



Why Consistency Wins: The Case for the Downside Efficiency of Alternatives

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EXECUTIVE SUMMARY:

While the Sharpe ratio remains a widely used performance metric, it penalizes all volatility equally, failing to distinguish between upside opportunity and downside risk. For pension plans and other long-term allocators, the Sortino ratio, which focuses only on returns below a required threshold, arguably offers a superior lens. Our analysis compares the Sortino and Sharpe ratios of key asset classes including farmland, private credit, private equity and private real estate under a 6% minimum acceptable return and 4% risk free rate. Key findings:

- Private real estate, reflecting a mix of core-plus and value-add strategies, had a Sortino ratio only slightly superior to public equities.
- Traditional private equity, despite strong headline returns, suffered from material downside deviation. Evergreen, lower mid-market (LMM) strategies appeared to provide better return behaviors.
- Bonds and public equities exhibited poor downside efficiency relative to typical minimum return hurdles.

In a stagflationary, higher-volatility environment, combining Sharpe and Sortino metrics may improve capital allocation decisions, shifting weight toward assets with superior downside resilience without sacrificing return targets.

INTRODUCTION:

Allocators often rely on the Sharpe ratio to assess portfolio efficiency. But this ratio penalizes both upside and downside volatility equally, an imperfect approach for most investors who over the long term are more concerned with shortfalls below a minimum required return, typically around 6–7% annually. The Sortino ratio refines risk-adjusted analysis by considering only downside deviation from a Minimum Acceptable Return (MAR), making it a more appropriate measure for portfolios driven by long-term return requirements. This paper analyzes Sharpe and Sortino ratios across major alternative asset classes, attempting to provide some input to allocators trying to align their investments with return thresholds and risk tolerance.

Sharpe ratio penalizes all volatility

Sortino ratio penalizes only downside volatility

METHODOLOGY:

The Sharpe ratio and the Sortino ratio are calculated as follows:

$$\text{Sharpe Ratio} = \frac{\text{Annualized Return} - \text{Risk-Free Rate}}{\text{Annualized Standard Deviation of Returns}}$$

$$\text{Sortino Ratio} = \frac{\text{Annualized Return} - \text{Minimum Acceptable Return (MAR)}}{\text{Downside Deviation}}$$

For this paper, the MAR is set at 6%, in line with common actuarial hurdle rates used by Canadian and U.S. pension plans. Risk free rate is set at 4%. Downside deviation measures the volatility of returns falling below the 6% MAR. Importantly, this analysis does not model individual fund dispersion or leverage levels but instead presents a strategy-level snapshot to enable comparisons.

RESULTS:

The following graphs provide an illustration of how the various strategy performed in terms of total return, volatility, Sortino and Sharpe ratio behavior.



