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Loss Aversion: The Case for Preservation

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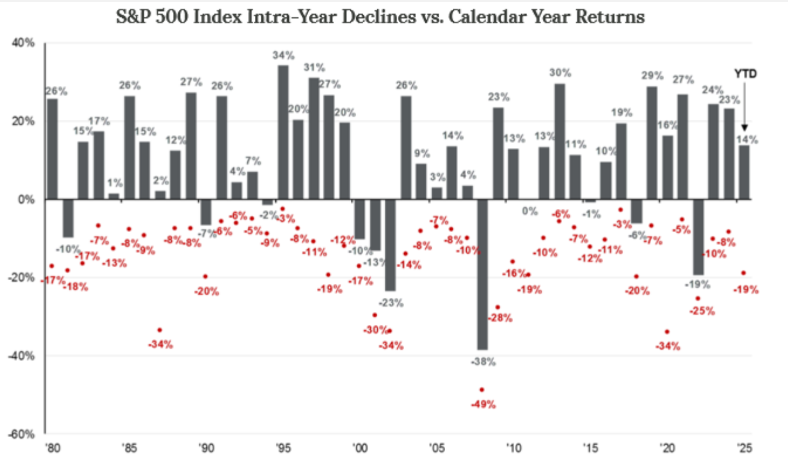
In traditional economics, investors are modeled as rational actors who weigh gains and losses equally. A dollar earned is assumed to bring the same satisfaction as a dollar lost brings pain. This tidy framework makes markets look efficient on paper, but in reality, human behavior tells a different story. Behavioral economics demonstrates that people experience losses roughly twice as powerfully as they experience equivalent gains. This phenomenon, known as loss aversion, has far-reaching implications for how investors behave, how markets function, and why certain investment strategies succeed or fail over time.

Loss aversion helps explain the emotional turbulence that investors feel during market drawdowns. A portfolio decline of 20% does not simply register as a setback to be calmly endured until recovery. Instead, the psychological weight of that loss creates fear, regret, and an overwhelming impulse to act. More often than not, that action is to sell at precisely the wrong time, locking in losses and missing the rebound. The old saying that “markets take the stairs up and the elevator down” is, in part, a reflection of how investor behavior compounds volatility. Fear-driven selling amplifies declines far more than rational models would predict.

This behavioral reality has clear consequences for long-term compounding. When investors succumb to loss aversion, they interrupt the compounding process. Consider the chart below on the impact of missing the market’s best days. Seven of the 10 best days occurred within just two weeks of the 10 worst days. In 2020, for example, the sharp crash was immediately followed by the second-best day of the year. This makes timing the market not only impractical but counterproductive. Staying invested through drawdowns is paramount to long-term success.



Source: FactSet, Standard & Poor’s, J.P. Morgan Guide to the Markets (Data as of 9/30/25)
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest peak-to-trough decline during the year. Returns shown are calendar year returns from 1980 to 2024, over which the average annual return was 10.6%. Past performance is no guarantee of future results.

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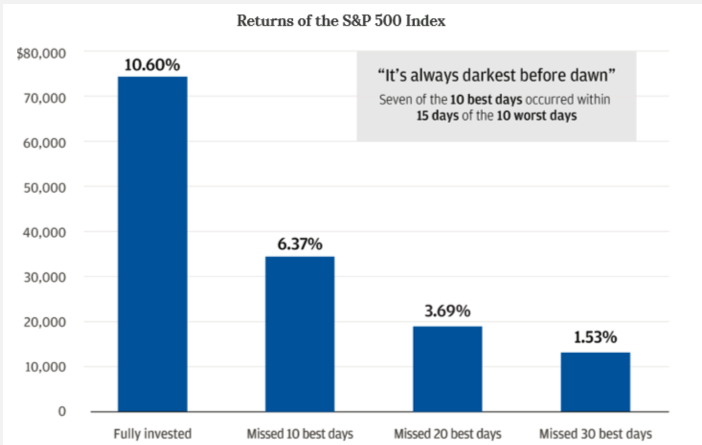
Of course, this is easier said than done. The next chart illustrates how severe intra-year declines can be, even when calendar-year returns finish in positive territory. Volatility is a regular feature of equity markets and enduring it requires resisting the urge to exit at precisely the wrong moment. Investors in the broad market must be willing to accept that turbulence is the cost of participation.



Source: J.P. Morgan Asset Management analysis using data from Morningstar Direct (Data as of 2/28/25)
Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large-capitalization domestic stocks representing all major industries. Past performance is not indicative of future returns. It is not possible to invest directly in an index. An individual cannot invest directly in an index. Analysis is based on the J.P. Morgan Asset Management Guide to Retirement.

At Crawford, we take a different approach. While the S&P 500 serves as a useful barometer for market performance, our return streams look very different by design. We know that portfolios avoiding major drawdowns have a much higher probability of meeting long-term objectives, even if they forgo some of the market’s most speculative upside. We also recognize that when withdrawals are being made from a portfolio to fund spending needs, drawdowns are magnified and the required recovery becomes even steeper.

Limiting the damage of losses is not simply a matter of comfort; it is a critical driver of long-run outcomes. At Crawford, we believe in the merits of downside protection and the idea that a portfolio that reduces losses on the downside, even if it does not participate to the full extent of every market rally, can deliver competitive returns over a full market cycle. We seek to limit losses by investing in companies that can endure a variety of market environments. As a part of our due diligence process, we fully assess a business’s risk/return profile, and we emphasize high-quality companies with durable competitive advantages, strong balance sheets, and disciplined management teams. An added benefit of our approach is that during times of stress, investors often gravitate toward the high-quality, dividend-paying companies that comprise our portfolios, which can amplify our relative advantage.

As it relates to investor outcomes, a smaller decline creates a much greater likelihood of recovering more quickly, particularly when withdrawals are being taken from the portfolio to meet spending needs. Just as importantly, avoiding large losses reduces the likelihood that investors abandon their investment program at precisely the wrong time, turning temporary volatility into permanent loss. Dividends reinforce this foundation. They provide a tangible, recurring return that arrives regardless of short-term market fluctuations. This steady income not only contributes meaningfully to total return but also helps counteract

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the psychological pull of loss aversion. Even during volatile periods, investors see real progress in the form of dividends, which fosters both comfort and discipline.

Our process is not about maximizing every possible gain. It is about capturing a substantial portion of the upside while offering greater protection on the downside, a disciplined recognition that the pattern of returns matters just as much as the average return itself. Over full market cycles, we believe this orientation toward quality, income, and preservation has often translated into stronger risk-adjusted outcomes for our investors.

From the beginning, Crawford has recognized that the asymmetry between gains and losses demands an investment approach built first and foremost on preservation. In short, our philosophy acknowledges the real-world dynamics of fear, loss, and compounding. By smoothing the pattern of returns and providing ongoing income, we help investors stay the course, capture the benefits of compounding, and ultimately, sleep better at night.