# The evolution of investment portfolios in the age of tokenization



For decades, investment portfolios have been heavily influenced by the efficient markets theory, a concept developed by economist Eugene Fama in the 1960s. This theory laid the foundation for modern portfolio theory and facilitated the rise of index funds, which have become a primary strategy for managing pensions and retirement accounts. Despite their success through varying market conditions, the underlying assumption that investors are perpetually rational has come under scrutiny.

The evolution of index fund investing began in the early 1970s when economist Burton Malkiel’s influential book "A Random Walk Down Wall Street," published in 1973, championed the idea of index funds. This concept was materialised with the launch of the Vanguard S&P 500 fund in 1975, spearheaded by John Bogle. Index funds gained popularity by promoting broad diversification and limited trading, but their success has been more complex than the efficient market theory anticipates.

Research by behavioural psychologists, including Daniel Kahneman and Amos Tversky, has highlighted inconsistencies in human decision-making processes, as discussed in Kahneman’s award-winning book "Thinking, Fast and Slow." In response, economists have adapted the efficient markets theory, proposing the notion of "pretty good markets" that acknowledges the occasional gaps in rationality in investor behaviour. Market prices tend to approach accuracy over time, yet significant discrepancies present opportunities for investors.

Institutional investing is typically governed by a rigorous regulatory framework that demands fund managers adhere to strict fiduciary duties, primarily focusing on minimising risk and safeguarding client interests. Such regulations result in the majority of portfolios being allocated to historically reliable assets, like government bonds and passive equity funds, constraining the exploration of new investment avenues.

The emergence of tokenized assets opens new possibilities for diversifying investment portfolios. Tokenization enables the digital representation of a variety of assets—from Thai real estate and Nigerian oil leases to New York taxi medallions—on a blockchain. This technology can provide continuous, transparent pricing data, which has previously been lacking for many asset classes. For example, the tokenization of Thai real estate could establish a consistent market data stream, potentially allowing the asset to be evaluated using traditional portfolio metrics.

Currently, alternative investment strategies, defined as anything outside stock or bond indexes, account for only 15-20% of institutional fund portfolios. The tokenization of diverse assets could significantly expand this percentage. It is conceivable that investors, including institutional fund managers and individual savers, will soon be able to access previously overlooked asset classes and regions due to improved data availability and liquidity.

As tokenized assets accumulate performance histories, it could lead fiduciary investors to reconsider their reliance on established investment strategies that heavily favour bonds and index funds. Rather than abandoning the principles of modern portfolio theory, there may be an extension of its applicability to encompass a wider array of risk and return profiles. A comprehensive dataset gained from tokenized assets has the potential to enhance risk assessments and produce portfolios that better reflect the diverse landscape of global value.

However, the transition to this new investment paradigm is not expected to occur rapidly. Analysts predict that it may take about a decade for tokenized assets to gain a substantial foothold, accompanied by five to seven years of data collection to create reliable pricing trends. Yet, once sufficient data is available, the adoption of these new assets could accelerate, particularly due to advancements in artificial intelligence.

Historical precedents indicate that shifts in investment strategy can be gradual. For instance, transitioning pension fund investors from a predominantly bond-focused approach in the 1950s to a majority equity index model by the 1990s took about 40 years. The emergence of AI-driven automated investment strategies might shorten this timeframe, with hundreds of trillions of dollars in global assets poised for redistribution through shifts in allocation strategies.

The upcoming EY Global Blockchain Summit, scheduled for April 1-3, will include discussions on the integration of digital assets into investment portfolios, indicating the growing attention on the evolving financial landscape and the potential role of tokenization in shaping future investment strategies.

Source: [Noah Wire Services](https://www.noahwire.com)

## References

* <https://corporatefinanceinstitute.com/resources/career-map/sell-side/capital-markets/efficient-markets-hypothesis/> - This URL supports the claim about the Efficient Markets Hypothesis (EMH) developed by Eugene Fama, which states that it is virtually impossible to consistently outperform the market. It explains how EMH underpins modern portfolio theory and the rise of index funds.
* <https://www.chicagobooth.edu/review/eugene-fama-efficient-markets-and-the-nobel-prize> - This article provides further insight into Eugene Fama's work on the Efficient Markets Hypothesis, highlighting its impact on financial economics and its role in shaping investment strategies.
* <https://www.wallstreetprep.com/knowledge/efficient-market-hypothesis-emh/> - This resource explains the three forms of the Efficient Markets Hypothesis (Weak, Semi-Strong, and Strong) and how they relate to passive investing strategies like index funds.
* <https://www.investopedia.com/terms/t/tokenization.asp> - This URL explains the concept of tokenization, which involves representing assets digitally on a blockchain, potentially expanding investment opportunities beyond traditional stocks and bonds.
* <https://www.investopedia.com/terms/i/indexfund.asp> - This article discusses index funds, which are a key investment strategy influenced by the Efficient Markets Hypothesis. It explains how index funds work and their popularity in managing pensions and retirement accounts.