International Portfolio Diversification Using CVaR Model: Thailand's Perspective

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June 2012

ABSTRACT

This research paper compares the performance of 3 constructing portfolios: Mean Variance (MV), Conditional Value-at-Risk (CVaR), and CVaR with Markov Regime Switching (MS-CVaR) in both local and international portfolios. CVaR is applied to capture non-normal distribution of asset return and Markov Regime Switching to predict asset return instead of using historical mean return. The results show that investors who invest in international portfolio will increase return per unit of risk. Moreover, the cumulative returns from CVaR model show the superior results as compared to the Mean-Variance model while results from MS-CVaR model are mixed depending on accuracy of MS prediction. On the other hand, all of fully hedged policy shows the superior results than unhedged policy measured by Sharpe ratio.

Keywords: International Portfolio Diversification; Mean-Variance; Conditional Value-at-Risk; Markov Regime Switching; Exchange Rate Risk