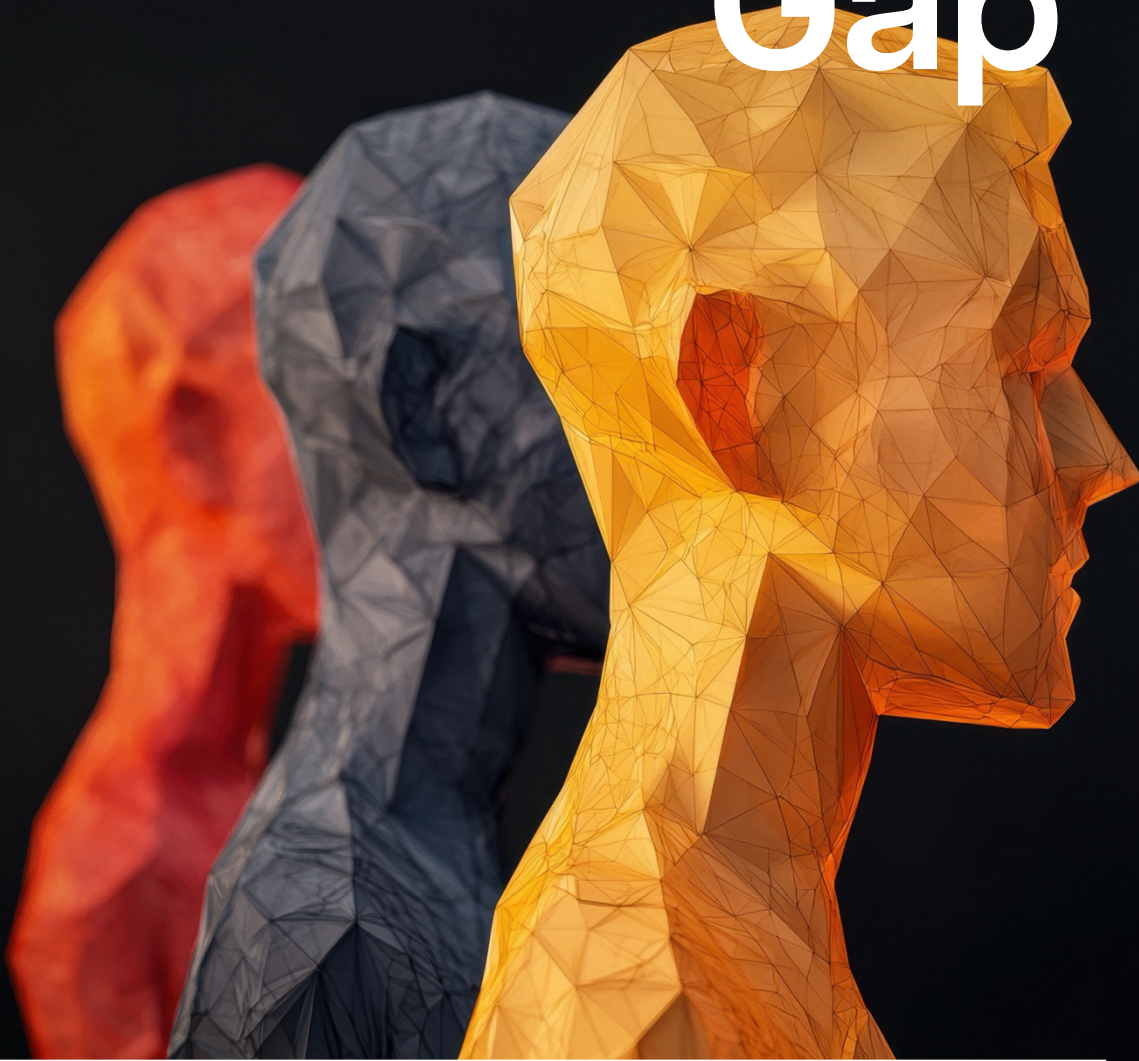


The Investor Gap



Returns & Reflexes

The Science and Practice of Goal-based Investing

Volume 1 | June 2026



Summary

Understanding the Psychology of Successful Investing

About this publication series

There is a well-documented **Investor Gap** between the returns of financial markets and what investors earn. This gap is caused by our behaviour – by the decisions we make under uncertainty and pressure, the ways in which we process information, and our natural instincts as investors and humans. Fees, friction or execution costs, which have narrowed massively over the last decades contribute to the gap, but it remains even after accounting for those drivers.

