# CITY UNIVERSITY OF HONG KONG
# 香港城市大學

## Identifying Regime Shifts in the Hong Kong Stock Market: Implementing a Regime-Based Strategy to Improve Hong Kong Equity Portfolio Returns
## 識別香港股票市場的狀態轉換：實施基於市場狀態的策略以加強香港股票組合的回報

Submitted to
College of Business
商學院
in Partial Fulfillment of the Requirements
for the Degree of Doctor of Business Administration
工商管理學博士學位

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August 2016
二零一六年八月

# **Abstract**

This study proposes a regime-based asset allocation strategy to improve Hong Kong equity portfolio returns. Investors are well aware that the stock market switches between bullish periods of substantial increase in market prices and bearish periods of persistent decrease in market prices. As these two different market regimes have a significant impact on the return of equity portfolios, it is worthwhile for investors to forecast the regime-switching behaviour of the market.

I apply the Markov-regime switching approach to model the shifts in Hong Kong stock market returns between bull and bear market regimes. This Hong Kong stock market regime-switching model is able to identify and forecast the regimes in market returns. A practical investment framework based on the forecast turning points in market regimes is developed in the research. Asset allocation decisions will be driven by shifts in market regime. This regime-based asset allocation strategy is tested with out-of-sample data and it is concluded that the strategy outperforms the buy-and-hold investment strategy.

**Keywords:** Markov chain**,** regime-switching model, Hong Kong stock market returns, regime-based asset allocation strategy