

Revisiting Static Portfolio Theory for HARA Investors*

Iñaki R. Longarela[†]

February 21, 2006

Abstract

The implications of the two-fund separation theorem have been carefully examined in the literature for the case of mean-variance preferences. However, even though the two-fund theorem applies to the whole class of HARA utility functions, its implications for the efficiency sets spanned by these preferences are much less known. Without dealing with general equilibrium issues, the goal of this paper is to show how most of the well-known constructions which arise in connection with the former subclass, extend in a relatively natural way to the whole latter set of preferences. Furthermore, graphical illustrations of the HARA portfolio problem that parallel mean-variance geometry are also provided. Along the same lines, It is also shown how the general problem can be seen as a choice between two parameters, one measuring reward and the other one measuring risk.

*I would like to thank the Wallander Foundation for financial support.

[†]Department of Finance, Stockholm School of Economics and Department of Economics, and Management, NFH, University of Tromsø. Correspondence: Stockholm School of Economics, Sveavägen 65, SE-113 83 Stockholm, Sweden. E-mail: Inaki.Rodriguez@hhs.se.