

NUNO SILVA

Coimbra University, Portugal

LIFE-CYCLE ASSET ALLOCATION AND THE PESO PROBLEM: DOES AMBIGUITY AVERSION MATTER?

Abstract:

The vast majority of previous studies on life-cycle consumption and asset allocation assumed that the equity premium is constant. In this paper, we evaluate the impact of rare disasters, that shift the stock market to a low return state, on investors' consumption and portfolio decisions. We show that this event leads an ambiguity averse investor to decrease his allocation to stocks significantly, relative to the constant equity premium framework. Furthermore, we find such an investor allocates a moderate fraction of his wealth to stocks throughout his lifetime.

Keywords:

Long-term asset allocation, ambiguity aversion,

JEL Classification: C63, G11, G17