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Macroeconomic indicators and their effect on Tactical Asset Allocation

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Abstract

In this thesis we develop a strategy for tactical asset allocation that takes into account macroe- conomic variables. The relationship between the macroeconomic variables and financial asset returns is modeled by using an M-GARCH error structure. This relationship will be used as a signaling value and implemented in the asset allocation strategy. In order to evaluate the effect the signaling value has on the performance of the portfolio, three allocation strategies will be compared, two of which will take into account the macroeconomic environment. We illustrate the benefits of the macroeconomic-based strategies by looking at three Swedish financial securities while using inflation and PMI as a macroeconomic factors. The portfolio performance will be measured by its' Sharpe ratio. The results show that the best performing strategy is the mean-variance allocation including both of the macroeconomic factors. In this study the dynamic modeling techniques that contain the influence of the macroeconomic environment outperforms the model that excludes it, thus offering greater risk-return combinations.

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