

# Portfolio Management Investment Proposal

## Sample Report

Prepared For:

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## Executive Summary

The purpose of this report is to present a detailed investment proposal that is thoughtfully tailored to align with your unique financial aspirations and risk tolerance. By leveraging the mean-variance portfolio framework, we strive to optimize your investment strategy, ensuring a harmonious balance between anticipated returns and the inherent risks involved.

In this proposal, we will outline our carefully recommended investment strategy, along with expected performance metrics and thorough risk assessments. Our goal is to provide you with a well-rounded approach to portfolio management that not only meets your financial objectives but also instills confidence in your investment journey.

# Introduction

In today's dynamic financial landscape, effective portfolio management is crucial for achieving long-term investment success. This report leverages the mean-variance framework, developed by Harry Markowitz, which emphasizes the trade-off between risk and return. By diversifying investments across various asset classes, we can enhance the overall performance of your portfolio while managing risk effectively.

# Investment Strategy Overview

We offer a variety of investment strategies, strategies tailored to meet different financial goals and risk tolerances. Heres a brief overview of the strategies we employ:

- *Aggressive Growth Portfolio*: Targets high returns through investments in high-risk assets, appealing to those with a strong risk appetite and a long-term vision.
- *Mean-Variance Optimized Portfolio*: Strategically designed to achieve the highest expected return for a given level of risk, catering to risk-averse investors seeking balance.
- *Tax-Efficient Portfolios*: Designed to minimize tax liabilities while maximizing after-tax returns, appealing to those who seek financial efficiency.

## Investment Strategy Overview (Continuation...)

- *Balanced Portfolio*: Strikes a balance between growth and stability, combining equities and fixed-income securities to satisfy moderate risk-takers.
- *Conservative Portfolio*: Focuses on capital preservation with lower-risk investments, ideal for those prioritizing security over high returns.

# Market Analysis

- *Economic Overview:* The current economic landscape is characterized by several key indicators:
  - *GDP Growth:* The Gross Domestic Product (GDP) growth rate is a crucial indicator of economic health. As of the latest reports, the GDP growth rate is projected at approximately 2.5% for the upcoming year, reflecting a steady recovery post-pandemic. This growth is essential as it indicates a favorable environment for equities and other investments.
  - *Inflation Rates:* Inflation has been a significant concern, with current rates hovering around 4.2%. While this is a decrease from previous highs, it remains above the Central Bank's target of 2%. Elevated inflation can erode purchasing power and impact fixed income returns, making it vital for investors to consider inflation-protected securities.

## Market Analysis (Continuation...)

- *Market Trends and Forecasts*

- Market trends indicate a shift towards sustainable and technology-driven investments. The rise of ESG (Environmental, Social, and Governance) criteria is influencing investor decisions, leading to increased allocations in green technologies and renewable energy sectors. Additionally, forecasts suggest a potential increase in interest rates as central banks aim to combat inflation, which could affect fixed income performance.

- *Asset Class Performance*

- *Equities:* Historically, equities have provided higher returns compared to other asset classes, averaging around 10% annually over the long term, but they are also subject to higher volatility, which aligns with the client's willingness to accept some risk.



## Market Analysis (Continuation...)

- *Fixed Income*: Fixed income investments, such as bonds, typically offer lower returns, averaging around 5% annually. They serve as a stabilizing force in a portfolio, especially during market downturns.
- *Real Estate*: Real Estate Investment Trusts (REITs) have shown resilience, with historical returns averaging around 8-10%. REITs provide diversification and a hedge against inflation, making them a suitable alternative investment in a balanced portfolio.

Given your moderate-risk tolerance and willingness to accept some volatility for the potential of higher returns, we believe that the proposed *Balanced Portfolio Strategy* aligns well with the current economic indicators and asset class performance.

## Market Analysis (Continuation...)

By diversifying across equities, fixed income, and a minimal allocation to alternative investments, including REITs and commodities, the portfolio aims to achieve the projected return while managing risk effectively.

As we navigate the market landscape, continuous monitoring and adjustments will be essential to maintain alignment with the your risk tolerance and investment goals.

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## Client Profile

Understanding your financial situation, investment goals, and risk tolerance is paramount. Based on our discussions, your profile is as follows:

- Client Name: **Andreas Carlsson**
- Risk Tolerance: **Moderate**; willing to accept some volatility for potential higher returns.
- Investment Horizon: **5-10 years**
- Investment Objectives: Primary objective is capital appreciation, with a secondary focus on income generation.
- Current Portfolio Overview: **USD: 500,000**; in various investment vehicles.

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# Portfolio Construction Using The Mean-Variance Framework

The mean-variance optimization approach, developed by Harry Markowitz, is a foundational concept in modern portfolio theory. It emphasizes the trade-off between risk and return, allowing investors to make informed decisions based on their risk preferences. The following steps outline the process of constructing the proposed portfolio:

- **Investment Objectives:** We will define our investment objectives.
  - Target annual return: 12%
  - Acceptable risk level (standard deviation): 20%
- **Asset Class Selection:** We will select a mix of asset classes.
  - Equities: 70%
    - Domestic Stocks: 40%
    - International Stocks: 30%

## Portfolio Construction (Continuation...)

- Fixed Income: 20%
    - High-Yield Bonds: 10%
    - Emerging Market Debt: 10%
  - Alternative Investments: 10%
  - Real Estate Investment Trusts (REITs): 5%
  - Commodities: 5%
- **Data Collection:**
    - Historical returns and standard deviations for each asset class.
    - Correlation coefficients to understand how asset classes interact.
  - **Efficient Frontier:**

We will plot the expected returns against risk to identify the efficient frontier, which represents the optimal portfolios that offer the highest expected return for a given level of risk.

