Paper ID: a22-agjpnm **Peer Reviewed** **Open Access**

DOI : *https://doi.org/10.26703/JCT.v17i1-7*
Archive : https://ideas.repec.org/a/jct/journl/v17y2022i1p37-41.html
http://EconPapers.repec.org/RePEc:jct:journl:v:17:y:2022:i:1:p:37-41

Select Asset Classes And Short-Term Risk Return Trade Off

Received : 22-3-2022
Revised : 5-4-2022
Accepted : 18-4-2022

Dr. Anand G. Jumle[1] **Dr. Pravin Narayan Mahamuni**[2]

Plagiarism: *10%*

[1]*Principal, Shree Chanakya Education Society's Indira College of Arts, Commerce & Science, Tathawade, Pune- 411033.*

[2]*Assistant Professor, Symbiosis School for Online and Digital Learning, Symbiosis International (Deemed University), Pune- 412115*

Keywords: *Short Term Investments, Risk Return Trade Off, Asset Classes, Inflation.*

Classification-JEL : *G10*

How to Cite: *Jumle, Anand G. & Mahamuni, Pravin Narayan (2022). Select Asset Classes And Short-Term Risk Return Trade Off. Journal of Commerce and Trade (H. Agarwal, Ed.) 17 (1), 37-41. doi:10.26703/JCT.v17i1-7*

ABSTRACT

Investors and investments are two inseparable constituents of financial system. However, investors are hardly be able to make informed decisions regarding asset classes for their short-term investments since the returns and risks in the very short term up to say 30 days would be very unpredictable. Still to compensate against the inflation, investors need to invest even their short- term surplus funds in suitable asset classes. While in the end the benefit of average is inherently available to address risk-return trade-off, the case of short-term investments is different. Considering this challenge, this research attempts to illustrate the returns, risks, and the trade-off for select asset classes in short term periods. This article endeavors to briefly discuss the investment decisions by looking at the returns of various asset classes in a very short-term period of about 30 days. The objective of the study is To compute the returns of various asset classes viz., equity in Sensex, gold, USD, and Bitcoin. This study does not rule out the possibility that there could be aberrations during different short- term periods where due to unforeseen, irrational and specific reason driven movements, the return in any of the select asset classes could be exponentially much higher than expected or justified.

1. INTRODUCTION

Presently, Indian economy is passing through challenging times. The reasons are several but significant of them include higher inflation, rising oil prices, volatility in stock markets, strengthening USD, teething problems of GST, and poised-to-rise interest rates. While investing is never a simple exercise, investing in such challenging times and that too if one must make a short-term investment, the decision appears to be even more challenging. This article endeavors to briefly discuss the investment decisions by looking at the returns of various asset classes in a very short-term period of about 30 days.

2. THEORETICAL BACKGROUND

As far as investment is concerned, every person will have dreams, plans and actions to make investments. If something is not clear it is only which asset class is better. There are several asset classes but the most popular are equity, bonds, real estate, mutual funds, gold, currency, commodities etc. Each of these asset classes has its specific features and its selection is dependent on certain factors of the investors such as age, investment objective, risk appetite, investment tenure, and monitoring ability.

The return and risk of each of the asset class are different. Expectations on return, time, risk, etc., of investors will influence them to accord more preference for some asset classes to other asset classes. Although more weightage may be given for preferred asset classes, for achieving diversification benefits, an investor would usually invest in multiple assets albeit at unequal proportions. The correlation between and among these assets is one aspect which would guide the investors in apportioning their investment amount amongst the assets.

Thanks to diversification theory, every investor has a portfolio whether it is constructed

intentionally or unintentionally. The size, composition, and objective of each of the portfolios could be different. If a portfolio is constructed intentionally, the investor will be cogent enough to appreciate the overall returns of the portfolio regardless of the individual returns of the assets held within the portfolio. However, if a portfolio is built unintentionally, the investor may irrationally measure only the returns of individual assets ignoring the overall return of the portfolio. In such a case, as the investor fails to appreciate the diversification effect, there is a risk that such an investor would make irrational decisions.

Nevertheless, regardless of the manner of measurement of returns and the aftermath decisions, in the medium to long run, the returns and risks of all the asset classes would mostly hover around their usual averages. Due to this, unless built very irrationally, each of the portfolios will yield expected returns on the total investment amounts. Thus, the long run has the advantage of absorbing intermediate fluctuations and may yield returns closer to the expectations. Therefore, although investors should not be insensitive towards choice of asset classes and proportion of investment therein, decision-making is not fraught with serious risks.

The case of short-term investments is different. In the short to very short term, all the assets will be under the domination of the prevailing economic and market scenario. Due to this, the correlation amongst most of the assets will be unity alternatively, close to unity. The correlation being close to unity means all the assets will yield same return and the investor can be indifferent between two choices since both of the assets would yield same return.

