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Harry Markowitz and the Discretionary Wealth Hypothesis

Jarrold W Wilcox


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Abstract

In his 1959 book, Portfolio Selection, Harry Markowitz showed how return mean and variance combine to determine the expected long-term growth rate of capital. But maximization of that growth rate seems to fit the risk preferences of only a narrow range of aggressive investors unconcerned about shortfalls. The growth rate goal may in fact be generalized to both conservative and aggressive investors by mapping the distribution of returns on total wealth to returns on discretionary wealth. The definition of risk may be broadened to include return skew and kurtosis when required, to fully encompass the concept of downside risk. The resulting change in frame of reference extends Markowitz's criterion to many practical investment decisions involving maximizing long-run wealth while controlling the probability of shortfalls along the way.

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