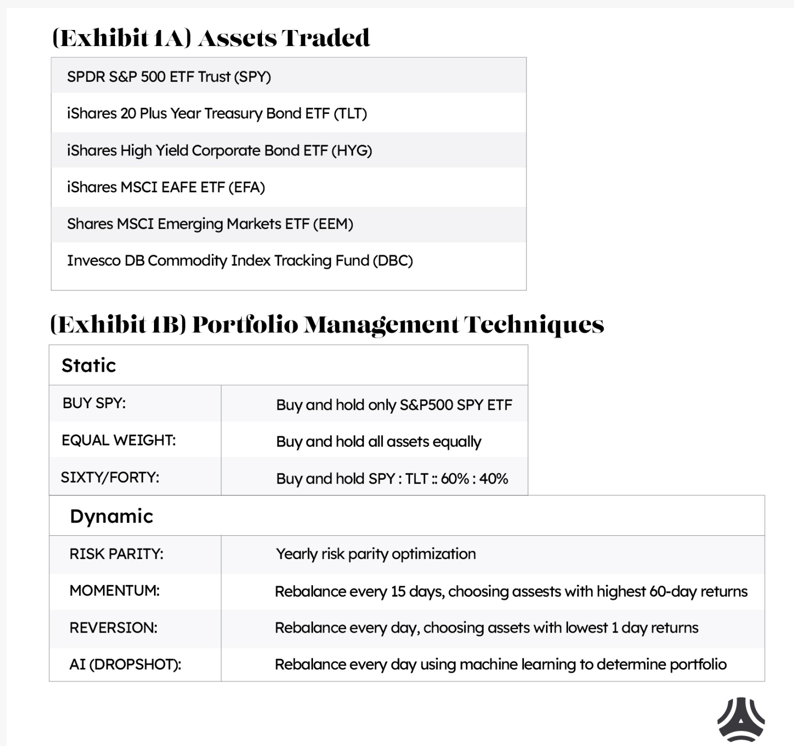
Diversified Portfolio Construction: A Case for Active Responsible Investment Strategies

DropShot Capital Management has performed a simulation showing the benefits of active and diversified investment management.

HOBOKEN, NEW JERSEY, UNITED STATES, March 21, 2023 /EINPresswire.com/ -- DropShot is an AI-Driven Fund that aims to generate superior returns with lower risk through automated investments. Their approach to portfolio management is active, long-only and leverage-free, trading in highly liquid ETFs. In this article, DropShot wishes to make the case that diversifying one's portfolio while maintaining active and adaptive trading methods is the most efficient way to mitigate risk while still participating in market returns.

DropShot Capital utilizes artificial intelligence to guide market strategy and outperform competitors.



(Exhibit 1A) Assets Traded

SPDR S&P 500 ETF Trust (SPY)
iShares 20 Plus Year Treasury Bond ETF (TLT)
iShares High Yield Corporate Bond ETF (HYG)
iShares MSCI EAFE ETF (EFA)
Shares MSCI Emerging Markets ETF (EEM)
Invesco DB Commodity Index Tracking Fund (DBC)

(Exhibit 1B) Portfolio Management Techniques

Static	
BUY SPY:	Buy and hold only S&P500 SPY ETF
EQUAL WEIGHT:	Buy and hold all assets equally
SIXTY/FORTY:	Buy and hold SPY : TLT :: 60% : 40%
Dynamic	
RISK PARITY:	Yearly risk parity optimization
MOMENTUM:	Rebalance every 15 days, choosing assests with highest 60-day returns
REVERSION:	Rebalance every day, choosing assets with lowest 1 day returns
AI (DROPSHOT):	Rebalance every day using machine learning to determine portfolio

Exhibit 1 displays the assets traded and the simulated portfolio management techniques. In the simulation, DropShot tested the effectiveness of various post-pandemic strategies.

The experiment is to compare the risk profile of various popular passive and active portfolio management strategies with varying degrees of activeness and diversification. For the test, DropShot used the post-Corona pandemic timeframe, starting on 3/24/2020 and ending on 3/10/2023, a total of 745 trading days. The three years simulated encompasses a variety of market regimes as a continuous stream of unprecedented events weighed continuously on markets.

The portfolio consists of the ETFs that represent a wide cross asset exposure (Exhibit 1A).

The simulation uses several portfolio management techniques to trade these ETFs, long only. The gross performance of DropShot's AI Alpha Fund was also included which uses machine learning to trade an even more diversified basket of assets (Exhibit 1B).

(Exhibit 2) Simulation Results

Strategy Type	Strategy	Returns	Sharpe	Max DD
Passive, No Diversity	Buy and Hold SPY	71%	0.99	-0.24
Passive, Some Diversity	60:40 Ratio of SPY/TLT	18%	0.48	-0.27
Passive, Diverse	Equally Weighted Asset Allocation	32%	0.81	-0.20
Active Yearly, Diverse	Yearly Risk Parity Asset Allocation	9%	0.34	-0.23
Active Bi-monthly, Diversity	15d Momentum Rebalancing	40%	0.89	-0.19
Active Bi-monthly, Some Diversity	15d Momentum - Concentrated to top 3	45%	0.90	-0.22
Active Daily, Diverse	Daily Reversion Rebalancing	45%	1.00	-0.19
Active Daily, Some Diversity	Daily Reversion - Concentrated to top 3	51%	1.01	-0.18
Active Daily, Diverse	DropShot AI Alpha Fund	86%	1.34	-0.15

Exhibit 2 displays the simulation result, showing a direct correlation between active diverse management and portfolio performance.

The simulation results (Exhibit 2) conclude that even in various unique market climates, best results are driven by an active, diverse trading strategy.

Simply put, passive strategies vastly underperformed during this time. With both stocks and bonds suffering during the back end of the simulation, 60:40 and risk parity portfolios were unable to keep up. The best passive strategy was to simply diversify by equally weighting the universe.

Active management outperforms Passive management.

Momentum and reversion, two opposing market investment philosophies, are used in the simulation and are almost equal in post pandemic performance. This means that whether you bet the losers will win, or the winners will win, you are still better off than a long term, non-dynamic bet.

Diversification of one’s portfolio is a concept that should be embraced diligently as a method of offsetting the risk of any one sector, country or instrument melting down. Risky propositions such as unknown crypto coins belong only as a small part of a portfolio. By picking from highly liquid ETFs, one can gain access to a wide variety of market exposures. By allocating to a wide range of safe assets, and applying advanced quantitative methods, strategies become much more robust particularly in difficult market conditions.

This is why DropShot’s proprietary trading algorithm achieved double the performance of the simplistic but active methods. The research process goes to extraordinary lengths to achieve favorable rewards for diminished risk in turbulent markets. Using machine learning is just one part of the approach, the most important point is that it is operated with common sense. The algorithms are continuously learning and adapting to new market conditions, which allows DropShot Capital to stay ahead of the curve and identify opportunities that other investors may overlook.

Happy trading!
DropShot Capital
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