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The Allocation Evolution: The Emergence of Total Portfolio Approach Investing

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Introduction: Responding to Market Transformation

Financial markets look radically different today versus how they looked at the turn of the 21st century. One notable change? The sharp increase in private sources either funding or managing large swathes of the economy. Cash-strapped governments have stepped back from funding many key infrastructure and energy projects. Banks, facing stricter regulation since the global financial crisis, have pulled back from long-dated and complex lending. In their place, private owners and lenders have stepped in to fund and manage essential infrastructure projects, as well as business development and expansion.

Other changes include more companies staying private or delaying listing on public stock exchanges. And the correlation between global stocks and bonds has risen, making traditional diversification less effective and bolstering the need to find additional portfolio diversifiers.

The result has been huge growth in private markets. Investors—especially institutional investors—are increasingly turning to alternatives as essential tools for portfolio diversification, income and long-term growth. And that has implications for asset allocation and portfolio construction frameworks.

In particular, it has complicated traditional strategic asset allocation (SAA), where institutional investors manage their portfolios by assigning weights to individual asset classes: many alternative investments do not fit neatly within conventional asset-class categories, and their illiquidity can make balancing toward benchmark weights more difficult. As a result, some investors have begun to explore new approaches, such as the total portfolio approach (TPA) which considers portfolio construction more holistically.

Here we outline how and why TPA has come about, its core tenets and practical considerations for institutions thinking about incorporating elements of TPA into their existing frameworks. Whether an institution adopts some or all of TPA will depend on its objectives, constraints, governance structure and risk tolerance.

Background: The Evolution of Asset-Allocation Frameworks

In the early 1950s economist Harry Markowitz published groundbreaking research that resulted in Modern Portfolio Theory.

Markowitz looked at the trade-off between risk and return across asset classes, which led to a focus on the structure of an entire portfolio rather than individual security selection. His work fundamentally changed the investing world and laid the foundation for the SAA framework used by institutional investors over the subsequent decades.

Under SAA, institutions create governing boards that set long-term investment policy and approve target asset-class weights, along with strict ranges and risk limits. Limited tactical asset allocation (TAA) allows for some short-term adjustments around that. Risk is defined and managed primarily at the asset-class level, reflecting core assumptions about predictable long-term risk premia, relatively stable correlations and volatilities, feasible and inexpensive rebalancing, and the ability to manage asset classes independently. Investment teams are typically evaluated relative to the policy portfolio benchmarks—either on their ability to add value within an asset class or through TAA.

The essential elements of Markowitz's theories remain foundational to investing—namely, a focus on the trade-off between risk and return across an entire portfolio. But financial markets are dramatically different today. While SAA remains an effective framework for many institutional investors, structural shifts in financial markets have prompted them to revisit and, in some cases, modify their portfolio construction frameworks.

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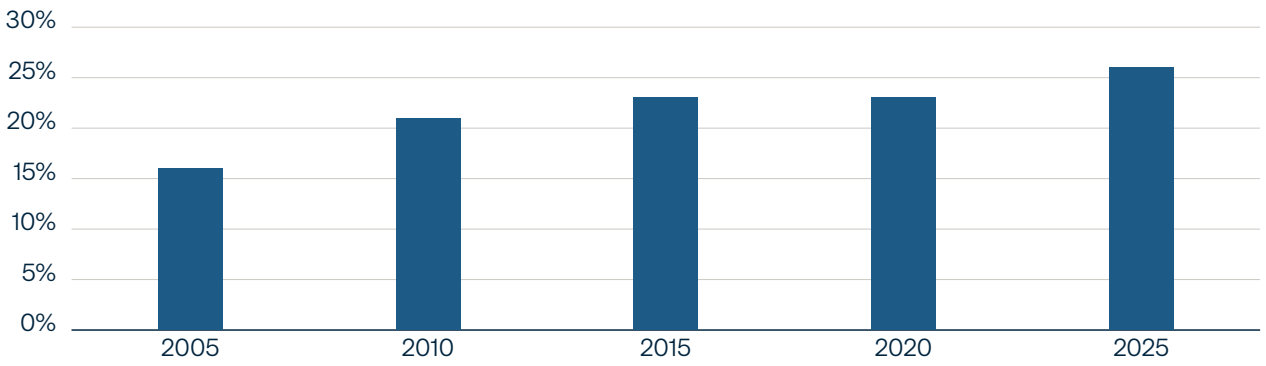
Perhaps the most notable shift is the growth of illiquid allocations—such as to infrastructure, private credit and direct private investments (**Figure 1**).

