Living Life Optimally – with a mean-reverting price of risk

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We explore the optimal dynamic asset allocation problem in an incomplete market. The economy has infrequent jumps and the investment opportunities are stochastic and predictable. An investor, consuming over time and with a bequest motive, attempts to maximise his/her lifetime utility in this environment. This study has confirmed that jumps, regardless of their directions reduce the demand for the risky asset. In addition, intertemporal hedging demand increases as the horizon increases but not to the same extent as an investor with no consumption.