NEW AGE ALPHA
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CIO Perspective
The Risk Diversification Can't Fix

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Every advisor knows the first rule: diversify. Spread risk across sectors, geographies, market caps. It's Portfolio Management 101, and it works—against company-specific risk.

But there's a risk diversification can't touch.

It's the risk that shows up when expectations run ahead of reality. When investors fill information gaps with stories instead of facts. When a stock gets priced not for what the company can deliver, but for what the crowd wants it to deliver.
This is behavioral overpricing risk. And here's what makes it dangerous: **it's uncompensated and non-diversifiable.**

The Diversification Paradox

Traditional portfolio theory assumes risks are independent. That assumption breaks when the risk is human behavior itself. Company A's problems shouldn't correlate with Company B's problems if they're in different industries.

But behavioral overpricing doesn't work that way.

When investors across the market make the same mistake at the same time (overpricing stocks with vague and ambiguous information) diversification offers no protection. This is not a market-timing framework. It's a pricing-discipline framework. You can own 50 stocks and still be exposed to the same behavioral risk in each one.

If you own the index, you own the overpriced stocks. Spreading them around doesn't make them safer.

What the h-factor™ Measures

The h-factor™ is a probability-based metric that measures one thing: the probability a company will fail to deliver the revenue growth indicated by its stock price.

It's scored from 0% to 100%. A score of 75% means there's a three-in-four chance the company won't grow fast enough to justify its current valuation.

This isn't a forecast about the future. It's a calculation about *right now*, using only known information: the stock price and the company's financial statements.

The mechanism behind behavioral overpricing is what Daniel Kahneman, recipient of the Nobel Prize in Economic Sciencess, called WYSIATI: *What You See Is All There Is*. When hard data is scarce, our brains fill the gaps. We construct narratives. We assume growth will continue. We price stocks for optimism, not evidence.

The h-factor identifies when that's happened.

Why You Can't Diversify It Away

Here's the problem: behavioral overpricing is a systematic risk caused by how humans process vague and ambiguous information. It shows up across the market simultaneously.

In bull markets, it creeps into growth stocks, speculative plays, and "story stocks" with thin fundamentals. In sector rotations, it concentrates in whatever narrative is hot.

You can't eliminate it by adding more positions. The only solution is to **avoid the losers before they disappoint**.

Over more than 20 years of market cycles, low h-factor stocks consistently outperform high h-factor stocks. Not because we're predicting which companies will succeed—but because we're avoiding stocks priced for growth they're unlikely to deliver.

That's not speculation. That's actuarial discipline applied to public markets.

The Choice

You can own a diversified portfolio of overpriced stocks.

Or you can own a portfolio that avoids uncompensated behavioral risk.

The difference shows up when the narratives break and reality reasserts itself. By then, diversification won't help—because the risk was never in individual companies. It was in how the market priced all of them.

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Human Factor™ "h-factor™" scores measure the probability that, according to the Human Factor algorithm, a company cannot deliver the growth necessary to support its stock price and are not alone a recommendation about how to invest. The h-factor is a risk that comes from humans interpreting vague or ambiguous information in a systematically incorrect way. We believe that the h-factor causes stocks to be mispriced. We measure how the h-factor affects stock prices to identify which stocks are over or underpriced. We apply our methodology to over 4000 stocks and global indexes to identify a risk that impacts stock prices and is caused by human behavior. Investments not included in the h-factor tool may have characteristics similar or superior to those being analyzed. The accuracy of the h-factor is materially reliant on the integrity of the information utilized in the calculations, including any assumptions and or interpretations made by the user about the data. Data discrepancies, user assumptions, and data input by user can all contribute to differing outcomes. The underlying assumptions and processes presented herein are subject to change. Furthermore, any h-factor score referenced herein is a snapshot taken at a particular point in time and any analysis or information contained in such score is outdated and should not be relied upon as investment advice as such information may have materially changed since publication.

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