

**Department of Banking and Financial Management
University of Piraeus**



Research Seminar Series

Thursday, May 21th, 2009
Time: 17:00 - 19:00, Room 013

Seminar Title

"Illiquid Assets and Optimal Portfolio Choice"

Eduardo Schwartz
Professor
University of California, Low Angeles, US

Summary

The presence of illiquid assets, such as human wealth or a family owned business complicates the problem of portfolio choice. This paper is concerned with the problem of optimal asset allocation and consumption in a continuous time model when one asset cannot be traded. This illiquid asset, which depends on an uninsurable source of risk, provides a liquid dividend. In the case of human capital we can think about this dividend as labor income. The agent is endowed with a given amount of the illiquid asset and with some liquid wealth which can be allocated in a market where there is a risky and a riskless asset. The main point of the paper is that the optimal allocations to the two liquid assets and consumption will critically depend on the endowment and characteristics of the illiquid asset, in addition to the preferences and to the liquid holdings held by the agent. We provide what we believe to be the first analytical solution to this problem when the agent has power utility of consumption and terminal wealth. We also derive the value that the agent assigns to the illiquid asset. The risk adjusted valuation procedure we develop can be used to value both liquid and illiquid assets, as well as contingent claims on those assets.

Eduardo Schwartz is the California Professor of Real Estate and Professor of Finance, Anderson Graduate School of Management at the University of California, Los Angeles. He has an Engineering degree from the University of Chile and a Masters and Ph.D. in Finance from the University of British Columbia. He has been in the faculty at the University of British Columbia and visiting at the London Business School and the University of California at Berkeley. His wide-ranging research has focused on different dimensions in asset and securities pricing. He has been associate editor for more than a dozen journals, including the Journal of Finance, the Journal of Financial Economics and the Journal of Financial and Quantitative Analysis. He is past president of the Western Finance Association and the American Finance Association. He is a Research Associate of the National Bureau of Economic Research.