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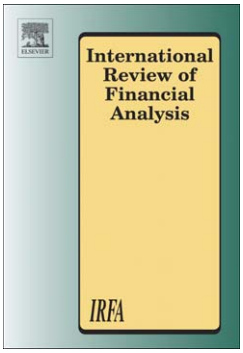

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A comparison of static and dynamic portfolio policies

Jianshen Wang* Nick Taylor†

Abstract

Garleanu and Pedersen (2013) show that the optimal static portfolio policy in light of quadratic transaction costs is a weighted average of the existing portfolio and the target portfolio. In this paper, we demonstrate the importance of the robust target portfolio in the static portfolio policy that considers quadratic transaction costs. By using both empirical and simulated data, we find no evidence that the optimal dynamic portfolio policy proposed by Garleanu and Pedersen (2013) is superior to the static portfolio policy that trades towards the robust target portfolio. The robust target portfolio is achieved by either introducing time-varying covariances or restricting portfolio weights. Furthermore, the static portfolio with time-varying covariances and the short sale-constrained static portfolio are both very efficient in reducing portfolio turnover. The good performance of the static portfolio policy is robust to parameter uncertainty and trading parameters.

Key Words: Dynamic/Static portfolio policy, time-varying covariances, transaction costs.

JEL Classification Codes: G11, G17.

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