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CIO Perspective
Loss Aversion: Turning Your Clients' Greatest Fear Into Their Greatest Advantage

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Don't Fear Your Clients' Fear of Loss, Embrace It

Every advisor knows that clients fear losing money. It's universal. It's emotional. And it's incredibly powerful.

But here's the shift: That fear is not a problem. It's an opportunity.

Loss aversion, the instinctive tendency to feel losses more acutely than gains, is more than a behavioral quirk. It's a source of real advantage.

First, it's a potential source of alpha. Long-term outcomes aren't driven solely by picking winners, but by consistently avoiding meaningful losses.

Second, it strengthens advisor-client relationships. When advisors frame risk management as a return driver, clients gain confidence, stay invested through volatility, and trust the process.

The key is not to fear loss aversion. The key is to understand its benefits and channel it.

Loss Aversion: A Negative Emotion That Creates Valuable Information

Loss aversion feels negative. It drives panic, hesitation, and bad timing. It can derail even the most carefully built portfolios. But at a market level, loss aversion does something remarkable: it creates predictable distortions in expectations.

When investors subscribe to stories instead of mathematical probabilities, prices drift away from reality. When they crowd into stocks that "feel safe," they overpay, and when they flee stocks that "feel risky," they are willing to discount. This is where the opportunity lies.

Loss aversion, when seen through the right lens, becomes a positive, measurable signal, a clue to where expectations are inflated and where the true risks are hiding.

How the h-factor® Turns Fear Into Power

Instead of trying to pick winners, investors should aim to avoid losses, because it's a hidden source of outperformance. The h-factor quantifies the probability of losses.

That's the bridge. Measuring the probability of loss and avoiding it is the key.
Clients want to know what they are buying has a reasonable chance of delivering what its price implies.

The h-factor gives advisors that information by:
- Measuring the probability a company fails to meet the expectations embedded in its stock price.
- Identifying hidden behavioral risk and quantifying it.
- Helping advisors steer clients away from elevated expectation risk.

In other words:
- Loss aversion highlights the danger.
- The h-factor is designed to show you how to avoid it.

How Advisors Can Use Loss Aversion to Build More Resilient Practices

When advisors embrace loss aversion instead of resisting it, we believe three things happen.

1. Clients become more engaged

Loss aversion is emotional.
Using the h-factor gives advisors a way to turn that emotion into a constructive conversation:

“Your fear of loss is valid. Here’s how we help you capitalize on these risks you’re worried about and avoid them.”

This doesn’t just inform the client; it benefits them.

2. Portfolios become more robust

Loss aversion pushes investors toward crowded, expensive stocks with high embedded expectations. These are exactly the stocks the h-factor warns against.

By acknowledging clients’ fears and using the h-factor to address them, advisors naturally build portfolios that are:
- designed to avoid losers
- less dependent on expensive story-driven companies
- better positioned to avoid disappointment

The emotional need for safety can be combined with an actuarial approach that is designed to measure and avoid potential losses.

3. Advisor–client trust deepens

Most advisors worry about clients’ obsession with loss aversion.
NAA’s approach is the opposite:

- Use it as a tool for engagement.
- When clients see that their emotional instincts have a role in the process - and that the h-factor operationalizes those instincts - trust grows. They feel understood, not corrected. Supported, not dismissed.

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Loss Aversion Isn't a Liability, It's Leverage

Loss aversion will never disappear.

Operating within the framework of the h-factor system gives advisors something that is both emotionally intuitive and mathematically grounded.

Conclusion: Turning Fear Into Foresight

Advisors don't need to fear their clients' fear of loss. They can use it to strengthen the client relationship.

Loss aversion is a powerful force - in human psychology and in markets. When it's understood, embraced, and paired with the h-factor, it becomes a strategic advantage for advisors and a source of confidence for clients.

Loss aversion points to risk.
The h-factor aims to help avoid it.
Together they build better portfolios, stronger relationships, and more resilient practices.

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