WELLS FARGO Wealth & Investment Management

Wells Fargo Institutional Outsourced Chief Investment Officer

Are you on course?

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At their core, benchmarks are designed to answer the question: "Am I on course?" While broad themes are common across nonprofit institutions, each client's definition of success (the destination) can look very different. Reviewed over shorter time frames, the core set of benchmarks we tend to see can lack the context required to determine if you are on course to meet your long-term objectives. The context of what follows may provide you with a better understanding of the purpose, limitations, and appropriate timeframe for some commonly used portfolio benchmarks that can help you stay on course to meet your goals.

Inflation + Spending Rate

Most nonprofits have an objective to grow their portfolio in real terms (i.e., after inflation) over time after distributions and fees. A benchmark of inflation plus your organization's spending rate not only measures investment performance but also the organization's ability to make a consistent impact through distributions over time. However, even though it tends to be the primary objective for many nonprofits, there are limitations that can make comparisons between inflation plus a spending rate, and your portfolio difficult, specifically over shorter time horizons. For ease of reference, let's assume the benchmark is the Consumer Price Index (CPI) plus 5%, sometimes referred to as CPI+5.

The primary challenge is that CPI+5 is not investable. Unlike other benchmarks like the S&P 500 or the Barclays Aggregate Bond Index, you can't go out and purchase a single investment product that will produce CPI+5; if you could, there would be no reason to invest the portfolio in anything else. As a result in any given quarter, year, or multiyear period, you should expect to see a relatively high variance between actual portfolio returns and CPI+5. Calendar performance since 2022 provides a stark reminder of why using this as your primary tool to measure investment performance can at times be misleading.

- In 2022, inflation began to accelerate, eventually peaking in the summer, and the Federal Reserve raised interest rates. This led to equities and bonds selling off simultaneously due to the impact of higher interest rates and fears of a recession. CPI ended the year up 6.5%, the 60% S&P 500/40% Bloomberg US Aggregate Bond Index portfolio was down -15.9% and underperformed a CPI+5 benchmark by 27.4%.
- Conversely, in 2023, both falling inflation and receding recession fears led to a reversal in performance for equities and bonds. CPI ended the year up 3.4%, the 60/40 portfolio returned 17.7% and outperformed a CPI+5 benchmark by 9.3%.

- The trend of rising asset prices and falling inflation has continued through 2025, producing outperformance of at least 5% in both 2024 and 2025 for the 60/40 portfolio compared to CPI+5.[1]

We use this example not as an attempt to discredit the use of this benchmark, but only to highlight the importance of using it over the appropriate time horizon, which in our view is 7-10 years.

Reference Portfolio

Another commonly used benchmark in the industry is the Reference Portfolio of 60% equities/40% bonds. It has been considered as a benchmark because it is simple to understand, can be fairly easily constructed by an investor with limited cost and complexity, and could be expected to meet a client's long-term risk and return objectives.

Our experience is that while a 60/40 portfolio could generate sufficient returns over a full market cycle, it comes with a level of volatility that is not required to meet your objective. During introductory meetings with clients and prospects, we often stress the importance of using alternative investments to increase the likelihood of meeting their long-term return objectives while producing a smoother return pattern.[2]

One alternatives strategy we tend to employ in client portfolios are hedge funds. Hedge funds seek to improve risk-adjusted returns through diversification and by attempting to generate uncorrelated sources of returns. For private capital, this is generally achieved through higher returns compared to public equities. Though we believe their inclusion is useful, alternative investments also increase the complexity of reporting from both an investment and audit perspective and are more illiquid than their public counterparts. By comparing your portfolio to the Reference Portfolio benchmark, you should be able to understand if the increased complexity was worth it in terms of risk and/or return.

Generally speaking, even when a portfolio includes alternatives, the majority of the invested assets are in public equities and public fixed income. Because the benchmark is investable and the portfolio has considerable overlap with it, the Reference Portfolio benchmark can provide more relevant information over shorter time horizons than CPI+5. However, like CPI+5, there can be period-to-period dispersion as a result of what isn't in the Reference Portfolio benchmark. Reviewing your portfolio over any given quarter or calendar year against the Reference Portfolio benchmark could over or understate the benefits of including alternative investments to your portfolio. While market environments can vary, this benchmark generally is appropriate for 3-5 year periods and beyond.

Client Policy Benchmark

Each of our clients has a weighted average Policy Benchmark where underlying benchmarks are given weights based on the strategic asset allocation set forth in the Investment Policy Statement (IPS). What the performance of the portfolio vs. the Policy Benchmark tells you is how well Wells Fargo's OCIO team is doing selecting managers and making tactical calls to overweight or underweight certain asset classes. IPS's have a long-term target allocation to the four broad asset classes (equities, fixed income, real assets, and alternatives). At times, we feel there are some asset classes (and sub-asset classes) that have favorable or unfavorable risk/return profiles. In those instances, we will overweight or underweight those investments. The performance of client portfolios will be impacted by these decisions, and the Policy Benchmark helps us demonstrate whether those were successful decisions or not.

