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A diversified portfolio is one way to cushion your organization from market volatility and economic uncertainty. That's because different investments behave differently in response to economic influences. When some asset classes are down, others may be up. By investing in multiple classes, you can enhance the overall stability of an investment portfolio.

There is a common misconception that diversification means having several accounts at different institutions or with multiple advisors. In truth, diversification refers to the asset allocation of investments within your portfolio, not where you hold them. It means spreading your investments across multiple asset classes so that the items within your portfolio are unlikely to move in lockstep with each other. Ideally, you'll have a range of assets that either move in different directions or react to different degrees. When responding to economic and market changes, greater diversification helps reduce volatility Risk. Volatility risk is the potential magnitude of gains and losses of any particular investment. Nonprofit organizations like other investors, should aim to strike a thoughtful balance between volatility, risk, and potential return, one that guards against the potential pitfalls of a concentrated portfolio while also helping meet their financial goals. A thoughtful investing approach includes setting a long-term plan to allocate resources across different asset classes based on the organization's goals and risk tolerance.

Endowments and foundations typically consider cash fixed income and equity as their primary options for investment. Many organizations also evaluate alternative investments, which can include things like real estate or private equity. Cash is typically used as a capital preservation vehicle and for liquidity purposes, cash investments include treasury notes, treasury bills, and money market mutual funds. These pay a rate of interest that is dictated by current short-term interest rates. Usually risks are low, but so are returns. Fixed income refers to an investment in a debt vehicle offered by a government, governmental agency, or corporation. Examples include US treasury bonds, foreign government bonds, US corporate bonds, and fixed income mutual funds or exchange traded funds. These are typically used as income producing assets with low to moderate risk. While the potential yield of the investment is generally known at the time of purchase, the market value of the bond itself can fluctuate Longer.

Dated bonds commonly exhibit more price volatility. Equity is an investment in the stock of a corporation. This includes individual stocks and equity funds. Equity is typically used as a capital growth vehicle, and returns are based on the market value of each share of stock available. This asset class usually carries the highest potential for returns, but also the highest volatility. Of these three, cash is historically the most stable. While fixed income and equity markets can be volatile, they typically do not move in the same direction At the same time when stock markets go up, bond markets usually go down and vice versa. Alternative investments can also play a role in diversification because they provide exposure to asset classes not typically found in traditional portfolios. Investments such as private equity, real estate, hedge funds and commodities can have unique risk and return profiles, which may help to balance out overall returns while reducing volatility.

However, it is important to keep in mind that alternative investments often come with higher fees and lower liquidity. A diversified portfolio in invests in multiple asset classes and multiple underlying investments within each asset class. To further enhance diversification, investors should consider spreading investments across different geographic regions and industry sectors. This helps mitigate risks associated with regional economic downturns or sector specific challenges. Determining the optimal mix of asset classes starts by understanding your nonprofit's mission, long-term, financial needs, constraints, risk tolerance, and objectives as capital markets and the organization both evolve asset allocation can be adjusted to meet the changing mission needs and to optimize the performance of each investment portfolio. For help determining the right mix of investments to meet your nonprofits goals, call captrust. Our financial advisors provide investment, fiduciary and risk management services for endowments and foundations all across the country.