

Application of the Black-Litterman Model on Fund of Funds

Che-Hung Liao

Abstract

This paper applies a popular asset allocation model: the Black-Litterman model on a fund of funds. First, an overview is given of the foundations of modern portfolio theory with the mean-variance model. Next, we discuss some improvements that could be made over the mean-variance model. The Black-Litterman model addresses some of these flaws and tries to improve them. Finally, simulation has been performed to compare the performance of the Black-Litterman model to mean-variance optimization. The models have been compared in intuitiveness and stability. The conclusion can be drawn that BL-model improves the mean-variance model, in our simulation, both in intuitiveness and stability.