## Expected Portfolio Performance

Based on our analysis, the expected annual return of the proposed portfolio is projected as follows:

- Expected Portfolio Return ( $E[R_p]$ ): 13.95%
- Portfolio Standard Deviation ( $\rho$ ): 18%.

This indicates a favorable risk-return profile.



## Performance Metrics

To evaluate the portfolio's performance, we will utilize several key metrics:

- *Sharpe Ratio*: Measures risk-adjusted return.
  - Calculated as the excess return per unit of risk, is projected to be 1.6, indicating a strong risk-adjusted return.
- *Alpha*: Indicates the portfolio's performance relative to a benchmark.
  - A positive Alpha suggests that the portfolio has outperformed the benchmark, and a negative Alpha indicates underperformance. Given your moderate risk tolerance, a target Alpha of at least 1.0 would be desirable, as it would signify that the portfolio is generating returns that exceed the benchmark by a meaningful margin.
- *Beta*: Assesses the portfolio's volatility compared to the market.
  - While you are willing to accept some volatility, you do not want to be overly exposed to market fluctuations. A Beta in the range of 0.8 to 1.2 would be ideal, allowing for some degree of market correlation while still managing risk effectively.

## Risk Assessment

Risk management is integral to our strategy. We will conduct a thorough risk assessment, focusing on:

- Market Risk: Exposure to market fluctuations.
- Credit Risk: Potential default of fixed-income securities.

Key features include:

- *Value at Risk (VaR)*: Estimates potential losses in normal market conditions.
  - Assuming a 95% confidence level, the Z-Score is approximately 1.645. Given the portfolio's standard deviation of 18%, the calculation would be:

$$VaR = 500,000 * 1.645 * 0.18$$

$$VaR = 14,835.$$

- This result indicates that, under normal market conditions, there is a 95% chance that the portfolio will not lose more than approximately *USD* : 14,835 over a one year time frame.

## Risk Assessment (Continuation...)

- *Volatility*: Measures the degree of variation in the portfolio's returns over time. A standard deviation of 18% suggests that the portfolio's returns can fluctuate significantly. To contextualize this, we can interpret the volatility as follows:
  - *Low Volatility (0-10%)*: Indicates stable returns, suitable for conservative investors.
  - *Moderate Volatility (10-20%)*: Reflects a balance between risk and return, aligning well with your moderate risk tolerance.
  - *High Volatility (20%+)*: Suggests significant fluctuations, which may be unsuitable for risk-averse investors.
- *Stress Testing*: Evaluates portfolio performance under extreme market scenarios. For Andreas's portfolio, we can consider two hypothetical scenarios:
  - **Scenario 1: Market Downturn**: Assume a market decline of 30%. The potential impact on the portfolio can be calculated as follows:
 
$$\text{PortfolioValueAfterDownturn} = \text{PortfolioValue} - (\text{PortfolioValue} * \text{MarketDecline})$$

$$\text{PortfolioValueAfterDownturn} = 500,000 - (500,000 * 0.30)$$

$$\text{PortfolioValueAfterDownturn} = 350,000$$

## Risk Assessment (Continuation...)

- **Scenario 1:** Indicates that in the event of a severe market downturn, the portfolio could lose USD: 150,000, highlighting the importance of diversification and risk management.
- **Scenario 2: Market Rally:** Conversely, if the market experiences a 20% increase, the potential gain would be:
 
$$\text{PortfolioValueAfterRally} = \text{PortfolioValue} + (\text{PortfolioValue} * \text{MarketIncrease})$$

$$\text{PortfolioValueAfterRally} = 500,000 + (500,000 * 0.20)$$

$$\text{PortfolioValueAfterRally} = 600,000$$
  - **Scenario 2:** Suggests that the portfolio could gain USD 100,000 in a favorable market environment, aligning with Andreas's objective of capital appreciation.

# Performance Monitoring

Regular performance reviews will be conducted to ensure alignment with your investment goals. We will provide quarterly reports detailing portfolio performance, market conditions, economic indicators and any necessary adjustments.

## Recommendations

Based on the analysis, we recommend the following actions:

- **Initial Investment Allocation:**
  - 70% Equities
  - 20% Fixed Income
  - 10% Alternatives
  - 5% Real Estate Investment Trusts (REITs)
  - 5% Commodities

This allocation is designed to balance growth potential with risk management, aligning with your investment profile.

- **Regular Review:** Schedule quarterly reviews to assess performance and make necessary adjustments.
- **Rebalancing Strategy:** Regular rebalancing will be crucial to maintain the desired risk-return profile.

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## Next Steps...

To ensure that this proposal aligns with your investment goals and expectations, I recommend scheduling a meeting to discuss the details further. During this meeting, we can:

- Review the proposed asset allocation and its alignment with your financial objectives.
- Discuss any adjustments based on your preferences or market conditions.
- Address any questions or concerns you may have regarding the investment strategy.

*Please let me know your availability for a meeting next week, and I will do my best to accommodate your schedule.*



## Contact Information

For further inquiries, please contact:

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