Stephen Johnston

Director

sjohnston@omnigenceam.com



Matt Barr

Director

mbarr@omnigenceam.com



Barclay Laughland

Director

blaughland@omnigenceam.com



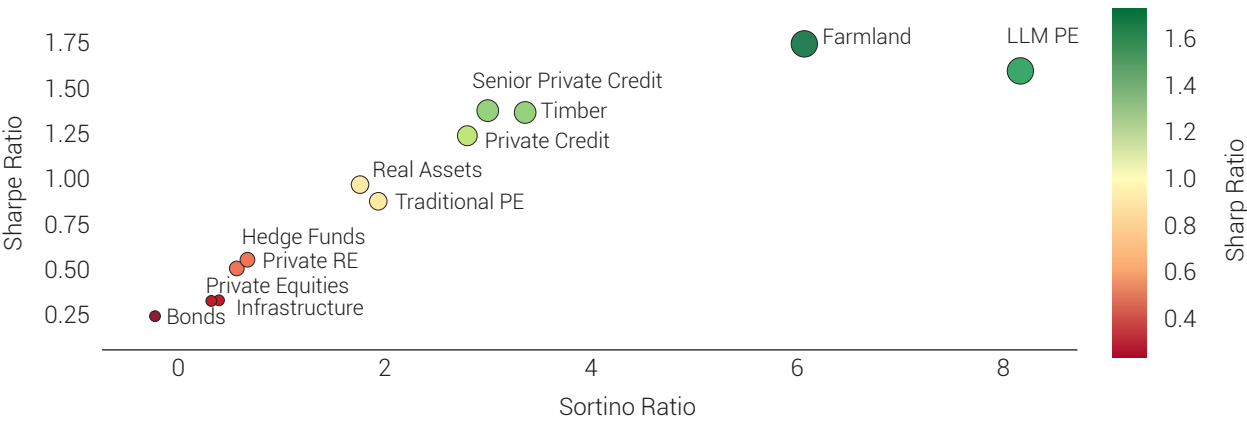
Kerri Furlong

Director

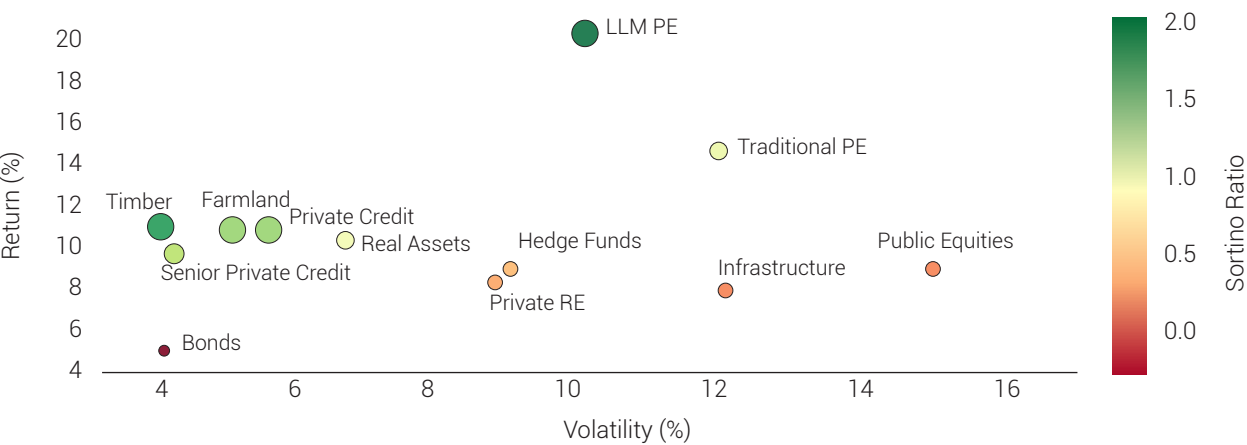
kfurlong@omnigenceam.com



Sortino vs Sharpe Ratio Estimated by Asset Class (Bubble Size & Color = Sharpe Ratio)



Volatility vs Return (Bubble Size & Color = Sortino Ratio)



DISCUSSION:

The analysis underscores a critical insight for allocators: volatility can be a poor proxy for risk; shortfall is the true threat to portfolios. Return asymmetry and drawdowns matter more than total volatility. Therefore, using the Sortino ratio alongside the Sharpe ratio may offer a better lens.

- Farmland’s performance was strong on a downside-adjusted basis, with Sortino ratio of 6.07 and Sharpe ratio of 1.75. Its consistency and low volatility make it well-suited for pension de-risking overlays, liability-driven strategies, and capital preservation mandates.
- LMM PE, Sortino ratio of 8.16 and Sharpe ratio of 1.60, reflects structural benefits of non-discretionary cash sweeps which accelerate DPI in the form of yield and thereby improve downside-adjusted returns.
- Traditional PE underperformed LMM PE with a Sharpe of 0.88 and a Sortino ratio of 1.9.

Farmland and LMM PE are material outliers with Sortino ratios above 5

- Timberland delivered a differentiated return stream with downside asymmetry. Its Sharpe ratio was 1.36, Sortino was 3.35, reflecting biological growth and harvesting income. Timberland's performance profile supports real asset overlays, diversification mandates, and inflation-sensitive portfolios.
- Real assets, comprising equally weighted farmland, timber, and private real estate, offered meaningfully stronger risk-adjusted returns than traditional equity or bond exposures. With a Sharpe ratio of 0.97 and a Sortino ratio of 1.71, this segment combined yield, inflation linkage, and downside resilience. The blend of low-volatility income from farmland and timber with moderate real estate exposure may provide a stable core allocation for institutions seeking long-term capital preservation and real-return exposure.
- Private real estate delivered reasonable risk-adjusted returns, with a Sharpe ratio of 0.51 and a Sortino ratio of 0.49. While it offers some inflation sensitivity and income generation, its downside efficiency is materially weaker than farmland, LMM PE or private credit.
- Infrastructure delivers long-duration cash flows and partial inflation pass-through, but its Sortino ratio of 0.27 suggests poor downside efficiency under a 6% MAR. While nominal volatility was elevated, and economic losses were somewhat tempered by regulated pricing and essential service demand, the asset class does not appear to consistently meet typical return thresholds. Infrastructure remains relevant for duration exposure and liability-matching, but allocators should reassess its role as a downside stabilizer in diversified portfolios.
- Private credit exhibited a Sharpe ratio of 1.24 and a Sortino ratio of 2.77 due to contractual yield, floating rate structures, and low realized default rates. However, allocators should remain attentive to covenant-lite risk, illiquidity, and NAV opacity.
- Bonds, while long considered portfolio ballast, exhibited a -0.29 Sortino ratio under a 6% MAR. This reflected their failure to consistently meet return hurdles. Beyond underperformance potential, they also expose portfolios to duration risk in rising rate environments where capital losses may offset modest coupon income. In short, bonds may no longer serve as reliable downside protection or yield anchors in a structurally higher inflation regime.
- Hedge funds showed weaker downside efficiency (Sharpe ratio of 0.56, Sortino ratio of 0.62), however select strategies, particularly market-neutral and credit long/short, may offer differentiated profiles warranting case-by-case consideration.

