will also help to protect the investor

a multiple stock portfolio. He takes the

ion to create portfolios with various

ils building portfolios beginning with

n analyzing the frequency distribution of

ren years is simulated to determine what

rns. His results showed that only

total return between 150% and 250%.

lios exhibited returns between 150%

e success obtained by a portfolio is to

% of the 5-stock portfolios reflected a

whereas only 4.2% of the 30-stock

the probability of a shortfall relative to

ed time to reach the investment goals

Active portfolio management is the

ark as opposed to passive portfolio

k. Benchmarks take on many different

, exchange rate or a benchmark could

this paper consists of a set of risky

ious work, he looked at the active

zing the probability that a

---

performance goal is reached before a shortfall occurs, minimizing the expected time until

the performance goal is reached, maximizing the expected time until a shortfall is

reached, maximizing the expected discounted reward obtained upon achieving the goal

and minimizing the expected discounted penalty upon obtaining a shortfall. In this case

the optimal strategy for each objective was a constant proportions asset allocation policy.

In this work, he looks at maximizing the probability that a performance goal is reached

while minimizing the expected time to get there. The optimal strategy in this case

become state dependent where the state variable is defined as the ratio of the wealth

process to the benchmark.

Companies like Merrill Lynch use asset allocation to develop investor profiles, which

give guidelines for the amount of wealth to invest in each asset class; stocks, bonds, and

cash. They suggest that an investor's profile is based on the goal and time frame of the

investment, the personality of the investor and the income and asset base of the investor.

Merrill Lynch has identified five investor profiles. The capital preservation profile

objective is to maintain capital. This profile is marked by less return and less risk with an

investment emphasis on bonds. The income profile seeks to obtain a continuing income

stream from dependable debt and equity sources. The income/growth profile aims to

achieve a balance between bonds for current income and stocks for growth. The growth

profile seeks to gain wealth over time rather than current income. The aggressive growth

profile achieves the most return with the highest risk and looks to obtain above-average

growth over time. The investment in this profile is concentrated in stocks. The asset

allocation pamphlet distributed by the company uses the 1987 stock market decline to

express the value of asset allocation. In October of 1987, the Dow Jones Industrial

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Average fell 21.5%, however bonds rose 6.2% and cash equivalents rose .6%. A diverse

portfolio would lose less than the loss sustained by the stocks. Table 2.2 summarizes the

main topics covered in this research by each author and points out the areas covered in

this thesis.

Author(s)	Active Portfolio Management	Asset Allocation Policy	Benefits of Investing in Multiple Stocks	Effect of Constraints on Asset Allocation	Investor Profiles	Risk Estimation Error	Style Analysis
Beutow, Johnson, Punkle [2000]							✔
Bogel [1998]	✔						✔
Brinson, Hood, Beebower [1991]		✔					
Eichhorn, Gupta, Stubbs [1998]				✔			
Merrill Lynch					✔		
Sharpe [1992]							✔
Sheedy, Trevor, Wood [1999]						✔	
Vassal [2001]		✔					
This Thesis		✔	✔	✔			

Table 2.2 Asset Allocation Topics in Research