Figure 1: Steady Growth in Alternative Investing

Allocations to Alts, 2005–2025 (%)

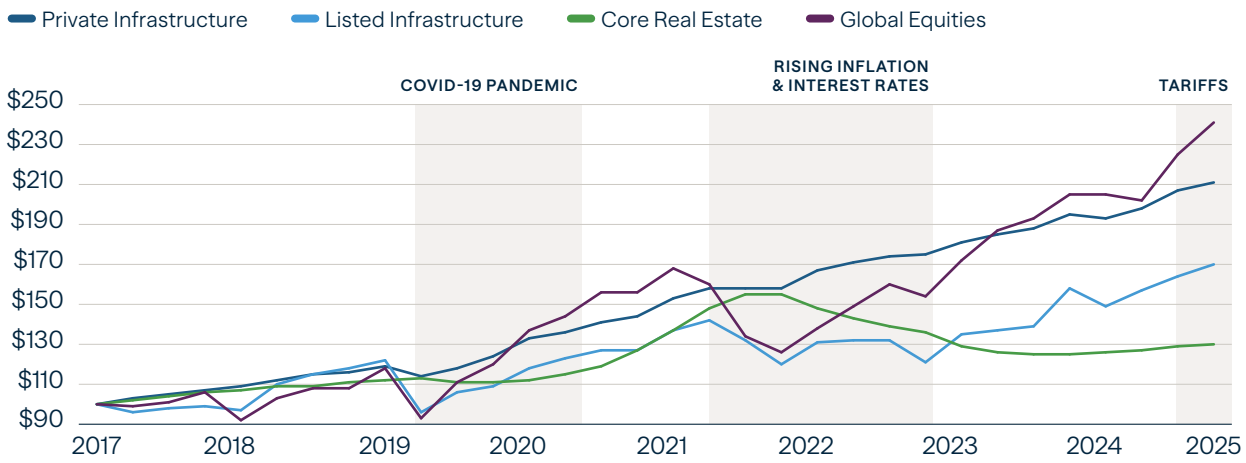


Source: Morningstar, PitchBook, as of December 2025.

SAA typically relies on frequent, low-cost rebalancing back to defined weights for each asset class. That becomes more difficult with illiquid assets that fit poorly into rigid asset-class buckets. Moreover, large deviations from those weights due to changes in private market valuations can consume a disproportionate share of the active TAA risk budget (**Figure 2**).

Figure 2: Changing Relative Valuations

Growth of $100 Investment



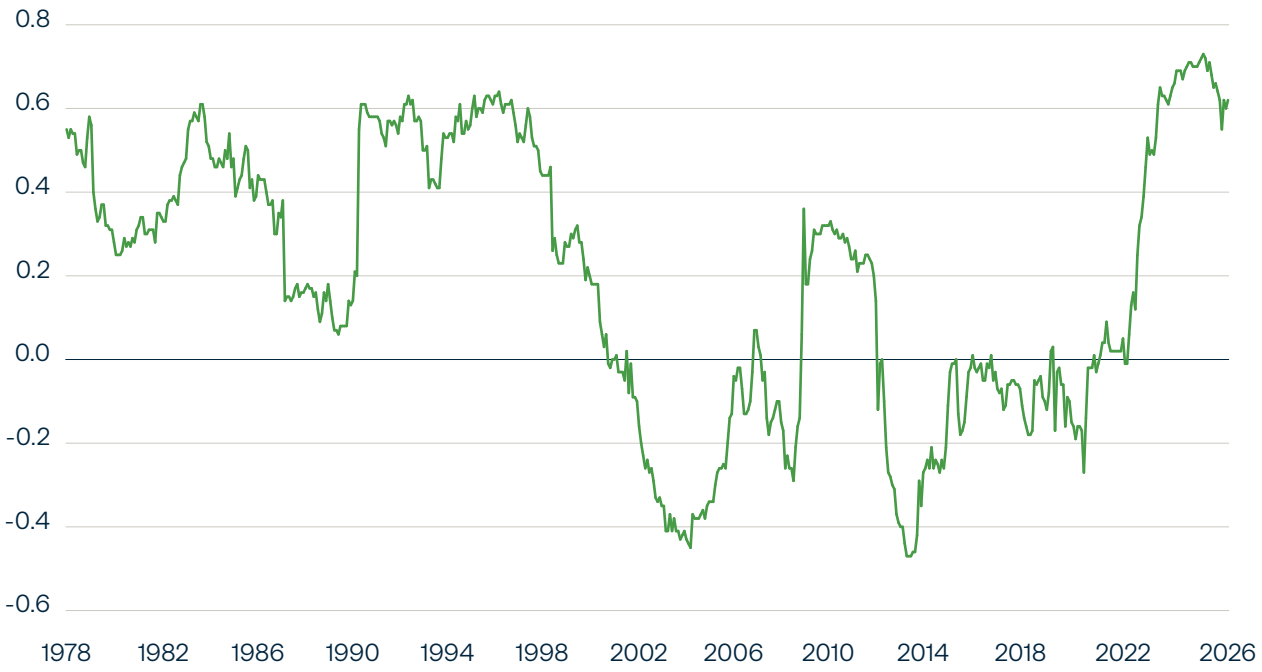
Past performance does not guarantee future results. Private Infrastructure represented by Cambridge Associates Private Infrastructure Index, Listed Infrastructure represented by FTSE Global Core Infrastructure 50/50 Index, Core Real Estate represented by NCREIF Fund Index–Open End Diversified Core Equity and Global Equities represented by MSCI World Index.