Therefore, during times when the correlation is unity or close to unity, usually investors would prefer to invest in any one or few of the popular and traditional assets say equity, gold etc. rather than in contemporary assets such as bonds, mutual funds, currency etc. This implies that investors do not consider diversification for short-term investments. Interestingly, investors prefer to invest in popular assets and naturally, the assets, which yield more returns during a particular period, will enjoy more popularity during such times.

Due to the concentration of investment in one or few asset classes and since short term investments do not have the flexibility to accommodate fluctuations, unless the decisions are informed, rational and smart, the returns could only be sub-optimal.

3. OBJECTIVE OF THE STUDY

Any investor looking forward to investing his temporary surplus will be very keen to understand which of the asset classes would yield better returns in the short term. Therefore, considering a case of very short-term investment of say 30 days.

The objective of the present study is to compute the returns of various asset classes viz., equity in Sensex, gold, USD, and Bitcoin.

4. DATA ANALYSIS AND INTERPRETATION

4.1 Data Representation

In the recent past, these four asset classes are in limelight, have caused many to book profits and many to lose their money, and yet looked like very promising asset classes in both the short term and long term.

The levels / prices of these four asset classes during an identified 30-days period are given in Table 1 overleaf.

The data is from reliable public sources viz., data of Sensex is from BSE website, gold prices from Goldline website, USD prices from RBI website, and bitcoin prices from investing.com website. The returns and risk computed from the above data for the said 30 days are given in Table 2 overleaf.

During non-trading days, the previous day's price / level is considered as prevailing for the purpose of simplicity of the calculations. The selected 30 days period has a striking significance since it briefly spreads over pre and post budget period, it captured the trend of bitcoin, it has seen a brief up and down trend of gold prices, and it has seen up and marginally decreased position of USD vis-à-vis Rupee and finally the pre-budget and post-budget Sensex levels.

Table 1: Daily average Prices

Sl. No.	Date	Daily Average Levels / Prices			
		Sensex	Gold/USD	USD/INR	Bitcoin/USD
1	7-Feb-18	34337	1330	64.1377	7832
2	6-Feb-18	34002	1335	64.2723	6930
3	5-Feb-18	34697	1337	64.0295	7518
4	4-Feb-18	35372	1337	64.0781	8622
5	3-Feb-18	35372	1333	64.0781	8842
6	2-Feb-18	35372	1335	64.0781	8587
7	1-Feb-18	35879	1341	63.6113	9626
8	31-Jan-18	35935	1344	63.6878	10086
9	30-Jan-18	36143	1346	63.7534	10557
10	29-Jan-18	36269	1345	63.4983	11516
11	28-Jan-18	36035	1353	63.4983	11790
12	27-Jan-18	36035	1352	63.4983	11253
13	26-Jan-18	36035	1352	63.4983	10973
14	25-Jan-18	36035	1360	63.4983	11290
15	24-Jan-18	36152	1352	63.6439	10992
16	23-Jan-18	36017	1337	63.7722	10642
17	22-Jan-18	35686	1334	63.8895	10948
18	21-Jan-18	35382	1333	63.7183	11876
19	20-Jan-18	35382	1333	63.7183	12214
20	19-Jan-18	35382	1334	63.7183	11264
21	18-Jan-18	35337	1330	63.8431	11198
22	17-Jan-18	34910	1335	63.9797	10361
23	16-Jan-18	34836	1334	63.7602	11777
24	15-Jan-18	34825	1343	63.4125	13829
25	14-Jan-18	34490	1335	63.5263	13633
26	13-Jan-18	34490	1335	63.5263	14170
27	12-Jan-18	34490	1326	63.5263	13437
28	11-Jan-18	34480	1321	63.7364	13794
29	10-Jan-18	34439	1320	63.8264	14117

Sources: Data Compilation

Table 2 : Computed Return and Risk

Particulars	BSE Sensex	Gold per Ounce	USD / INR	Bitcoin
Return in %	7.73%	9.47%	13.52%	(26.15%)
Standard Deviation %	704%	10.79%	0.24	2268%
Coefficient of Variation %	0.02	0.01	0.004	0.20

Sources: Data Compilation

4.2 Inferences

From the computation, it is evident that for the selected period, the return on USD i.e., the currency asset class yielded comparatively higher return. It posted an annualized return of 13.52%. Its standard deviation is also much lower resulting in a much lower coefficient of variation (CV). While such a short trend cannot be a guide for investments in currency assets, this certainly explains about the stability or volatility of this asset as a class. Naturally, the exporters and importers will have greater interest about the trends of currency assets. Good stood next in order with relatively higher annualized return of 9.47% with a corresponding standard deviation of 10.79%. Its' CV is also much lower and indicates safety. The usual favourite asset viz., Sensex has scored third in the order posting only 7.73% annualized return and a higher standard deviation of 704%. The last in order and terrible was bitcoin the most popular crypto currency. It posted a negative annualized return of 26.15% during the period with an astronomical standard deviation and highest CV amongst all asset classes.

