

# Intertemporal Preference with Loss Aversion: Consumption and Risk-Attitude

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## ABSTRACT

We study the consumption and portfolio selection problem of an agent who faces *consumption irreversibility*: there is disutility from changing consumption levels. The derived preference exhibits *loss aversion* toward a consumption gamble with the previous consumption level being the reference point. The optimization problem involves the non-monotonic and non-concave utility function. By combining a duality method and the super-contact principle, we derive the closed-form solution. We show that the consumption policy involves an inaction interval for the consumption-wealth ratio, which can explain the four stylized facts about consumption at once. The optimal portfolio choice exhibits a U-shape in the inaction interval, which sheds light on the empirical debate on the relationship between a household's financial wealth and the share invested in risky assets.