Source: Cambridge Associates, LSEG, MSCI and National Council of Real Estate Investment Fiduciaries, as of September 30, 2025.

In addition, more frequent macroeconomic regime shifts in recent years have heightened the need for portfolio agility, undermining assumptions around long-term risk premia, stable asset-class correlations and volatilities. The fluctuating correlations of equities and bonds in recent years (**Figure 3)** have weakened the diversification benefit of the classic 60/40 portfolio.

Figure 3: Fluctuating Stock/Bond Correlations

Three-Year Rolling Monthly Return Correlation (U.S. Aggregate vs. SPX)



Source: Bloomberg, S&P and Brookfield, as of December 31, 2025.

The Emergence of TPA

TPA emerged in the early 2000s in response to the growth of illiquid allocations and more frequent economic regime shifts. TPA is a framework for portfolio construction and management that views an institutional investor's assets as a single, integrated portfolio rather than as a collection of discrete asset-class allocations. It reframes portfolio management around total risk, total return and total liquidity rather than around predefined asset classes.

This has become easier thanks to advances in data, modeling and risk analytics. Investors are now better able to identify common exposures across asset classes—whether to individual companies, sectors or underlying risk factors. They can also manage portfolios in a more integrated manner, rather than through largely independent asset-class allocations.

Institutional interest in TPA has picked up in the last couple of years. Several pension plans and sovereign wealth funds have either begun utilizing TPA or are discussing it. In 2024, 16 asset owners rated themselves as being, on average, roughly halfway through their transition to TPA, with many aiming to achieve broader adoption in the next five years, according to the Thinking Ahead Institute.[1]

Key Features of TPA

A focus on "one portfolio." Under TPA, investment decisions are evaluated based on their contribution to the institution's overall financial objectives, including return targets, liability needs, risk tolerance and liquidity needs—all of which underscore a "one portfolio" mindset.

A flexible investment model. Competition for capital within the portfolio and marginal dollar allocation decisions are based on the expected impact on the portfolio-level risk and return of a particular investment. This flexibility helps incorporate investments that do not fit neatly into traditional asset-class definitions but nonetheless serve the fund's objectives.

Dynamism. TPA can enable reallocation in response to macro shocks, valuation dislocations or liquidity opportunities. Investments—whether public or private, liquid or illiquid—are consistently assessed as expected returns, risks, correlations and opportunity costs evolve over time, without being constrained by periodic rebalancing to fixed targets.

Centrality of team integration and collaboration. With TPA, collaboration across integrated investment teams is central, with risk management, portfolio construction and implementation of investment decisions tightly linked.

A risk-management focus on meeting fund objectives and managing risk factor exposures. In TPA, risk is framed in terms of the overall objectives and underlying risk factor exposures, not volatility relative to asset-class benchmarks.

A CIO-centric governance model. The governance model supporting TPA typically begins with the board or investment committee setting the overarching investment objectives, risk appetite and constraints—often articulated through a reference portfolio or similar construct. The board then delegates broad implementation authority to the Chief Investment Officer and investment staff.

However, it is important to emphasize that SAA and TPA are not mutually exclusive frameworks but endpoints on a spectrum of portfolio-management approaches (**Figure 4**).

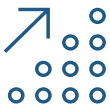
Figure 4: The SAA and TPA Continuum

	SAA ←	→ TPA
Performance assessed vs.:	Benchmarks	Fund goals
Success measured by:	Relative value added	Total fund return
Opportunities for investment defined by:	Asset classes	Contribution to total portfolio outcome
Diversification principally via:	Asset classes	Risk factors
Asset allocation determined by a:	Board-centric process	CIO-centric process
Portfolio implemented by:	Multiple teams competing for capital	One centralized team

Source: Willis Towers Watson, *Total Portfolio Approach (TPA): A Global Asset Owner Study into Current and Future Asset Allocation Practices,* 2019.

In many cases, fully transitioning to TPA would require an overhaul of a firm's embedded processes and seamless coordination across investment teams to maintain a clear portfolio-level view of risks. Consequently, many investors are instead incorporating elements of TPA into their existing SAA frameworks. That way they can retain features of traditional SAA discipline (e.g., long-term policy anchors) while benefiting from TPA's holistic view of risk and return.