LMM PE outperforms traditional PE with a Sharpe ratio of 1.6 and a Sortino ratio of 8.16

Infrastructure and public equities share approximately the same downside-adjusted profile (Sortino ratio ~0.27), despite seemingly different characteristics.

CONCLUSIONS:

Institutional allocators should prioritize downside efficiency in portfolio construction by incorporating the Sortino ratio alongside the Sharpe ratio as a core evaluation metric for all asset classes. By focusing on downside deviation rather than total volatility, allocators can identify assets that deliver consistent returns above thresholds without excessive drawdown exposure. Recent industry outlooks emphasize this shift amid higher inflation and economic uncertainty, where traditional volatility measures may understate true risks. Based on the estimated ratios (e.g., Farmland Sortino: 6.07; LMM PE: 8.16; Timberland: 3.35; Private Credit: 2.77), allocators should prioritize allocations to these assets as they demonstrate superior downside efficiency. These also offer, to varying degrees, yield, inflation linkage, and asymmetry that traditional equities and bonds lack, especially in a regime of elevated base rates and potential tariff impacts. Allocators may want to consider de-emphasizing bonds for the time being (Sortino: -0.29) which failed to meet MAR thresholds consistently. Bonds may underperform in structurally higher inflation, exposing portfolios to duration losses. For infrastructure (Sortino: 0.27) and private real estate (Sortino: 0.49), maintain allocations if necessary for duration matching and income, but reassess amid elevated volatility (~12% for infrastructure) and depressed transaction volumes in real estate.

REFERENCES & NOTES:

Sortino and Sharpe ratio calculations are for illustration purposes only and are based on best estimates as to return, volatilities and drawdowns for each asset class.

- NCREIF Farmland Index
- NCREIF Timberland Index
- FCC Farmland Values Report
- Cliffwater Direct Lending Index
- Ninepoint Credit Opportunities Fund
- Purpose Credit Opportunities Fund
- Cambridge Associates
- Preqin
- MSCI World Total Return Index
- HFRI Index
- OECD
- TIAA
- Domain Capital Group
- TIR Europe
- CAIA Association
- Brookfield Oaktree
- Ares Capital Management
- Bloomberg Barclays U.S. Aggregate Bond Index
- Real Assets composite was calculated using a simple average of Farmland, Timber, and Private RE

MAIN ANALYSIS:

Sortino & Sharpe ratios across asset classes are estimated using Risk Free Rate = 4%, MAR = 6%. Downside deviation for each asset is approximated assuming normally distributed annual returns and using the average mean return and volatility data.

Asset Class	Return %	Vol %	Downside Dev %	Sharpe	Sortino
Farmland	11.0	4.0	0.82	1.75	6.07
LMM PE	20.0	10.0	1.72	1.60	8.16
Timberland	10.8	5.0	1.43	1.36	3.35
Real Assets	10.4	6.6	2.57	0.97	1.71
Senior Private Credit	9.8	4.2	1.28	1.38	2.97
Private Credit	10.8	5.5	1.73	1.24	2.77
Traditional PE	14.5	12.0	4.48	0.88	1.90
Hedge Funds	9.0	9.0	4.80	0.56	0.62
Private RE	8.4	8.7	4.88	0.51	0.49
Public Equities	9.0	15.0	8.99	0.33	0.33
Infrastructure	8.0	12.0	7.40	0.33	0.27
Bonds	5.0	4.0	3.42	0.25	-0.29



Toronto Office:
TD Canada Trust Tower, 161 Bay St.
27th Floor, P.O. Box 508
Toronto, ON, M5J 2S1

Calgary Office:
Suite 300, 4954 Richard Road SW
Calgary, AB, T3E 6L1

Montréal Office:
1250 René Levesque, 22nd Floor
Montréal, QC, H3B 4W8

www.omnigenceam.com

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