II is green, indicating that the client portfolio is within the target range defined for that asset class. But Actual % for **Core - International** is red, indicating that the client portfolio is out of balance for that asset class.

Asset Class or Symbol	Description	Target %	Actual %
Core - II		33.8%	35.1%
DFQTX	DFA U.S. Core Equity II		
DGEIX	DFA Global Equity 60%		
DFLVX	DFA Large-Cap Value		
Core - International		19.8%	15.6%
DFIEX	DFA International Core		
DGEIX	DFA Global Equity 31%		
DISVX	DFA Intl Small Cap Value		
Core - Emerging Markets		13.9%	12.7%
DFCEX	DFA Emerging Markets Core		
SFENX	Schwab Fdmtl Emerging Markets		
SSEMXX	SSgA Emerging Markets		
LZOEX	Lazard Emerging Markets		
DGEIX	DFA Global Equity 9%		

Rebalancing with Fractional Securities

When you enter a trade for a fractional security, the rebalancing tool should automatically create trades for the appropriate dollar amounts in all asset classes to which the security contributes. You don't have to do any of the fractional calculations, and the trades are immediately displayed for your review and possible adjustment.

For example, if you enter a Buy for \$12,000 of DGEIX, the rebalancing tool automatically enters DGEIX Buy trades for \$7200 for **Core – II**, \$3720 for **Core – International**, and \$1080 for **Core – Emerging Markets**. You can then adjust these trades and the rebalancing tool signals if the amounts are not appropriate. For example, if your adjustment pushes one of the other asset classes out of balance, the Actual % for that asset class turns red. A user-friendly rebalancing tool adjusts as you adjust, keeping fractional securities consistent, until you reach your new desired portfolio allocation.

Some of the more sophisticated rebalancing tools also offer automatic rebalancing features. When you auto-rebalance, the tool should use fractional security definitions, along with other heuristics, to produce a recommended set of trades to rebalance the portfolio.

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