

Asset Allocation and Stock/Bond Cycle:

Evidence from Thai Market

Abstract

Since optimizing asset allocation decisions through the uncertain state cycle of asset returns in stocks and bonds has never been found before in Thailand, we perform empirical investigation on this topic under Markov regime switching framework. The return distributions are characterized as ‘Bear’ ($s_t = 1$) and ‘Bull’ ($s_t = 2$) states for Thailand’s financial market. Given that the mean and the variance of asset returns depend on an unobservable regime variable, s_t , we deploy Monte Carlo simulation technique to solve for the dynamic optimal asset allocation of a buy-and-hold investor with power utility as objective function. Our empirical findings suggest that, starting from the bear state, the optimal allocation to stocks and risk-free assets seems to gradually increase as T grows whereas the weight on bonds declines as much as T expands. Meanwhile, when we initiated with the bull state, the investor seems to increase his/her optimal weight on stocks while the bond asset is neglected from the buy-and-hold investor with a nearly zero percentage of the portfolio.