Elements of TPA That Can Be Implemented While Maintaining a Traditional SAA Framework



Improved Liquidity Modeling

Specifically with respect to private assets, liquidity modeling can help forecast capital calls, distributions and cash needs, reducing the risk of forced asset sales or missed opportunities.

Explicit Risk Budgeting

Institutions can allocate risk across strategies and factors, not based solely on asset-class weights.

Opportunistic Overlays

Overlay trades—typically using derivatives rather than buying/selling underlying assets—can provide more flexibility to respond to market dislocations than traditional tactical asset allocation.

Cross-Asset Coordination

Sharing data and analysis across teams, or centralized reporting, can improve decision quality even when investment teams continue to operate within asset-class mandates.

Moreover, the range of institutional investors is broad—spanning pension plans, foundations and insurers—and each has unique objectives, liabilities, needs and risk tolerances. As a result, they are adopting the approach that best fits their needs and reflects their governance structures, liquidity profiles and long-term objectives.

Practical Considerations When Incorporating TPA

We see three main practical considerations for institutions that are evaluating incorporating TPA: choosing the appropriate *risk-management* framework, managing *liquidity* as allocations to illiquid assets grow, and ensuring optimal *manager selection* (Figure 5).

Figure 5: Risk, Liquidity and Manager Selection With TPA

Risk

The risk framework is chosen based on the institution's ultimate objectives and liabilities, rather than asset-class volatility or tracking error.

Liquidity

Liquidity considerations are central to determining the size and composition of illiquid asset allocations.

Manager Selection

Managers are selected based on their potential contribution to total portfolio outcomes, not just for their asset-class expertise.

TPA and Risk

Approaches to risk management differ significantly between TPA and SAA. Under SAA, risk is typically framed at the asset-class level in terms of volatility, tracking error versus a policy benchmark, or asset-class-level drawdowns. By contrast, TPA seeks to define and manage risk in relation to the institution's overall objectives and liabilities.

Under TPA, managing risk has three key stages:

1. **Identify the specific needs of the institution.** Public pensions, endowments, sovereign wealth funds and insurers all possess distinct time horizons, liquidity needs and tolerance for interim volatility. For example, a sovereign wealth fund with limited near-term liabilities may be able to tolerate equity sell-offs and illiquidity risk in pursuit of long-term growth, while a defined-benefit pension plan with high benefit outflows may prioritize income, liquidity and downside protection.

2. **Determine the reference portfolio.** An important concept in TPA is the reference portfolio, which typically consists of a globally diversified mix of public equities and bonds. For some TPA allocators, the reference portfolio functions as an opportunity-cost benchmark—a way to evaluate every allocation, manager hire or private market investment based on whether it is expected to improve total portfolio outcomes. In other institutions utilizing TPA, the reference portfolio is more of a guidepost for expected risk and return, informing long-term expectations. In either case, introducing a reference portfolio is one of the earliest and most consequential steps in transitioning from a pure SAA model to a TPA or hybrid framework, as it shifts attention from static weights to dynamic value creation.

3. **Align the risk budget with portfolio objectives.** Under TPA, the emphasis is on managing risks that could jeopardize the fund's overall mission. Risk budgets focus on income generation, inflation protection and capital preservation in proportions that reflect the institution's funding status, spending needs and governance capacity. Risk budgets will look different across institutions, depending on their specific objectives, risk tolerance and liquidity needs. Three broad frameworks are commonly used to categorize and measure risk: asset-class based, bucket based and factor based.

Asset-class frameworks. Asset-class frameworks focus on the risks of individual asset classes. This framework is typically used in SAA but can be incorporated into TPA. It is intuitive and easy to communicate, but can be vulnerable to regime changes. In addition, assets with similar economic sensitivities may be placed in different categories (leading to unintentional concentration risk), while atypical or hybrid investments can fall through definitional gaps.

Bucket frameworks. Increasingly used in TPA, bucket frameworks group assets according to the role they are designed to play in the portfolio, such as growth, income generation, defensive positioning or inflation protection (**Figure 6**). This approach is aligned with outcomes and can improve strategic clarity, but can be difficult to measure because assets often serve multiple purposes and can change over time.

