

# *Determining the Right Asset Allocation for Nonprofits*

Determining the appropriate asset allocation is often the first—and most consequential—investment decision a nonprofit’s finance or investment committee will make. Balancing growth, risk, and liquidity helps determine how an organization can support its mission in both favorable and challenging market conditions.

Unlike tactical decisions such as manager selection or short-term portfolio adjustments, strategic asset allocation establishes the foundation for a portfolio’s ability to meet spending needs, preserve purchasing power, and maintain financial stability over time.

## *Why Asset Allocation Matters Most to Nonprofits*

Asset allocation—the strategic mix of stocks, bonds, alternative assets, and cash—is the primary driver of long-term investment outcomes. Research suggests it explains more than 85% of a portfolio’s volatility and performance.<sup>1</sup> For nonprofits, making the right strategic allocation decision is especially important.

A disciplined asset allocation balances risk and return to support spending needs, long-term growth, and financial sustainability. In a period of increasing financial and operational challenges for many nonprofits, maintaining an allocation aligned with return objectives—not short-term market conditions—can help organizations achieve stronger long-term outcomes.

## *Linking Investment Strategy to Mission*

Establishing an appropriate asset allocation begins with linking the investment strategy to the organization’s mission priorities and long-term sustainability. Objectives may include supporting annual spending, preserving purchasing power, incorporating mission-aligned investments, or growing assets to support future needs. It is also important to recognize that different asset pools may have distinct objectives based on their purpose and time horizon.

### *Example 1: Operating Nonprofit Foundation*

- **Financial Objective:** Support a 4% annual spend in perpetuity to fund programmatic needs.
- **Portfolio Approach:** Growth-oriented portfolio with a tilt toward growth assets to meet spending requirements.

### *Example 2: Program & Capacity Grants*

- **Financial Objective:** Meet liquidity needs aligned with a drawdown schedule while preserving capital.
- **Portfolio Approach:** Fixed income portfolio with maturities matched to expected liquidity needs.

### *Example 3: Mission-aligned Investments*

- **Financial Objective:** Ensure investments do not conflict with organizational values.
- **Portfolio Approach:** Integrate ESG considerations into the investment selection process.



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*Understanding Constraints & When to Pivot*

Every nonprofit operates within constraints that shape how its portfolio can be invested. Spending policies, liquidity needs, time horizon, risk tolerance, and legal or donor restrictions all influence asset allocation decisions. Advisors should also help assess whether an organization's objectives are achievable given these constraints and realistic capital market assumptions.

Because conditions change, allocations should be reviewed periodically to ensure they remain aligned with organizational goals. In recent years, many institutions have reconsidered their allocations as market conditions have evolved.

Liquid alternatives and private market investments have also become increasingly common components of institutional portfolios.

*Example 1: Liquid Alternatives – Why?*

- Provide diversification beyond traditional stocks and bonds, with historically lower correlation to both.
- Seek returns higher than intermediate-duration investment-grade fixed income.
- Historically exhibit lower volatility than long-only equities.
- May provide a hedge in rising interest rate environments.

*Example 2: Private Markets – Why?*

- Expand the investment opportunity set for institutional portfolios.
- Offer access to investments not available in public markets.
- May improve portfolio diversification when combined with public assets.
- Private companies are remaining private longer, while some valuations appear attractive relative to public markets.

Diversification through both public and private assets can help portfolios generate additional return sources and better withstand varying market and economic environments.

*Defining Risk & Return Expectations*

Defining risk and return expectations means translating organizational objectives into a required rate of return while recognizing the trade-offs between volatility, potential drawdowns, short-term stability, and long-term growth. The goal is to align the committee's risk tolerance with realistic capital market assumptions to support sound decision-making.

*Governance & Decision Framework*

Once a strategic asset allocation is established and expected to meet objectives over a market cycle (typically 5–7 years), effective governance becomes essential. Asset allocation recommendations typically originate with the Finance or Investment Committee and are approved by the board.

Best practices include documenting decision rationales, ensuring alignment with the Investment Policy Statement (IPS), and periodically stress testing the allocation to confirm it can meet organizational objectives. These practices help committees avoid reacting to short-term market volatility or chasing performance.

*Conclusion: Asset Allocation as a Strategic, Not Tactical, Decision*

Strategic asset allocation should be reviewed periodically, particularly after significant organizational changes such as a major gift or leadership transition. These reviews ensure the portfolio remains aligned with organizational goals and evolving market expectations.

Strategic changes should reflect long-term views rather than short-term market movements. When thoughtfully constructed and maintained, asset allocation anchors financial resources to the organization's mission, supporting current needs while sustaining long-term impact.

<sup>1</sup> Vanguard, "Asset allocation: Key to your investment climate," [investor.vanguard.com/investor-resources-education/how-to-invest/asset-allocation](https://investor.vanguard.com/investor-resources-education/how-to-invest/asset-allocation).

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