
WHY REBALANCING IS SO CRITICAL TO EXCHANGE TRADED FUNDS (ETFs)

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As we've [discussed previously](#), [smart beta](#) approaches, such as WisdomTree's, have been growing in popularity. Perhaps this is due to the fact that they try to beat the market, rather than be it. But all smart beta approaches may not be created equal. We believe that truly smart beta approaches (as opposed to smart marketing techniques) offer investors:

- High [correlations](#) to established benchmarks
- A rules-based, repeatable methodology that offers broad, representative exposure to an asset class
- Alternative weighting methods
- A proven track record on a total and risk-adjusted return basis

And perhaps one of the most important characteristics, at least in our approaches, is the regular rebalancing back to a relative value. Why is this so important? Rebalancing keeps an eye on relative value

Consider that stock prices can be driven up for many reasons. And when prices are driven up, ETF weightings can be as well. Unless you believe that price is always the best indicator of value, you can appreciate the risks this can add. This is precisely why a [fundamental](#) rebalance is so important to WisdomTree—and should be to all investors. Rebalancing can help reduce the risk of giving too much weight to stocks whose price increases are not supported by improvements in underlying fundamentals. It can provide the opportunity to sell stocks that have become more expensive relative to their underlying fundamentals and buy stocks that have become less expensive relative to their underlying fundamentals. (Please note that stocks are affected by how the market performs. When stock prices fall, you should expect the value of your investment to fall as well.) Put simply, rebalancing to relative value allows us to effectively lower the prices of the markets we invest in*—helping us to:

- Avoid paying too much for growth
- Reduce valuation risk
- Provide the potential for outperformance

So, why don't more ETFs rebalance to relative value—or even rebalance at all? Your guess is as good as ours. **See the [difference rebalancing makes](#) for yourself.** *Ordinary brokerage commissions may apply.

For more investing insights, check out our [Economic & Market Outlook](#)

Smart Beta : A term for rules-based investment strategies that don't use conventional market-cap weightings.

Fundamentals : Attributes related to a company's actual operations and production as opposed to changes in share price.