Figure 6: Risk Buckets in a TPA Framework

Bucket	Typical Exposures	Risk Characteristics	TPA Insight
Return-Seeking/Growth	• Public equities • Private equity • Value-add/opportunistic real assets	• High drawdown risk • Equity-like beta can dominate	• Private equity sits here because of the equity beta, not because it falls under alternative investments
Income/Contractual Return	• Private credit • Core infrastructure • Long-lease real estate • Asset-backed finance	• Lower beta to growth • Downside driven by default/inflation risk • Limited liquidity is okay in exchange for higher yield	• Deliver stable, predictable cash flows that replace the traditional “fixed income” role
Defensive/Capital Preservation	• Government bonds/duration • Cash and liquidity sleeves • Defensive credit • Tail-risk hedges	• Low volatility • Negative to low correlation to growth assets • Liquidity essential	• About liquidity and convexity, not return maximization
Inflation Protection	• Infrastructure with CPI-linked revenues • Real estate with rent escalators • Commodities • Inflation-linked bonds	• Sensitive to inflation regimes • Capital intensive • Can overlap with income/growth buckets	• Preserve real purchasing power over time • Although some assets overlap with other buckets, better able to align which risk is being underwritten
Alpha/Opportunistic	• Distressed/special situations • Co-investments • Dislocation trades	• Strategy specific • Often episodic • Requires strong governance and timing	• True manager skill most important

Factor-based frameworks. Factor-based frameworks are most closely associated with TPA. They seek to divide the portfolio into underlying macroeconomic and financial drivers—such as economic growth, inflation sensitivity, real interest rates, default risk or credit spreads, and style premia. Factor models have the advantage of identifying potential risks at the portfolio level that impact exposures across public and private markets. The trade-off is complexity: factor models can be difficult to construct and interpret. Successful implementation therefore depends heavily on governance quality and analytical infrastructure.[2]

In practice, institutions often adopt hybrid versions of these three frameworks, reflecting their governance structures and individual objectives and needs.

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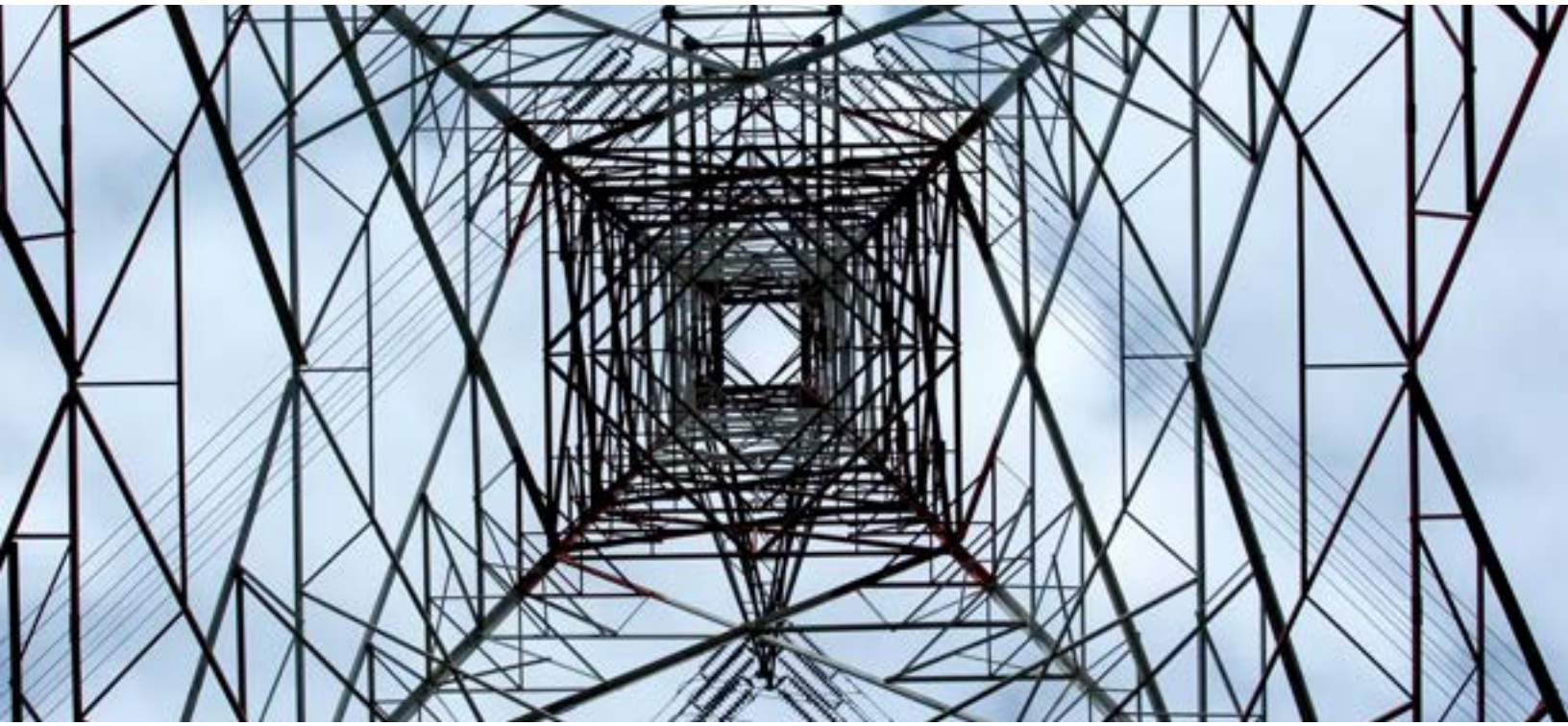
TPA and Liquidity

