

University of California, Los Angeles  
Department of Statistics

Statistics C183/C283

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Project

Due: Week 8, 19-23 May

Select at least 25 stocks (plus the market *S&P500*) from <http://finance.yahoo.com>. Make sure you select stocks from at least 5 sectors. To find the sector in which each stock belongs go to [http://biz.yahoo.com/ic/ind\\_index.html](http://biz.yahoo.com/ic/ind_index.html).

To answer the questions of part (A) below, you must use ONLY data for the period 31-Dec-2006 to 31-Dec-2011 (you will get returns from 31-Jan-2007 to 31-Dec-2011):

**Part A:** Constructing optimal portfolios:

1. Assume short sales are allowed. Choose an appropriate value of  $R_f$  to find the composition of the point of tangency (use the classical Markowitz model). Also compute the expected return and standard deviation of the point of tangency. Draw the line and show the point of tangency on the line.
2. Refer to part (1). Choose two values of  $R_f$  to trace out the efficient frontier.
3. Equally allocate your funds into your stocks. Calculate the expected return and standard deviation of this portfolio (use historical means and standard deviations).
4. Assume that the single index model holds and that risk-free lending and borrowing exists. Use the excess return to beta (you can work with unadjusted or adjusted betas) ratio to find:
  - a. The composition of the optimum portfolio, its expected return, and its standard deviation when short sales are not allowed.
  - b. The  $\alpha$  and  $\beta$  of the optimum portfolio of part (a).
  - c. Repeat (a) and (b) when short sales are allowed.
5. Use the constant correlation model and the same risk-free rate as in part (4). Based on the excess return to standard deviation ratio find:
  - a. The composition of the optimum portfolio, its expected return, and its standard deviation when short sales are not allowed.
  - b. Repeat (a) when short sales are allowed.
6. Use the multigroup model, short sales allowed, and the same risk free rate as in (4) and (5), to find the composition of the optimum portfolio, its expected return, and its standard deviation.
7. Place all the stocks you have used and all the portfolios you have constructed on the space expected return against standard deviation.

**Part B:** Portfolio performance:

Compute now the monthly returns for each stock for the period 31-Dec-2011 to 31-Mar-2014 and use them to compute the monthly return for each of the following portfolios that you have constructed above:

- a. Equal allocation (part 3).
- b. Single index model with no short sales allowed (part 4a).
- c. A portfolio that consists of 50% of the portfolio of part 4a and 50% of the risk free asset.
- d. Constant correlation model with no short sales allowed (part 5a).
- e. Multigroup model (part 6).

Plot the returns of portfolios (a-e) on the space return against time for the period 31-Jan-2011 to 31-Mar-2014. Also on the same graph plot the return of the market *S&P500*. Which of these portfolios performed the best (highest return)? Which portfolio was the worst (lowest return). What is the average return of each portfolio in this period (31-Jan-2011 to 31-Mar-2014)? Compare the performance of each portfolio with the market *S&P500*. Write 1-2 paragraphs discussing your findings.

Note: I strongly suggest that you use the `stockPortfolio` package for fast and easy calculations.

Please submit a hard copy of all your work (R code, graphs, and any other relevant outputs), and also upload your file on CCLE (<https://ccle.ucla.edu>) by Friday, 23 April, at 20:00. One should be able to reproduce your results by running your R code on any computer!

Good luck!