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## Reaching Nirvana with a Defaultable Asset?

*CAREFIN Research Paper No. 11/2010*

36 Pages

Posted: 31 Mar 2011

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Date Written: June 1, 2010

### Abstract

We contribute a new insight into the pre-crisis massive levered exposures to default risk by formulating a parsimonious, closed-form analysis of conspicuous risk taking in default-prone assets. Under no arbitrage, default risk is compensated by an ‘yield pickup’ that can strongly attract aggressive investors via an investment horizon effect in their optimal non-myopic portfolios. We show that default risk decoupled from event risk does not discourage the formation of markedly geared portfolios. Our results add a new portfolio-based perspective to a mainstream model of default risk: even if arbitrage-free, the model may not find unconstrained support in general equilibrium.

**Keywords:** dynamic asset allocation, defaultable asset, Sharpe-ratio uncertainty, levered non-myopic speculation, the Constant Elasticity of Variance (CEV) model**JEL Classification:** G11, G12, C61[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN\\_ID1798636\\_code1137091.pdf?abstractid=1798636&mirid=1\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1798636_code1137091.pdf?abstractid=1798636&mirid=1)[Open PDF in Browser \(Delivery.cfm/SSRN\\_ID1798636\\_code1137091.pdf?abstractid=1798636&mirid=1&type=2\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1798636_code1137091.pdf?abstractid=1798636&mirid=1&type=2)

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