Quantitative Finance > Portfolio Management

Portfolio Selection with Small Transaction Costs and Binding Portfolio Constraints

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An investor with constant relative risk aversion and an infinite planning horizon trades a risky and a safe asset with constant investment opportunities, in the presence of small transaction costs and a binding exogenous portfolio constraint. We explicitly derive the optimal trading policy, its welfare, and implied trading volume. As an application, we study the problem of selecting a prime broker among alternatives with different lending rates and margin requirements. Moreover, we discuss how changing regulatory constraints affect the deposit rates offered for illiquid loans.

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