

AI-00884 Risk Parity Funds

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What are risk parity funds?

Risk parity funds are a type of investment strategy that focuses on allocating investment capital based on risk rather than just the amount of money. This means they aim to spread your investment across different asset classes (like stocks, bonds, and real estate) in a way that makes all the asset classes contribute about the same level of risk to your overall portfolio.

Here's a breakdown of the key points about risk parity funds:

- **Goal:** Achieve a good return for the amount of risk you're willing to take (measured by volatility).
- **Strategy:** Allocate funds to different asset classes based on how much risk they carry, rather than just the amount of money. This often involves using leverage (borrowing money to invest) and short selling (borrowing shares to sell hoping to buy them back cheaper).
- **Benefits:** Potentially lower risk and more consistent returns compared to traditional portfolios (like a simple 60% stocks/40% bonds split).
- **Drawbacks:** More complex and can be expensive due to the use of leverage and potentially complex investment strategies. Also, they can underperform in situations where the relationships between different asset classes change dramatically (like during the 2020 market crash).

Risk parity funds are a strategy often used by hedge funds and sophisticated investors because they involve complex calculations and can be risky. If you're interested in learning more, it's a good idea to talk to a financial advisor to see if they're right for you.

Are Risk Parity Funds RPF performing better than Nasdaq 100?

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It depends on the specific time frame you're considering and your risk tolerance. Here's a breakdown:

Risk Parity Funds (RPFs):

- **Potential Advantages:**

- **Lower downside risk:** By diversifying across asset classes and aiming for equal risk contribution, RPFs may offer more protection during market downturns compared to the Nasdaq 100, which is heavily weighted in technology stocks.
- **More consistent returns:** Historically, RPFs have aimed to deliver smoother returns with less volatility than the often-volatile Nasdaq 100.

- **Potential Disadvantages:**

- **Lag in bull markets:** RPFs may underperform compared to the Nasdaq 100 during strong bull markets, especially when tech stocks are leading the surge.
- **Complex and potentially expensive:** RPF strategies often involve leverage and complex investment structures, which can lead to higher fees.
- **Sensitive to changing correlations:** If the relationships between asset classes change significantly, RPF performance may suffer.

Nasdaq 100:

- **Potential Advantages:**

- **High growth potential:** The Nasdaq 100 is known for its concentration in large, tech-driven companies with a history of high growth. This can lead to significant returns during bull markets.
- **Relatively simple and transparent:** The Nasdaq 100 is a straightforward index, making it easy to understand its holdings and performance.

- **Potential Disadvantages:**

- **Higher risk:** The concentration in technology stocks makes the Nasdaq 100 more susceptible to downturns in that sector.

- **More volatile:** The Nasdaq 100 can experience significant price swings, which may not be suitable for all investors.

Overall:

- If you prioritize **capital preservation** and **consistent returns** even during market downturns, then RPFs might be a better choice.
- If you are comfortable with **higher risk** in exchange for the potential for **greater returns**, the Nasdaq 100 could be more appealing.

Here are some additional resources to help you decide:

- Are Alternative Portfolios The New Risk-Parity Strategy? - Nasdaq [Are Alternative Portfolios The New Risk-Parity Strategy? - NASDAQ nasdaq.com]
- Risk Parity: What It Is, How It Works, And Why It Matters | Nasdaq [Risk Parity: What It Is, How It Works, And Why It Matters | NASDAQ nasdaq.com]