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A Comprehensive Review of Reinforcement Learning Augmented by Large Language Models for Portfolio Management

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Abstract: This paper presents a comprehensive review of reinforcement learning (RL) frameworks augmented by large language models (LLMs) for portfolio management. By examining existing literature and state-of-the-art methodologies, the review identifies the challenges faced in financial decision-making and explores solutions provided by the integration of LLMs with RL systems. Key areas of focus include real-time sentiment analysis, transaction cost optimization, and strategic portfolio allocation. This review highlights comparative performance metrics, challenges, and opportunities for improvement in leveraging LLMs for RL-based financial strategies. Furthermore, future directions are proposed to refine these hybrid systems for broader market applications.

Keywords: Reinforcement Learning, Large Language Models, Sentiment Analysis, Portfolio Management, Financial Strategies

I. INTRODUCTION

Portfolio management has traditionally relied on static financial indicators and historical price data for decision-making. However, with increasing market volatility driven by qualitative factors like news and sentiment, traditional methods are often inadequate. Reinforcement learning (RL) has emerged as a promising alternative, enabling adaptive decision-making by learning from dynamic environments. The integration of large language models (LLMs) adds a layer of sophistication, allowing RL systems to process and interpret unstructured textual data, such as financial news and social media sentiment. This review paper explores how RL augmented by LLMs can address key challenges in portfolio management. Innovations in sentiment analysis, transaction cost optimization, and strategic portfolio allocation are discussed in depth. The subsequent sections outline existing literature, propose a comprehensive framework, and discuss avenues for future research.

II. PROBLEM STATEMENT

Traditional portfolio management systems are constrained by several limitations. Conventional approaches, which often rely heavily on static models based on historical data, lack the flexibility to adapt to real-time market changes. These methods are limited in their ability to incorporate unstructured data, such as financial news or investor sentiment. This shortcoming leads to suboptimal decision-making, where strategies fail to adapt to the complexity and dynamism of financial markets. Additionally, frequent trading strategies or poor allocation decisions contribute to significant transaction costs, further eroding potential profits. This creates a critical need for systems capable of adaptive learning and processing qualitative market data. Reinforcement learning (RL) integrated with large language models (LLMs) presents a robust solution by combining sentiment-driven decision-making with cost-sensitive optimization, addressing both adaptability and efficiency.

III. LITERATURE SURVEY

The application of RL in finance has shown significant potential for optimizing trading strategies and portfolio management. Jiang et al. [1] proposed a financial-model-free deep RL framework that integrates an Ensemble of Identical Independent Evaluators (EIIE) for robust decision-making. Their portfolio value equation accounts for transaction costs:

$$V(t) = V(t-1) \times [1 + r(t) - c \times |w(t) - w(t-1)|],$$

where $V(t)$ is portfolio value, $r(t)$ is portfolio return, c is the transaction cost, and $w(t)$ represents portfolio weights.

Yang et al. [2] developed a "Smart Trader" model based on normalizing flows, enabling better representation of asset price distributions. Their likelihood estimation is given as:

$$\log p(x) = \log p(z) + \sum_{i=1}^K \log \det \frac{\partial f_{i-1}}{\partial f_{i-1}^{-1}}, \quad (2)$$

where x is input data, z is latent representation, and f^{-1} are transformations.

Cost-sensitive RL approaches by Zhang et al. [3] optimize profitability while minimizing transaction costs using:

$$\max_{\pi} E[R(\pi) - \lambda C(\pi)], \quad (3)$$

where π is policy, $R(\pi)$ represents returns, and $C(\pi)$ accounts for transaction costs.

Zhang et al. [4] introduced "Instruct- FinGPT" to improve financial sentiment analysis, processing financial texts into sentiment scores (S):

$$S = \text{FinGPT}(\text{Text}). \quad (4)$$

These scores integrate qualitative insights into RL models.

IV. PROPOSED FRAMEWORK

The proposed hybrid RL-LLM framework addresses key challenges in modern portfolio management. Its primary components include:

- 1) **Data Collection:** The system aggregates real-time financial data and news using APIs and automated web scraping tools. This includes historical stock prices, trading volumes, and sentiment-rich text data from financial news and social media platforms.
- 2) **Sentiment Analysis:** Pre-trained large language models, such as FinBERT, are used to extract sentiment scores from text. The models process financial articles and social media posts to identify positive, negative, or neutral sentiment, providing qualitative context for market trends.
- 3) **Feature Engineering:** Quantitative features, such as moving averages, volatility indices, and sentiment scores, are integrated into a unified state representation. This state information is fed into the RL agent for decision-making.
- 4) **Reinforcement Learning Model:** The system employs deep RL algorithms like Proximal Policy Optimization (PPO) to learn optimal trading actions. The model balances long-term reward optimization with transaction cost minimization, adapting dynamically to market conditions.
- 5) **Reward Mechanism:** A cost-sensitive reward function ensures that trading actions account for profitability and efficiency. By penalizing unnecessary transactions, the system minimizes operational costs while maximizing returns.

V. DISCUSSION

The integration of RL with LLMs offers significant advantages for portfolio management, particularly in adapting to volatile markets and processing qualitative data. However, challenges persist. Computational complexity is a significant concern, as training deep RL models and LLMs requires substantial resources. Efficient implementation will need advanced hardware and optimization techniques to reduce training time and computational costs.

Additionally, sentiment analysis models, while effective, may introduce biases if the input data is skewed, overly localized, or incomplete. For example, over-reliance on specific financial news outlets or social media can distort sentiment scores, leading to suboptimal decisions. Mitigating these issues requires robust preprocessing techniques and diverse data sources.

Another challenge is scalability. The proposed framework's application to multi-asset portfolios or markets with diverse trading behaviors necessitates additional enhancements. This includes developing modular RL models capable of adapting to unique asset characteristics and evolving market conditions. Multi-objective optimization techniques could also be incorporated to handle competing goals like risk management, profitability, and transaction costs.

Finally, ensuring interpretability in decision-making remains a crucial aspect. Traders and portfolio managers need insights into why the RL agent selects specific actions. Future systems must integrate explainability tools to provide actionable and transparent feedback.

VI. CONCLUSION

This review highlights the transformative potential of RL-LLM integration in revolutionizing portfolio management practices. The hybrid framework enables real-time, sentiment-driven decision-making while addressing traditional limitations such as static models and high transaction costs. By bridging quantitative financial data with qualitative insights from sentiment analysis, this approach represents a paradigm shift toward adaptive, data-driven strategies.

Future research directions should focus on optimizing computational efficiency to make such systems accessible to a broader range of users. Expanding the framework's applicability to global markets and multi-asset portfolios is another critical step. Additionally, addressing biases in sentiment analysis and ensuring the scalability of RL models are necessary for broader adoption. Emphasizing explainability in RL-LLM systems will further enhance trust and usability for financial professionals.

By addressing these challenges, the integration of RL and LLMs has the potential to set a new benchmark for innovation in financial decision-making, paving the way for robust, adaptable, and intelligent portfolio management systems.

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