This series explores the “hidden risks” of investing, drawing on years of behavioural science research, original studies conducted by Caplign Wealth in collaboration with leading academic institutions, and decades of experience in wealth management and goal-based investing.

“Returns & Reflexes” is for everyone interested in understanding what separates a good portfolio from a good investment strategy – and why the difference is not always where we expect it.



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What is the Investor Gap?

There is a number that should sit at the heart of every serious conversation about wealth management, but almost never does. We're not referring to market returns or a volatility measure, but the difference between what financial markets return and what investors actually earn – a persistent, well-documented shortfall that has come to be known as the investor gap.

2-4% p.a.

This gap has been measured, independently and from different angles, for over thirty years. Dalbar's Quantitative Analysis of Investor Behavior¹ tracked actual investor returns against benchmark performance since 1994 and found a remarkably consistent picture: Over rolling twenty- and thirty-year periods, the average equity investor captures significantly less than the markets they are invested in, typically three to five percentage points per year. A similarly robust finding comes from J.P.Morgan Asset Management² documenting a gap of 3.6% p.a. across years. More conservative studies by Morningstar's "Mind the Gap"³ and others⁴ arrive at figures between one and two percentage points lost each year in this way, while other analyses of individual investor accounts⁵ found they underperformed by more than six percentage points per year.

The estimated magnitude varies materially by methodology and remains subject to methodological debate. But the direction remains the same: most commonly cited studies find a negative investor-return gap. To put that in concrete terms: on a well-diversified €1 million equity portfolio compounding over three decades, a behavioural drag of three percentage points p.a. amounts to a difference of over €3 million in wealth (see chart below). Part of this difference can be explained by execution costs and fees. But a significant gap is left that is due to our behaviour as investors, as these studies show. That part is, quietly, one of the largest financial risks a wealth client faces – and it appears nowhere on a standard risk assessment.

¹ Dalbar, Inc. (2025). *Quantitative Analysis of Investor Behavior (QAIB)*, 31st Annual Edition.

² J.P.Morgan Asset Management (2022). *Guide to the Markets, Q2/2022*.

³ Morningstar Research (2025). *Mind the Gap 2025: A Report on Investor Returns in the United States*.

⁴ Friesen & Sapp (2007). Mutual Fund Flows and Investor Returns: An Empirical Examination of Fund Investor Timing Ability. *Journal of Banking and Finance*.

⁵ Barber & Odean (2000). Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors. *Journal of Finance*.



Chart: How the Investor Gap Compounds Over 30 Years

Simulated growth of market and investor-earned returns.



Based on 500 simulated runs (own calculations, © Caplign Wealth) and randomly simulated market shocks based on historical mean returns and volatility data. Assumed an investor gap difference of 3 percentage points p.a.^{2,3}. Shaded areas represent 15th and 85th percentile. Lines show one simulated path of the two investments.

At a Glance

- The “Investor Gap” describes the difference between market returns and what investors actually earn. Studies across contexts and time have independently estimated it roughly between 2-4% p.a.
- On a €1 million portfolio over 30 years, a gap this size can compound to a several million EUR in wealth lost.
- While execution costs, fees etc. matter, a significant portion of the gap is driven by human investor behaviour.

The Process of Elimination

The natural instinct, when confronted with a gap this large, is to look for mechanical explanations. Transaction costs, poor fund selection, lack of diversification – these are the usual suspects, and none of them is entirely innocent. Fund expenses, while lower than they were a generation ago, still vary considerably and compound meaningfully over long horizons. Transaction costs have



fallen dramatically, but they have not disappeared – and for investors who trade frequently, they remain a significant drag⁵, explaining part of the investor gap. Fund selection, too, plays a role; not all products are created or perform equally, and the choice of vehicle matters.

