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CAPM Risk Adjustment for Exact Aggregation Over Financial Assets

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📄 201215.pdf (180.8Kb)

Issue Date
1997-06-01

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Publisher
Cambridge University Press

Type
Article

Article Version
Scholarly/refereed, author accepted manuscript

Metadata
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Abstract
Barnett originated the Divisia monetary aggregates, which in continuous time exactly track any monetary aggregator function under perfect certainty. With user costs measuring the prices of the services of components, Barnett's aggregates are based on Francois Divisia's derivation of the Divisia line integral from the first-order conditions for optimizing behavior by economic agents under perfect certainty. We derive an extended Divisia index from the first-order conditions (Euler equations) that apply under risk. Our extended Divisia index is the first extension of index number theory into the domain of decision making under risk and thereby produces a route for the extension of all index number theory to permit non-risk-neutrality. We generate simulated data from a modeled rational consumer and investigate the tracking accuracy of the extended Divisia index to the consumer's exact aggregator function.

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Citation

Barnett, William A., Liu, Yi, and Jensen, Mark "The CAPM Risk Adjustment for Exact Aggregation over Financial Assets," with Yi Liu and Mark Jensen, Macroeconomic Dynamics, vol 1, no 2, 1997, pp. 485-512. http://dx.doi.org/10.1017/S1365100597003088

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