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Nils H. Hakansson

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by Nils H. Hakansson

The Purchasing Power Fund:

A New Kind of Financial Intermediary

This article introduces a fundamentally new kind of intermediary (called a purchasing power fund) offering a fundamentally new kind of financial instrument (called supershares). Supershares differ from all previously issued financial instruments in that (1) they provide a payoff only for a prespecified level of the market return over the period between issue and maturity and (2) the payoff can be denominated in real (i.e., deflated) terms.

The underlying assets of the fund are managed like an index fund. The range of possible outcomes, expressed as a return on the initial value of the assets, is finely divided, and a particular kind of supershare assigned to each division. On the maturity date the supershare corresponding to the actual outcome pays off; the others become worthless.

By purchasing the appropriate mix of various kinds of supershares, an investor can purchase the equivalent of a mutual fund share, a purchasing power bond, a levered position in a mutual fund, a short position in a mutual fund, a call or a put—and all without borrowing either shares or money.

Life is really simple, but men insist on making it complicated. —*Confucius*

TO MOST people, the term "financial markets" denotes the market for stocks and bonds. But others would interpret financial markets more broadly to include the market for options, insurance, commodities, savings accounts, mortgages and consumer loans in general. In any case, there is general agreement that financial markets provide a mechanism through which an investor can change the form of wealth that he holds.

Even though all national wealth (real wealth) is ultimately owned by individuals and families, only a fraction of that wealth (in particular, the nonpersonal wealth) is owned directly. Most ownership by individuals and families is indirect, via ownership in the nation's economic units (i.e., its partnerships, private organizations, governmental units and corporations) which in turn own the real assets. This ownership is represented by claims issued by the direct owners; many of these are explicit while others are unwritten and implicit. The written claims are generally tradeable while the implicit ones are untradeable. Stocks, bonds, commercial notes, warrants, commodity options and paper money are examples of tradeable claims; they are often referred to as financial assets or financial instruments.

Other things equal, the more variety a nation's financial markets offer, the better off that nation's individuals are. There is a direct relationship between the economic welfare of the nation's individuals and families and the variety of instruments actively employed in its financial markets.[1]

Financial assets add flexibility to the form in which the nation's wealth can be held in that they implement division of that wealth into many more components. This type of flexibility is particularly important when returns to scale induce the establishment of large economic units. The desire for flexibility in asset holdings has in fact been so strong that it has led to the establishment of financial intermediaries whose main function is the creation of new types of claims based on pools of claims issued by di-

1. Footnotes appear at end of article.

Nils Hakansson is a Professor at the Schools of Business Administration, University of California, Berkeley. *This article is based on presentations to the Australian financial community and to the Institute for Quantitative Research in Finance. Partial financial support from the Dean Witter Foundation is gratefully acknowledged. The author is indebted to William F. Sharpe for helpful comments.*

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