FE460: Homework 5

1 Martingale Asset Management

1. What do you think of Martingale as a firm? Does it have an edge in investing?

2. Which issues should investors consider when deciding whether to invest in a 130/30 fund?

3. Martingale's strategy consists of over-weighting low-vol (or low beta) stocks and under-weighting high-vol (or high-beta stocks). Do you think this is a good strategy? Comment on the average return and risk of these portfolios, based on the evidence in Exhibit 8.

4. To help you evaluate the risk and return of the low-vol strategy, I have constructed 5 portfolios of firms sorted on past total vol. You can find the data in HW5_DATA.xls, part A. I have also included the risk-free rate and excess returns on the market portfolio. Compute:

    - Average returns and standard deviations for these 5 vol-sorted portfolios.
    - Compute the market beta of each portfolio. Are the average returns on these five portfolios proportional to their market beta?
    - Let's construct our own version of Martingale's 130/30 strategy (ignoring transaction costs) as follows:
        - Invest 100% into the market portfolio
        - Invest 30% into the low-vol strategy
        - Short 30% of the hi-vol strategy

      How does this strategy compare with the market portfolio?

5. Do you believe the Risk Anomaly (the beta-adjusted underperformance of high volatility stocks) will persist? How confident are you that the historical performance isn't simply data mining?