One reason for the recent growth in alternatives is investor desire to capture the "illiquidity premium"—the additional returns or yields on offer as compensation for the risk of holding illiquid assets. Those risks include committing capital upfront that is deployed gradually over time and returned at irregular intervals, as well as the difficulty—and cost—of selling or reducing holdings prematurely.

While the presence of those risks tends to mean more compensation for investors, the risks are real and require effective management, especially as illiquid assets take up an ever-growing share of institutional portfolios. For institutions with strict SAA targets, rebalancing portfolios is more challenging if individual asset-class buckets include illiquid investments or if public market valuations fluctuate sharply as private valuations adjust more slowly. That can lead to forced asset sales at precisely the worst time. Conversely, allowing allocations to drift may consume a disproportionate share of the portfolio's active risk budget, limiting the ability to pursue other opportunities.

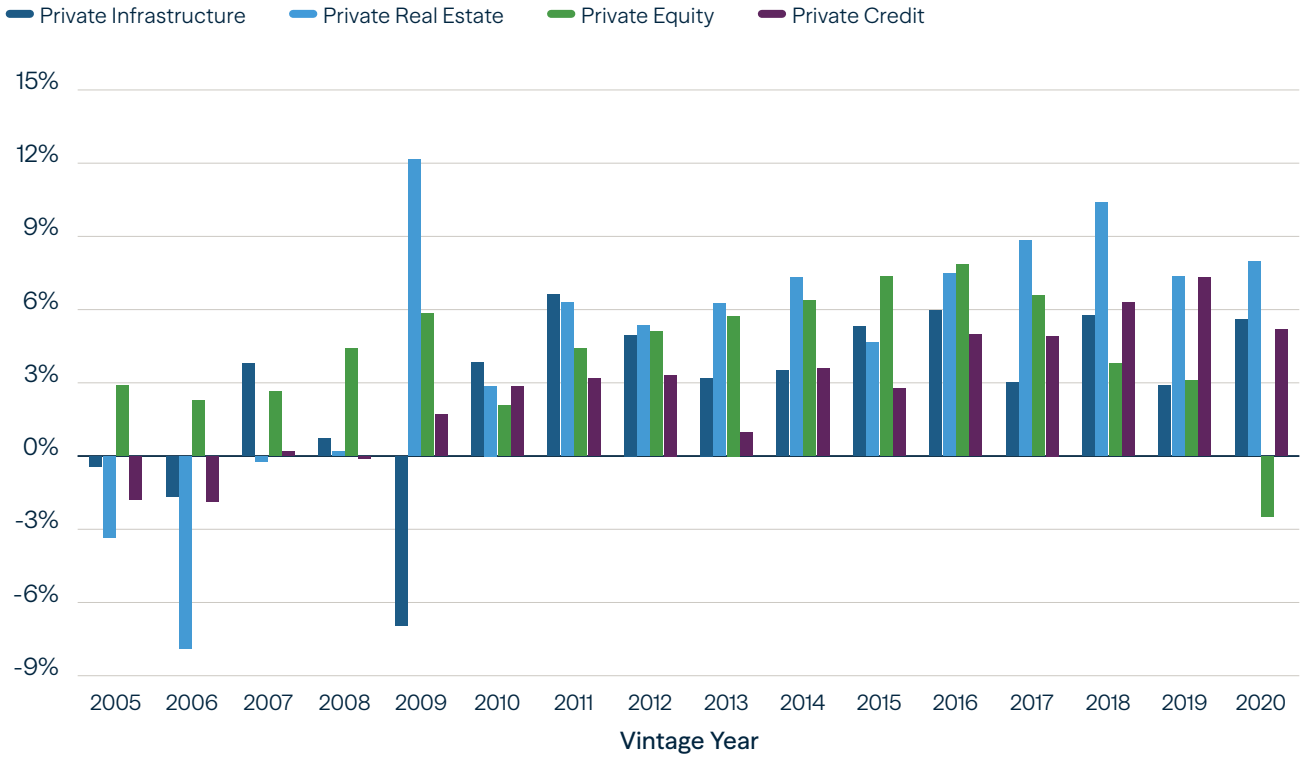
These risks are why some institutional investors are turning to TPA's holistic approach to liquidity risk management and modeling or incorporating this thinking into an SAA framework.

