

Should I Use Benchmarks to Evaluate My Advisor's Investment Performance?

By: Exchange Capital Management

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How do you know when your advisor is meeting the mark? When the market is down, it's easy to look at investment returns as the sole indicator of your advisor's overall performance. However, it's important to look at the whole picture when evaluating how your portfolio is measuring up.

What Is a Benchmark?

When assessing performance, investors often look to benchmarks as the guiding light. A benchmark is a standard against which the performance of an investment can be measured. They allow you to evaluate how your investments are doing compared to a similar basket of securities.

The most popular benchmarks are indices designed to track a specific market or sector, such as the S&P 500 index. This index tracks the performance of the 500 largest publicly traded companies in the U.S. and is a better indicator of the overall market than the Dow Jones Industrial Average (the Dow is garbage, ask Andy why).

How Accurate Are Benchmarks?

Benchmarks don't work unless you're comparing like to like. Most portfolios consist of stocks, bonds, and other investments. Using a stock market benchmark, like the S&P 500, won't accurately depict how a balanced portfolio is doing.

You must consider each investment in your account to find the appropriate benchmarks. For instance, emerging stock market investors will not find the S&P 500 to be an accurate benchmark when assessing returns. In this case, you should look at the MSCI Emerging Markets Index, but even that might not be a perfect fit.

Advisors often build portfolios based on their client's goals. Benchmarks allow you to measure performance to the overall market but do not measure how your portfolio aligns with your individual circumstances. An investor who is more risk-tolerant and prefers a more aggressive investment strategy may deviate further from a standard benchmark. Another consideration is your advisor's investment strategy. Advisors using active management may use benchmarks as a reference point but ultimately make investment decisions based on their own analysis and research.

How Do I Know Which Benchmark My Advisor Uses?

An advisor should place the appropriate benchmarks on your client portal or quarterly reports. If you can't find them, consider calling your advisor and asking. A good advisor will be able to provide a clear and detailed explanation of how your investments are performing and which benchmarks are applicable to evaluate performance.

The Bottom Line

Benchmarks can be a reference point in your research but should not be the sole indicator of performance. A portfolio that outperforms a benchmark in one period may underperform in another. Ultimately, a portfolio's success should be measured by how it aligns with your financial goals and risk tolerance.