OPTIMAL ASSET ALLOCATIONS IN DIFFERENT STAGES OF BUSINESS CYLES

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ABSTRACT

Optimal portfolios maximizing the Sharpe ratio allocated 60% to stocks and 40% to bonds in expansions, and 100% to bonds in recessions. The optimal portfolio for the overall study period allocated 66% to bonds and 34% to stocks, resulting in a Sharpe ratio that was well below that in expansions, and only slightly higher than that in recessions. Investing in the different optimal allocations for expansions and recessions increased the overall risk premium by 70% while increasing the standard deviation by only 16% , resulting in a Sharpe ratio that was 50% higher than that of the fixed optimal allocations across business cycles.

Keywords: *Optimal Asset Allocations, Business Cycles*