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Beating the Market? Dream On.

By Jill Schlesinger October 3, 2016

Jill on Money

When he entered the investment world 50 years ago, Charles Ellis found that diligent financial analysts and portfolio managers could routinely outperform the stock market. But as the investment industry changed — information became widely distributed and institutional investors eclipsed individuals — it has become, in his view, “unrealistic to try to beat today's market.”

I recently spoke with Ellis about his impressive career and his new book, “The Index Revolution: Why Investors Should Join It Now.” The book and the conversation left me even more convinced that investors are spinning their wheels using anything but index funds to achieve their long-term financial planning goals and objectives.

It is quite stunning to hear this message from a man who began on Wall Street in the early 1960s as an analyst and then became a respected financial industry consultant at Greenwich Associates, the firm he founded in 1972.

In 1975, in a prescient article titled “The Loser's Game,” he argued that most active portfolio managers cannot keep up with the benchmarks they are trying to beat and that investors are better off in low-cost index funds. In his 18th book, Ellis sounds a familiar theme. “The stunning reality is that most actively managed mutual funds fail to keep up with index funds,” he writes. The most recent evidence from S&P Global, the financial information and analytics giant, proves the point. The S&P indices vs. active (SPIVA) scorecard shows that 90.2 percent of actively managed U.S. funds failed to beat their benchmarks when their returns are calculated net of fees.

These types of reports have been available for years, yet index or passive funds still only account for one-third of all mutual fund assets. True, that's up from one-quarter of all assets three years ago. Still, a majority of individuals and professionals, some of whom owe fiduciary duties to their clients, in Ellis' words, “refuse to accept the objective data or insist on looking past it.”

Why do people delude themselves about beating the market when, as Nobel laureate Daniel Kahneman notes, “They're just not going to do it. It's not going to happen.” Maybe investors want to believe that someone, some firm or some algorithm can beat the market, because the industry has told them that it is possible.

Early on, the asset management business condescendingly proclaimed that indexing was “for losers” and that investing in an index fund was tantamount to accepting merely “average” performance. The industry's marketing tactics have evolved, but even today companies make big ad buys and tout “market-beating” funds when the plain fact is that over time they will not deliver consistent market-beating performance.

Ellis notes that in making their case for active management, these folks rarely mention risk, nor do they adjust their data for taxes.

If you cling to the belief that you can beat the indices, Ellis' book should persuade you otherwise. Perhaps the worst consequence of wasting time and energy in search of market-beating investments, he suggests, is that it diverts your attention from planning more important financial matters.

“Indexing simplifies everything,” he writes, which should enable people to concentrate on “developing a balanced, objective understanding of themselves and their situation.”

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