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Equilibrium policy portfolios when some investors are restricted from holding certain assets
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Abstract: Asset managers usually define a policy portfolio to provide a long-term benchmark. According to the CAPM, the policy portfolio should be the value weighted market portfolio of all assets. However, the practical implementation of such a policy portfolio is not straightforward. First, it is non-trivial to determine the market value weights of tradable assets. Second, even if one ignores human capital as a component of the market portfolio, there are large parts of the asset universe which are difficult to trade, such as non-listed equity. While some investors are endowed with such illiquid assets or are able to pay the (fixed) costs associated with accessing them, other investors are effectively precluded from holding such assets. In this paper we analyze the equilibrium effects of non-tradable assets on optimal policy portfolios. We find that the existence of non-tradable assets implies that investors do not hold the market portfolio. Investors with (without) access to non-tradable assets tilt their portfolios away from (towards) assets to which non-tradable assets exhibit positive betas.

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