Zeroes in International Portfolio Choice

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Abstract :

Using large data on international equity portfolio allocations of international mutual funds, I observe many reported country shares of zero. Identifying corner solutions from misreported zeroes, I estimate 27% of all observations are corner solutions. I identify those corner solutions by using the investment mandate given by the fund manager. I motivate corner solutions with a N-assets model of optimal portfolio choice with shortselling constraints, heterogeneous investors and portfolio frictions. This model gives a linear portfolio equation which relates the country share to the average country share, the past share and the discounted present value of expected future excess returns. I estimate this portfolio equation with a two-limit random effect Tobit. Linking the regression coefficients to the structural parameters of the model, Tobit estimates the coefficient of risk aversion to be 6.4. Moreover, it estimates the cost of portfolio friction to forgoing 1.2% of annual portfolio return. In contrast, OLS overestimates the risk aversion.