For instance, for similar 30-days period during July 2017, Indian Rupee had appreciated by an annualized 9.17% and during December 2017, Indian Rupee had appreciated by an annualized 12.58%. Further, interestingly, the interest rate paid by Banks on fixed deposits ranged between 5% and 6% for similar short periods. The returns on money market mutual funds for very short periods range between 4% and 5% during the same period of this study. However, if the comprehensive risk of the asset classes is high, they may fail the CV test. The consumer price index (CPI) inflation was at 5% plus during the same period. This reveals that while the real return was positive for the selected period of this study, the real return was negative in case of investments in money market mutual funds and fixed deposits.

5. SUGGESTIONS

The observations suggests that investors may invest their temporary funds in the selected asset classes rather than parking them in passive avenues such as fixed deposits since even after considering the inflation, the returns from the select asset classes was positive in the short term period.

Investors need to pay additional attention to the trend of the asset classes during budget period and this compares well for our discussion on short-term investment and suitable asset class/es. The trend of asset prices prevailing during budget period must also be considered as an indicative trend that may prevail all through the period if no other swaying developments occur.

The financial system should facilitate stability where investors would earn a minimum positive return in the absence of which the investors would lose their valuable sacrificed purchasing power to the speculating traders and gamblers.

6. CONCLUSION

For short term investments, the possibility of relying upon correlation among the assets is quite less as the correlation varies along with the fluctuating returns of the assets from time to time. However return, risk and CV may not be the only factors determine short term investment decisions of the investors as key objectives for making very short term investments would be principal protection, high liquidity, ease of transaction, and whatever possible return.

While the time span for which the computations are made is too short, the observations do broadly explain the trend of the return, risk, and CV of the selected four asset classes. Given the extant inflation of about 5%, the real returns are either just equivalent to the risk free rate or lower than the risk free rate. Therefore, within the finite observations, the computations of this research meritoriously explain that in the short term, the returns from various asset classes are marginally greater than inflation and have high levels of standard deviation but interestingly with lower coefficient of variation; the dispersion is spread across and is not concentrated around the mean. Further, while the returns during the observed short term period for the select asset classes was greater than money market instruments,

irrational investments in such risky asset classes may result in negative real returns for the investors.

7. SCOPE OF STUDY

This study does not rule out the possibility that there could be aberrations during different short- term periods where due to unforeseen, irrational and specific reason driven movements, the return in any of the select asset classes could be exponentially much higher than expected or justified. In such cases, the observations could be very different from the computations for the chosen time of this study. In fact, analysis would be well founded if same study were done for several such short periods, which of course could be undertaken in a different and a wider research. ●

REFERENCES

1. *Bollerslev, Tim. 1990. "Modeling the Coherence in Short Run Nominal Exchange Rates: A Multivariate Generalized ARCH Model." Review of Economics and Statistics, vol. 72, no. 3 (August):498—505.*
2. *Campbell, John Y. 1987. "Stock Returns and the Term Structure." Journal of Financial Economics, vol. 18, no. 2 (June):373—399.*
3. *Campbell, John Y. 1991. "A Variance Decomposition for Stock Returns." Economic Journal, vol. 101, no. 404 (January):157—179.*
4. *Fama, Eugene and G. William Schwert. 1977. "Asset Returns and Inflation." Journal of Financial Economics, vol. 5, no. 2 (November):115—146.*
5. *Hodrick, Robert J., 1992. "Dividend Yields and Expected Stock Returns: Alternative Procedures for Inference and Measurement." Review of Financial Studies, vol. 5, no.3:357—386.*
6. *Xia, Yihong. 2001. "Learning About Predictability: The Effect of Parameter Uncertainty on Dynamic Asset Allocation." Journal of Finance vol. 56 no. 1 (February):205—246.*
7. *Retrieved from https://www.quikr.com/homes/blog/can-masala-bonds-spruce-up-funding-costs- for-real-estate+3467*
8. *Retrieved from https://cfo.economictimes.indiatimes.com/cfo-speak/have-masala-bonds-become- less-spicy/2507*
9. *Retrieved from www.rbi.org.in*
10. *Retrieved from www.investing.com*
11. *Retrieved from www.bseindia.com*
12. *Retrieved from www.goldline.com*
13. *Retrieved from www.gold.org*