

What is an Investment Benchmark?

An investment benchmark is a standard against which the performance of a security or investment manager can be measured. Thousands of indexes have been created to be used for this function. These indexes often measure hundreds or thousands of securities representing some aspect of the total market. In the equity market for example, the S&P 500 is one of the most popular large cap stock benchmarks. It is comprised of 500 of the largest U.S. publicly traded companies and is often used to gauge the performance of the U.S. large-cap equity segment of the market.¹

Why are Benchmarks Important?

Identifying and setting a benchmark can be an important aspect of tracking an investment manager's performance over short- or long-term time frames. When evaluating the performance of any investment, it is important to compare it against an appropriate benchmark. For example, benchmarking a U.S. large cap mutual fund against a global stock market index may not be an appropriate way of measuring that fund's performance because they both have different underlying constituents and therefore probably will not move in the same way.

When an investment manager's performance deviates from the selected benchmark, it's natural to wonder why the fund performed the way that it did. There are many possible reasons for underperformance: the investment manager may make poor decisions, expenses could drag on the returns, or the investment style may be out of favor. Analyzing benchmark deviations may help investors to make more informed decisions regarding their investments.

Limitations of Benchmarks

Appropriate benchmarks tend to work relatively well for traditional asset classes such as stocks and bonds. However, alternative investment strategies are often difficult to benchmark. For example, in the diversified alternatives category, managers may use different investment strategies which may lead to inconsistent returns for each fund, especially over shorter periods of time, such as a quarter or one year. A manager pool can be selected as a benchmark to measure a group of these managers, but individual manager returns may vary widely from the selected benchmark.

In addition, benchmarks for traditional asset classes are typically updated daily, however, benchmarks for alternative investments are often only updated monthly. During a volatile period, a person may perceive a large variation in daily or weekly performance relative to the benchmark, when in reality the benchmark data may be several weeks old and not applicable.

Final Thoughts on Benchmarks

Although benchmarks play an important role in selecting and measuring investments, investors may find it useful to focus on the big picture. For many individuals, the "benchmark" that matters is whether your portfolio is helping you to meet your financial goals. Spending a lot of time and energy assessing whether a fund outperforms or underperforms an arbitrary benchmark, especially over a short period of time, may not be productive. In fact, it may lead to making emotional decisions. A financial advisor can help you gain perspective, sift through the noise, and give you recommendations specific to your situation.



1. Rosen, R. (2019). Using benchmarks in investing. Retrieved <https://www.investopedia.com/articles/investing/032516/how-use-benchmark-evaluate-portfolio.asp>