The valuation of risk assets and the selection of risky investments in stock portfolios and capital budgets.

Publisher Summary

This chapter discusses the problem of selecting optimal security portfolios by risk-averse investors who have the alternative of investing in risk-free securities with a positive return or borrowing at the same rate of interest and who can sell short if they wish. It presents alternative and more transparent proofs under these more general market conditions for Tobin's important separation theorem that the proportionate composition of the non-cash assets is independent of their aggregate share of the investment balance and for risk averters in purely competitive markets when utility functions are quadratic or rates of return are multivariate normal. The chapter focuses on the set of risk assets held in risk averters' portfolios. It discusses various significant equilibrium properties within the risk asset portfolio. The chapter considers a few implications of the results for the normative aspects of the capital budgeting decisions.
of a company whose stock is traded in the market. It explores the complications introduced by institutional limits on amounts that either individuals or corporations may borrow at given rates, by rising costs of borrowed funds, and certain other real world complications.

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[Professor Sharpe's paper, â€œCapital Asset Prices: A Theory of Market Equilibrium Under Conditions of Riskâ€ (Journal of Finance, September 1964) appeared after this paper was in final form and on its way to the printers. My first section, which parallels the first half of his paper (with corresponding conclusions), sets the algebraic framework for sections II, III and VI, (which have no counterpart in his paper) and for section IV on the equilibrium prices of risk assets, concerning which our results differ significantly for reasons which will be explored elsewhere. Sharpe does not take up the capital budgeting problem developed in section V below.]

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