But here is the difficulty with relying on these explanations alone: the gap persists even after controlling for them. The Dalbar and Morningstar data measure investor returns against the returns of the funds those investors actually held – not against some theoretical benchmark they never owned. The shortfall is the difference between what the clients' own funds returned and what the client earned from those same funds, after accounting for the timing and sequencing of their own investment decisions. Fees and fund quality explain some of the variation between investors, but they cannot explain why investors so consistently earn less than the products sitting in their own accounts.

Information asymmetry, once a plausible candidate, has also become harder to sustain as an explanation. The gap between what professional and retail investors know about markets has narrowed substantially – research is widely available, data is abundant, and market commentary is, if anything, too plentiful rather than too scarce. Access to sophisticated portfolio construction has improved markedly. And yet the gap endures, across market environments and investor segments, with a consistency that points beyond any single structural factor.

What remains, after these factors have been accounted for, is us – the investors. The investor gap is not caused by our portfolio – it is caused by the way we handle it, decisions we make, and the patterns we repeat without recognising them. If investors are consistently leaving returns on the table even in their own holdings, then something about how we invest deserves much closer examination.

Irrational Investing?

It has long been established that human decision-making under uncertainty is subject to systematic bias. Decades of research in behavioural economics⁶ have demonstrated that we feel loss more strongly than equivalent gains; that recent events are weighed more heavily than base rate probabilities; or that our confidence in an idea grows the more information we consume, even when that information is contradictory or irrelevant.

What is less widely appreciated is how these tendencies play out in real-world investing – and why they are so difficult to override, even for investors who are fully aware of them. For example, the

⁶ Kahneman, D. & Tversky, A. (1979). Prospect Theory: An Analysis of Decision under Risk. *Econometrica*.



simple act of looking at our portfolio can be a mistake: studies⁷ have found that the frequency with which an investor reviews their holdings materially changes how they experience (and respond to) the same underlying market. Over any given year, a diversified equity portfolio will show a positive return more often than not. But on any given day, the odds are closer to a coin flip. An investor who reviews monthly sees a reassuringly upward-trending picture, punctuated by occasional setbacks. An investor who reviews daily sees a random walk, dense with small losses that each trigger a disproportionate emotional response. The portfolio is the same, but the experience of owning it is not. And this experience can lead to decisions to sell or buy that hurt our performance in the long run.

Or consider what happens after a period of strong returns. Most investors would describe themselves as disciplined and patient. Yet the data consistently shows that capital flows into equity funds peak not when valuations are attractive, but after markets have already risen substantially⁸. The mechanism is not greed in any crude sense – it is narrative. Strong performance generates compelling stories: a structural shift in the economy, or a technology cycle with years left to run. These narratives feel like robust and informed analysis. They are, however, in many cases, the product of extrapolating the recent past into the indefinite future – one of the most deeply embedded tendencies in human cognition.

The mirror image plays out during downturns. Investors do not typically sell because they have lost confidence in their long-term strategy. They sell because the experience of loss – the daily confrontation with a declining number on a screen – becomes psychologically intolerable, and because the mind begins constructing equally plausible narratives for why this time the recovery will not come. The process feels like rational reassessment. It is, essentially, pattern recognition misfiring under stress.

There are many more examples of how our behaviour is driven by such patterns. None of them are a failure of intelligence, or even strictly irrational. They are simply a mismatch between our natural instincts and the environment of making long-term investment decisions. Our instincts for processing risk, evaluating information, and responding to uncertainty were shaped over hundreds of thousands of years in conditions where threats were immediate, physical, and best met with rapid action. Financial markets operate on a fundamentally different logic – one in which the threats are abstract, the time horizons are measured in decades, and the optimal response is very often the one that feels most uncomfortable. Understanding this mismatch is the starting point for doing something about it.

⁷ Benartzi & Thaler (1995). Myopic Loss Aversion and the Equity Premium Puzzle. *Quarterly Journal of Economics*.

⁸ ICI (2025). 2025 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry, 65th edition.