First, institutions should have a clear picture of what is an appropriately sized allocation to illiquid assets for them. That will look different depending on the type of institution and its risk tolerance. For example, an endowment that always preserves the original sum invested may target a higher allocation than an insurance company that has many near-term payouts and is bound by regulatory capital requirements.



Typically, the investors likely to have the biggest allocation to alternatives are those with long-dated, stable sources of capital and sufficient liquidity reserves to fund capital commitments through downturns or to bridge timing differences. In other words, they are well placed to avoid becoming a forced seller in stressed markets. One reason for the recent growth in alternatives is investor desire to capture the "illiquidity premium"—the additional returns or yields on offer as compensation for the risk of holding illiquid assets (**Figure 7**).

Figure 7: Private Index Return Premium vs. Public Market Equivalent by Vintage Year



Past performance does not guarantee future results. Private Infrastructure represented by Cambridge Associates Private Infrastructure Index, Private Real Estate represented by Cambridge Associates Private Real Estate Index, Private Equity represented by Cambridge Associates U.S. and ex U.S. Private Equity Index, and Private Credit represented by Cambridge Associates U.S. and ex U.S. Private Credit Index.

Source: Cambridge Associates, as of December 31, 2023.

Second, the composition of the allocation matters. Different private market segments have varying degrees of liquidity. For example, some strategies generate higher cash yields, while evergreen structures offer more liquidity than closed-end funds. The fund life of strategies can also vary, and loans may have distinct repayment schedules. Accounting for these differences is key to optimizing a portfolio's liquidity profile.

A skilled manager can help tailor both the size and composition of an allocation to alternative assets to make sure it fits the investor's liquidity needs.

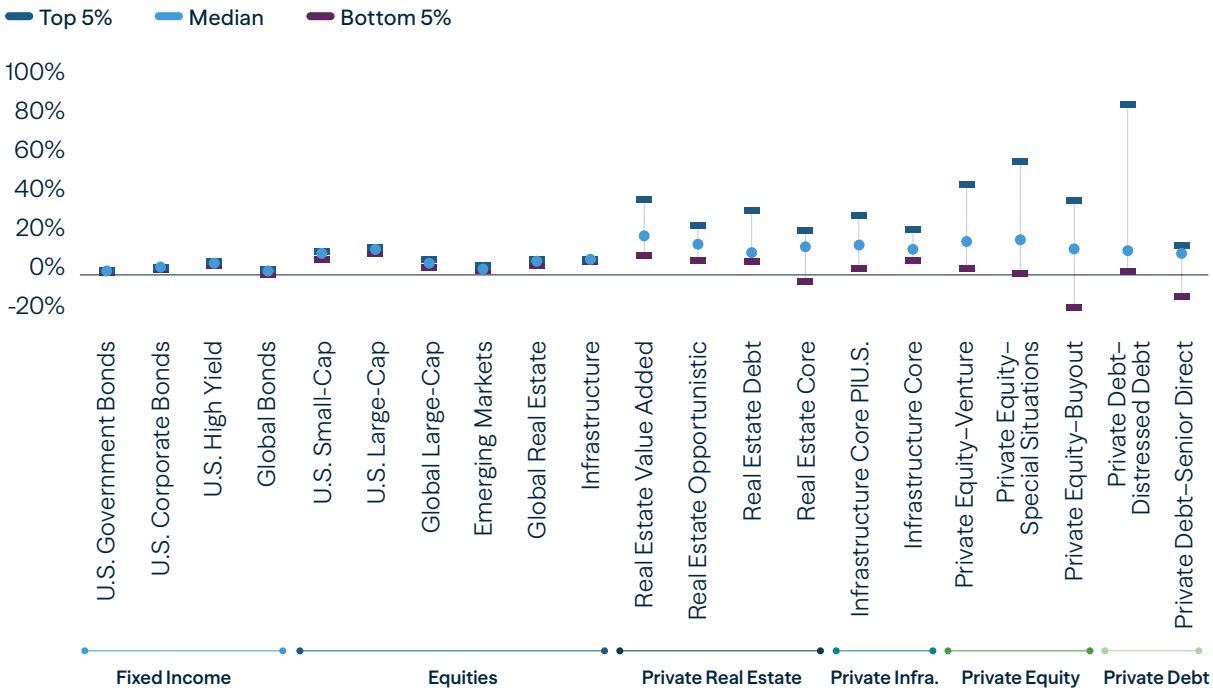
Manager Selection

Manager selection is central to portfolio management regardless of whether the fund adopts SAA, TPA or a hybrid of the two. In all cases, investors can benefit from a manager that understands their long-term investment objectives and can offer both asset-class expertise and strategic portfolio-level support.

