

PORTFOLIO MANAGEMENT TECHNIQUES

In the previous chapter, we explored the concept of active portfolio management and of how the success of those who reject a passive approach can be assessed. Active management takes the form of either the selection of assets that are expected to outperform the market index or the allocation of funds between equities, bonds and cash so as to place capital where it will earn the highest return over shorter periods. In this chapter, we discuss just how active management is executed, that is, what specific techniques can be used to invest in accordance with the results of selectivity or timing analysis.

We shall begin the discussion by explaining the passive strategy of indexing, or how purchasing the market portfolio is achieved. Since this is passive only with respect to equities, we continue with the issue of asset allocation, which turns passive strategies with respect to selectivity into active timing. In the following section, we demonstrate how selectivity can be optimally conducted, while respecting the notions of portfolio optimization; this is effected by purchasing an index portfolio, but also adding specific equity positions that respond to security analysis decisions. Next we discuss how active or passive positions can be hedged by the use of derivatives. Finally, we describe how the success of a portfolio manager in asset allocation and security selection can be assessed by specific attribution of the results to particular skills.

