Asset Management Forum

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Trends in Asset Management

Abstracts

A Generalized Approach to Portfolio Optimization: Improving Performance by Constraining Portfolio Norms

By *Raman Uppal*

We provide a general framework for finding portfolios that perform well out-of-sample in the presence of estimation error. This framework relies on solving the traditional minimum-variance problem but subject to the additional constraint that the norm of the portfolio-weight vector be smaller than a given threshold. Our framework also explains how to allocate optimally a short-sale budget of the kind in 130/30 portfolios and gives rise to several new portfolio strategies. Finally, we compare empirically the out-of-sample performance of the new portfolios we propose to ten strategies in the literature across five datasets. We find that the our strategies often have a higher Sharpe ratio than the other common portfolio strategies.

Robust Performance Hypothesis Testing with the Sharpe Ratio

By *Michael Wolf*

Applied researchers often test for the difference of the Sharpe ratios of two investment strategies. Unfortunately, the most popular tests is not valid when returns have tails heavier than the normal distribution or are of time series nature; both phenomena are common with financial returns. Instead, we propose the use of robust inference methods that can be safely used in practice. A simulation study demonstrates the improved finite sample performance compared to existing methods. In addition, two applications to real data are provided.

Automated Risk Management
By *Bernd Scherer*

Recent events in active quantitative management have seen large losses in July and August 2007. Given these sudden losses came as a surprise to the whole industry this caused many quantitative managers to review the case for and against automated risk management practices like stop loss trading rules or volatility cut outs. Given recent evidence on the success of momentum strategies we will review stop loss rules. Can the returns from avoiding downside momentum offset the opportunity costs of remaining not invested after a stop out occurs? In particular, we investigate whether extreme returns from popular currency trading strategies create conditional positive (negative) autocorrelation that makes stop loss profitable (value destroying).

Effectively managing risk in a hedge fund portfolio
By *Benjamin Moute*

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