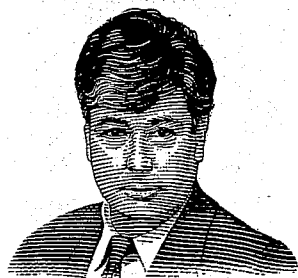


# I'm still battling the active demons

On a 12-step program  
to end my addiction  
to active investing



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About 98% of individual investors are "active" investors who pick their own stocks or buy mutual funds which do so on their behalf.

By contrast, only 70% of institutional investors (pensions) are active investors, while the other 30% (and rising) believe in low-cost, stress-free index investing.

Are professional investors aware of something you're not? If you don't know or care, odds are you're an unofficial member of "Active Investors Anonymous."

Perhaps you believe that in addition to your uncanny ability to pick stocks or top fund managers, you can guess the best time to be in or out of the market. Or you pride yourself on your ability (or your advisor's) to pick hot sectors of the economy or geographic regions best poised for explosive growth.

Despite the high costs and tax ramifications of such activities, you are likely encouraged by enablers who profit from your addiction — a vast army of brokerage firms, mutual fund companies, newsletters, market timing services and yes, even the financial press.

But there's help for you. It's called the 12-step program to indexing, available free to anyone with Internet access and Acrobat Reader.

Dedicated to help "cure the self-destructive behavior of active investors" and eradicate "Prediction Addiction," the 2004 edition of *Index Funds, the 12-step program* can be downloaded from ifa.com.

IFA stands for Index Fund Advisors Inc., an independent fee-based investment advisory created by California-based Mark Hebner. Hebner's story is interesting in itself. The author was a self-made multi-millionaire who estimates he lost US\$30-million because of his addiction to active investing.

Once he began researching why his investment performance was so disappointing, he unearthed a gold mine of academic research on the futility of active management which reached back to the early 20th century.

The financial industry's "darkest secret" was first uncovered in 1900 by Louis Bachelier. It was simply that money managers do not beat markets. Over the subsequent decades, many academics and Nobel laureates came to similar conclusions.

Even so, their work may still appear a "secret" to the average investors dubbed by DailyReckoning.com as "lumpeninvestors."

Hebner eventually cured his own addiction, discovering first Vanguard Index Funds and later Dimensional Fund Advisors. So strongly does he feel about the self-serving spin of those who profit from active management that he made his 260-page book free to all. Those who prefer a traditional printed book can purchase it for US\$50 plus shipping charges.

Hebner covers similar ground as similar books mentioned in this space in the past, by authors like Ted Cadsby, Larry Swedroe, Mark Heinzl, Brian Noble and the team of Howard Atkinson/Donna Green.

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## *Kicking shameful habit*

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I won't describe Hebner's 12 steps in detail: they are more chapter titles than a sequence of concrete actions comparable to the methodologies of better-known self-help groups like AA. His chapters cover risk, fees (The Silent Partner), style drift, market timing, rebalancing, asset classes, asset allocation, taxation and other topics investors need to absorb before setting up well-balanced global portfolios of index funds or exchange-traded funds (invested in 15,000 companies in 35 countries).

Since the first step in comparable programs is to admit and declare your addiction, let me take the opportunity here. Yes, I am personally still battling the demons of active management. I'm only half way to kicking the shameful habit — convinced of the tax efficiency of index funds and ETFs, I've finally eschewed active funds for non-registered

investments [although a few individual stocks still rear their ugly heads.]

But in my RRSP, protected from the tax consequences of high-turnover active funds, I still cling to the belief a few top-flight managers running concentrated portfolios can allow me to sleep better at night.

Perhaps I'm handicapped by being a member of the press. Hebner says "the media wants investors to worry" because it benefits from investors hooked on financial and economic news. In fact, the first point of his executive summary focuses on the true nature of news.

"Markets are moved by news. News is unpredictable and random by definition. If it could be predicted, then the prediction would be part of today's news. Therefore, the market's movements are unpredictable and random."

From there, Hebner describes capitalism and global stock markets and recaps the dogma of the efficient market: "due to the mil-

lions of intelligent and highly competitive investors, it is unlikely that any individual will consistently profit at the expense of all other investors."

He then concludes that in aggregate, active funds must lag the market by at least the cost of their fees and other costs. Most similar treatments concede the odd fund manager may outperform some of the time but argue it's almost impossible to determine which in advance.

By contrast, the 12-step indexing program means investors do "not require constant vigilance, following daily returns or listening to today's star money managers." Instead of worrying about the ups and downs of the market, such investors can invest and relax.

He concludes the sooner you start saving for retirement, the better.

"A prudent and intelligently managed investment portfolio of index funds has the highest probability of providing security in the years when it will be needed the most."

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