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Role of Cryptocurrency in Portfolio Diversification

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Abstract : Financial advisors and investors seek new assets which could potentially increase portfolio returns and decrease portfolio risk. Cryptocurrencies represent a relatively new asset class which could serve in both these roles. There has been very little research done in the area of the risk/return tradeoff in a portfolio consisting of fixed income assets, stocks, and cryptocurrency. The objective of this study is a rigorous examination of this issue. The data used in the study are the monthly returns on 4-week US Treasury Bills, S&P Investment Grade Corporate Bond Index, Bitcoin and the S&P 500 Stock Index. The methodology used in the study is the application Modern Portfolio Theory to evaluate the risk-adjusted returns of portfolios with varying combinations of these assets, using Sharpe, Treynor and Jensen Indexes, as well as the Sortino and Modigliani measures. The results of the study would include the ranking of various investment portfolios based on their risk/return characteristics. The conclusions of the study would include objective empirical inference for investors who are interested in including cryptocurrency in their asset portfolios but are unsure of the risk/return implications.

Keywords : financial economics, portfolio diversification, fixed income securities, cryptocurrency, stock indexes
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