At a Glance

- Once fees, fund selection, and information access are accounted for, a large and persistent shortfall remains that is generated not by the portfolio itself, but by how we as investors treat it.
- The frequency of reviewing your investments, the pull of narrative during market upswings, and the fear of loss during downturns all motivate decisions that feel rational in the moment but can erode returns over time.
- These patterns are not failures of human intelligence. They reflect a mismatch between our natural instincts and an environment where the optimal response often feels counterintuitive.

The Sophistication Trap

A natural assumption is that the investor gap is primarily a problem of the inexperienced – that financial literacy and market knowledge inoculate against it. The evidence points the other way. Studies of Swedish household portfolios⁹, German brokerage clients¹⁰, and US retail investors¹¹ converge on the same finding: wealthier, more knowledgeable investors allocate more efficiently in some respects, but also concentrate more aggressively, trade more confidently, and ultimately incur comparable or even larger return losses from behavioural errors. The biases do not disappear with sophistication. They change shape – from panic selling to over-concentration, from herd behaviour to conviction-driven overexposure, from inertia to compulsive tinkering. The investors who most need structured behavioural support are sometimes those who are most confident they do not.

How to Close the Investor Gap

If the gap is behavioural in origin, then the response should be structural. Fighting it by providing better information or awareness tends to be an uphill struggle – instead the key is building an architecture for how wealth clients experience their investments and are advised. We draw on years of cutting-edge behavioural research (including new data collections at Caplign Wealth) and our experience to argue that **goal-based investing** provides this architecture.

Traditional wealth management is organised around benchmarks, which means every market movement implicitly feels like a personal event. Goal-based investing reframes the question: what

⁹ Calvet, Campbell, & Sodini (2007). Down or Out: Assessing the Welfare Costs of Household Investment Mistakes. *Journal of Political Economy*.

¹⁰ Goetzmann & Kumar (2008). Equity Portfolio Diversification. *Review of Finance*.

¹¹ Hackethal, Haliassos, & Jappelli, (2012). Financial Advisors: A Case of Babysitters? *Journal of Banking and Finance*.



matters is not performance relative to an index, but performance relative to the client's specific wealth objectives, time horizons, and preferences. A fifteen-percent drawdown in an equity allocation you will not touch for two decades is not a crisis, but expected statistical variation. Yet it only feels that way if the framework makes it visible.

The psychological foundation of this approach is well established. Research on mental accounting¹² shows that investors who divide their wealth into concrete goal-based buckets – a safety allocation, an education fund, a long-term growth portfolio – respond very differently to market downturns than those who view their holdings as a single pool. When wealth is structured around distinct objectives, a drawdown in the growth allocation does not trigger the same alarm as a drawdown in the overall portfolio, because the safety bucket remains visibly stable. The loss is emotionally categorised differently: it belongs to a time horizon that has not yet arrived, not to money that was needed tomorrow. This reframing reflects how people naturally think about their financial lives – in terms of goals, milestones, and priorities – and it harnesses that instinct rather than fighting it.

Making this tangible matters just as much as getting the structure right. Clients today expect more than benchmark reports. They want to see how their wealth connects to the life they are planning – when they can retire, whether the children's education is on track, how a market correction affects the things they care about. Visual tools that map portfolio performance against personal milestones – retirement, a property purchase, a family legacy – make goal-based investing concrete in a way that tables of relative returns never can. When an investor can see that their retirement goal remains comfortably funded despite a rough quarter in equities, the urge to intervene loses much of its force. The architecture does the behavioural work. We will explore the mechanics and evidence for goal-based investing in greater detail in a future article in this series.

At a Glance

- Goal-based investing reframes the client experience: putting personal investment goals at the centre, and structuring the strategy to align with those goals.
- The right investment architecture leads to a different experience of market volatility – and with it the tendencies that create the investor gap lose much of their force.
- Narrowing the investor gap is less about willpower or more information, and more about how wealth is organised, communicated, and experienced between advisors and clients.

¹² Das, Markowitz, Scheid, & Statman (2010). Portfolio Optimization with Mental Accounts. *The Journal of Financial and Quantitative Analysis*.



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