Importantly, there is more evidence of dispersion in manager skill among private market managers than public market managers (**Figure 8**). In public equities or fixed income, the range between top- and bottom-quartile active managers is roughly 100–300 basis points. In private markets, dispersion can be significantly wider, as seen in Figure 8, reflecting differences in sourcing capability, operational expertise and access to proprietary deal flow, particularly for private equity and venture capital. Higher dispersion increases both the potential reward for strong manager selection and the cost of poor selection.

Figure 8: Private Investments Demand Expertise

Manager Dispersion



Past performance does not guarantee future results. Data shown are 15-year annualized. Fixed Income and Equities are represented by their respective Morningstar peer group of U.S. open-end funds with a 15-year track record. Private Real Estate, Private Infrastructure, Private Equity and Private Debt are represented by their respective Preqin peer group. Private asset-class returns are based on net IRR (internal rate of return) based on a population of private funds with vintages from 2010 to 2015 that are classified as liquidated, with a minimum 95% of capital called, and distributions paid in (DPI) > 0 on Preqin.

Source: Morningstar, Preqin. Data as of September 30, 2024.

Manager performance should be evaluated by taking a long-term perspective: consistent performance across multiple economic cycles and investment vintages (the year when the fund begins to deploy capital) matters more than standout performance in a single year or point in time. A good manager can also help investors track the composition of returns—how much is attributable to manager skill versus the illiquidity premium, for example. That's important because if too much weight is put on manager skill, it can lead to an underappreciation of the liquidity risk and an overallocation to illiquid strategies in the belief that superior returns will compensate for reduced flexibility.

In the case of TPA, managers are evaluated on how their strategies align with the institution's objectives, as well as its funds' exposures and overall levels of risk. As a result, external managers often become in effect extensions of the internal investment team, with the ability to provide customized exposures and strategies.[3] Co-investment programs in private assets underscore this trend, offering potential fee efficiency, greater transparency and stronger alignment of interests between the asset owner and the asset manager. Essentially, TPA can reframe manager selection from a search for isolated outperformers into a strategic exercise in building a smaller network of partners aligned with portfolio objectives.

Working with one strategic partner for alternative investments, for example, can have several advantages.

Alignment on total portfolio risk and return. Rather than evaluating each mandate in isolation, a strategic partner can work with clients to understand the characteristics of the reference portfolio they are seeking to achieve. Investment decisions are made in terms of the contribution to overall objectives rather than asset-class performance.

Holistic private markets exposure. Allocation decisions shift from selecting discrete investments in private equity, private credit or real assets toward constructing a more holistic private markets exposure designed to outperform the reference portfolio or compete effectively with alternative uses of capital. The emphasis moves from asset labels to functional roles within the portfolio—growth, income, inflation protection, or diversification—and to how these roles interact across market environments.

Enhanced risk management. Having a single alternatives manager can also enhance risk management, especially during periods of market volatility. In such environments, continuing to meet the portfolio objectives often matters more than outperformance within an individual asset class. A unified approach can improve the sizing and pacing of commitments and reduce the likelihood of unintended concentration risks.

Liquidity management. A single strategic partner can arguably add value when managing liquidity. Viewing liquidity at the total portfolio level improves the ability to size commitments and the pacing of those commitments and find multiple potential sources for liquidity rather than relying on any single mechanism. Over longer horizons, this flexibility can also support a more deliberate effort to harvest the illiquidity premium, allocating capital more aggressively when compensation for illiquidity is attractive and exercising restraint when it is not.

Whether operating within a traditional SAA framework or moving toward a more integrated TPA model, a good strategic partner should work with institutions offering a combination of insights, specialist expertise and portfolio construction solutions that set it on a course to achieve its objectives.

Conclusion

The investment landscape looks dramatically different today. That calls for a rethink of traditional portfolio construction techniques.

As allocations to private equity, private credit, real assets and other illiquid strategies increase, the importance of understanding their risk and return characteristics—and how they interact with the rest of the portfolio—has increased. Liquidity management, valuation uncertainty, manager dispersion and capital-commitment pacing are no longer peripheral considerations; they have become central to portfolio construction.

With SAA and TPA at two ends of a spectrum, the exact portfolio-management approach each institution takes will vary. We believe institutions can benefit from working with a strategic partner that can tailor solutions to best meet their goals and objectives—regardless of the approach chosen.

Endnotes

1. Thinking Ahead Institute, *The TPA Journey: A Practical Guide to Implementing Total Portfolio Approach,* August 2025.
2. Robert Bass, Scott Gladstone and Andrew Ang, "Total Portfolio Factor, Not Just Asset, Allocation," *Journal of Portfolio Management* 43, no. 5 (2017): 38–53.
3. CAIA Association and Thinking Ahead Institute, *From Vision to Execution: How Investors Are Operationalizing the Total Portfolio Approach,* 2025.

Disclosures

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