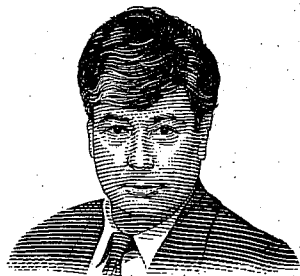


# Let the market make your decisions

You can't know more  
than the indexes,  
so sit back and relax



JONATHAN CHEVREAU

I don't know and I don't care. This seven-word mantra for believers in passive "index" investing was coined by the talented American financial writer Jason Zweig.

The indexers' rallying cry is supposed to illustrate how simple and care-free investing can be once you abandon attempts to pick individual stocks or time markets.

But when an earlier (Aug. 17) column highlighted the phrase, it sparked heated debate on the Internet from believers in stock-picking or "active" management. Chartered accountant and financial planner Bob Novoselac was even moved to pen a rebuttal entitled [inevitably]: "I do know and I do care!"

Novoselac — of Toronto-based Creative Financial Results Inc. — panned Zweig's mantra as a "pessimistic and piti-

ful investment philosophy."

That suggests the phrase can easily be misunderstood. So I bounced Zweig's mantra off indexing pioneer Rex Singuefield, chairman of Santa Monica, Calif.-based Dimensional Fund Advisors.

"He's right. That phrase captures a lot of wisdom," he said in an interview in Toronto this week. "When you say I don't know, you're saying the market already knows and I can't possibly know more than the market. Neither can anyone else. The phrase I don't care means I don't have to get excited about other people's opinions. The market has sorted it out and I trust in the market."

Investors don't need to burn the midnight oil investigating companies or industries. The market has already done it for you, Singuefield says. "It would be a waste of societal resources for someone individually to try and invest their time and study this and try and outguess the markets. They should be doing something more productive."

Zweig added a corollary to the seven magic words: "You must know that you do not care, and you must not care that you do not know."

Zweig concedes living this philosophy is more easily said than done. Not one in three investors has the emotional strength to invest truly passively.

"That's a shame, since so many others could benefit from this strategy. On the other hand, it makes the truly passive approach far more lucrative for anyone who has the imperturbability to persist with it."

The same column highlighted Index Fund Advisors' 12-point program for active investors, which aims to wean them from the belief they can consistently beat the market. (see [www.ifa.com](http://www.ifa.com).)

Novoselac's essay — also distributed in his client newsletter — tries to rebut IFA by citing top-notch stock pickers like Warren Buffett, Irwin Michael and Francis Chou.

Novoselac concedes there is "poor" active investing, citing high-fee wrap accounts or mutual funds sold by commissioned salespeople he terms "financial peddlers."

He agrees index funds may generate better investment results than such "poor" active investing modes. However, he disagrees this means index funds will always outperform "good" active investing.

To this, IFA founder Mark Hebner quips: "Good active investing is an oxymoron." Some of the stock-pickers cited by Novoselac are also on record as defending indexing.

"The best way to own common stocks is through index funds," said Warren Buffett in his 1996 shareholder letter.

And Buffett's mentor, Benjamin Graham, wrote: "I am no longer an advocate of elaborate techniques of security analysis in order to find superior value opportunities. This was a rewarding activity, say, 40 years ago ... I

doubt whether such extensive efforts will generate sufficiently superior selections to justify their cost." A hundred similar quotes are on Hebner's site.

Another famed stock-picker cited by believers in active management is Peter Lynch, legendary manager of the giant Fidelity Magellan Fund. But in 1990, Lynch told *Barron's*: "Most individual investors would be better off in an index mutual fund."

Lynch also popularized the "invest in what you know" strategy in his bestseller, *One Up on Wall Street*. It showed how investors can find stock ideas in products or services they encounter in their daily lives.

The indexers shoot this argument down, too. Larry Swedroe, author of *What Wall Street Doesn't Want You to Know*, is circulating an essay recounting four stories where investors applied the "buy what you know" doctrine. They are Black & Decker in 1972, Campbell's Soup in 1961, Digital Equipment Corp. in 1987, and Enron in 1999.

All four stories ended badly, with losses for investors. "People overconfidently confuse familiarity with knowledge," Swedroe concludes, citing a book on investing mistakes. Too often, such knowledge is "insufficient to justify the investment."

How much easier to admit "I don't know....."

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