Because the Policy Benchmark is mapped directly from your IPS there is less variance, making it the most applicable when reviewing performance on a quarterly basis. However, the same reason it is the most appropriate benchmark over shorter horizons is also the source of its potential limitations. Strategic asset allocation targets are derived in order to meet your long-term goals and objectives and are also the source of the Policy Benchmark.

Therefore, the Policy Benchmark informs one of how well we are doing according to the plan, but it fails to tell you how well the plan is doing relative to your goals and objectives. Said differently, a portfolio could be outperforming its Policy Benchmark while simultaneously failing to grow the corpus of the portfolio in real terms.

Conclusion

In the end, we generally see successful nonprofits use at least two, if not all three, of the benchmarks referenced due to the insights and limitations outlined above. Over long-time horizons, CPI+5 can tell you if your organization is on track to replicate its impact in perpetuity, the Reference Portfolio asks if there might be a simpler way to do it, and the Policy Benchmark lets you know how the decisions we make on an ongoing basis in your portfolio have been additive towards your goals. While we always strive to outperform all of our benchmarks over the appropriate time horizon, the most important goal is to ensure our clients get to their destination and are able to continue their organization's mission.

1. Bloomberg, as of December 31, 2025. Data is calculated monthly from January 2022 to December 2025. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.

2. Alternative investments carry specific investor qualifications which can include high income and net-worth requirements as well as relatively high investment minimums. Available to pre-qualified investors only.

Risk Considerations

All investing involves some degree of risk, whether it is associated with market volatility, purchasing power, or a specific security. There is no assurance any investment strategy will be successful. Asset allocation does not guarantee a profit nor does diversification protect against loss.

Alternative Investments: Alternative investments, such as hedge funds, funds of hedge funds, managed futures, private capital, real assets and real estate funds, are not suitable for all investors. They are speculative, highly illiquid, and are designed for long-term investment, and not as trading vehicle. These funds carry specific investor qualifications which can include high income and net-worth requirements as well as relatively high investment minimums. The high expenses associated with alternative investments must be offset by trading profits and other income which may not be realized. Unlike mutual funds, alternative investments are not subject to some of the regulations designed to protect investors and are not required to provide the same level of disclosure as would be received from a mutual fund. They trade in diverse complex strategies that are affected in different ways and at different times by changing market conditions. Strategies may, at times, be out of market favor for considerable periods with adverse consequences for the fund and the investor. An investment in these funds involve the risks inherent in an investment in securities and can include losses associated with speculative investment practices, including hedging and leveraging through derivatives, such as futures, options, swaps, short selling, investments in non-U.S. securities, "junk" bonds and illiquid investments. The use of leverage in a portfolio varies by strategy. Leverage can significantly increase return potential but create greater risk of loss. At times, a fund may be unable to sell certain of its illiquid investments without a substantial drop in price, if at all. Other risks can include those associated with potential lack of diversification, restrictions on transferring interests, no available secondary market, complex tax structures, delays in tax reporting, valuation of securities and pricing. An investment in a fund of funds carries additional risks including asset-based fees and expenses at the fund level and indirect fees, expenses and asset-based compensation of investment funds in which these funds invest. An investor should review the private placement memorandum, subscription agreement and other related offering materials for complete information regarding terms, including all applicable fees, as well as the specific risks associated with a fund before investing.

Equities: Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Investments in equity securities are generally more volatile than other types of securities. There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guarantee and are subject to change or elimination.

Fixed Income: Investments in fixed-income securities are subject to market, interest rate, credit, and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

Index Definitions

The benchmark performance is for illustrative purposes only and is not reflective of any investment. Index returns do not represent returns or the results of actual trading nor are they forecasts of expected gains or losses a portfolio might experience. Index returns reflect general market results, assume the reinvestment of dividends and other distributions, and do not reflect deduction for fees, expenses, or taxes applicable to an actual investment. Comparisons to benchmarks have limitations because benchmarks have volatility and other material characteristics that may differ from those of the portfolio. Because of the differences, benchmarks should not be relied upon as an accurate measure of comparison. There is no guarantee that any of the securities invested in the portfolio are included in the index. Past performance does not guarantee future results. An index is unmanaged and not available for direct investment.

S&P 500 Index: The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the in index proportionate to its market value.

Bloomberg US Aggregate Bond Index: Bloomberg US Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

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