

MGMT 675

AI-ASSISTED FINANCIAL ANALYSIS



RICE | BUSINESS
Jones Graduate School of Business

OPTIMAL PORTFOLIOS

A futuristic robot with a white and blue metallic body stands in the center of the frame. It has a humanoid form with a head, torso, and limbs, featuring glowing blue circular accents on its joints and head. The robot is positioned in front of a complex digital interface. To the left, a large screen displays a world map with a grid overlay and a line graph below it. To the right, another screen shows a large globe, several bar charts, and line graphs. The background is a blurred server room with rows of server racks. The overall color scheme is a cool blue and white, giving it a high-tech, digital feel.

TOPICS

- Frontier portfolios of risky assets (minimize risk subject to achieving a target expected return)
- Tangency portfolio (maximize Sharpe ratio)
- Estimate means, standard deviations, and correlations from historical returns

GOAL SEEK IN PYTHON

- There are several choices in python for optimizing functions.
- The qp function from cvxopt is a very good choice for portfolio optimization.
 - cvxopt = convex optimization
 - qp = quadratic programming

EXAMPLES

- From Applied:
 - U.S., U.K., France, Germany, Japan
 - U.S., Developed, Emerging
- ETFs from Yahoo Finance

U.S., U.K., FRANCE, GERMANY, AND JAPAN

DATA

- Download international.xlsx and international_corrs.xlsx from the **course website**.
- Upload the files to Julius. Ask Julius to read them.
- Ask Julius to convert the means, standard deviations, and correlation matrix into numpy arrays.
- Ask Julius to compute the covariance matrix as a numpy array.

FRONTIER PORTFOLIOS (W/O RISK-FREE ASSET)

- Ask Julius to use cvxopt to minimize variance subject to achieving a target expected return.
 - If allowing short sales, tell Julius there are no inequality constraints.
 - If excluding short sales, tell Julius to not allow short sales.
- Ask Julius to repeat for a range of target expected returns and to plot the expected returns and standard deviations.

DIGRESSION ON CVXOPT

FRONTIER PORTFOLIOS ALLOWING SHORT SALES

- minimize $(1/2)x'Px$ subject to $Ax = b$
- P = covariance matrix. $x'Px$ is portfolio variance
- A = array with two rows. First row = `np.ones(n)`. Second row = asset expected returns.
- $b = \text{np.array}([1, \text{targ}])$
- $Ax = b$ means weights sum to 1 and expected return = targ.
- Julius should figure all of this out.

FRONTIER PORTFOLIOS EXCLUDING SHORT SALES

- minimize $(1/2)x'Px$ subject to $Ax = b$ and $Gx \leq h$
- P , A , and b as before
- $G = -\text{np.eye}(n)$ and $h = \text{np.zeros}(n)$
- $Gx \leq h$ means weights are nonnegative (no shorts)
- Again, Julius should figure this out.

BACK TO EXAMPLE

TANGENCY PORTFOLIO

- Give Julius a number for the risk-free rate.
- Ask Julius to minimize the variance minus the risk premium.
 - If allowing short sales, tell Julius there are no inequality constraints.
 - If excluding short sales, tell Julius to not allow short sales.

- Ask Julius to divide by the sum of the weights to compute the tangency portfolio.
- Ask Julius to include the tangency portfolio and the capital market line on the previous plot.

ANOTHER DIGRESSION ON CVXOPT

CVXOPT FOR TANGENCY PORTFOLIO

- Minimize $x'Px - q'x$
 - $P = 2$ times covariance matrix (but the 2 is not important)
 - q = risk premia
- No equality constraints
- If no short sales, then $G = -\text{np.eye}(n)$ and $h = \text{np.zeros}(n)$
- Then divide by the sum of weights.

US, DEVELOPED, AND EMERGING

- Start a new chat.
- Upload us_developed_emerging_rets.xlsx and ask Julius to read it.
- Ask Julius to compute the sample means, sample standard deviations and sample correlation matrix as numpy arrays.
- Repeat the frontier and tangency portfolio calculations.

DATA FROM YAHOO

ETFs FROM YAHOO

- Example: ask Julius to use yfinance to get Yahoo adjusted closing prices for
 - SPY = S&P 500
 - VBR = Vanguard small-cap value
 - IEF = Treasury bonds
 - UUP = U.S. dollar bullish
- Ask Julius to downsample prices to end-of-month and compute monthly returns as percent changes in the downsampled prices.

- Ask Julius to compute means, standard deviations, and correlation matrix as numpy arrays.
- Ask Julius to find frontier of risky assets and tangency portfolio as before.