

Carry-based expected returns for strategic asset allocation

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Abstract

This paper investigates expected return forecasting methodologies and their application in an asset allocation context. Although present value model-related methods are popular in practice, little is known about their performance when used for asset allocation. An intuitive and traceable carry-based method was developed as well as tested and benchmarked against competing alternatives. The results were evaluated from different perspectives and the obtained returns also regressed on well-known risk factors. It outperformed other return forecasting variants on various metrics and generated significant alphas regardless of the weight determination approach used. The methodology can be extended to further asset classes as well as geographic regions and provides a framework for allocating assets strategically.

JEL classification: G10, G11, G17.

Keywords: Asset allocation, carry, expected returns.