

PERSONAL FINANCE Personal Finance

The art of low-cost investing

Burned by active management and big-fee brokerages, investor aims to help other 'addicts' with a 12-step program, outlined in his new, lushly illustrated coffee-table book

JONATHAN CHEVREAU
Financial Post

If you're addicted to chasing hot stocks or the mutual fund du jour, help is on the way. It's called Active Investors Anonymous, a simple 12-step program for kicking the habit of "active investing."

As with the first step of similar programs, liberation from stock-picking and fund-rating comes from first admitting you have a problem.

"I'm Joe Blow and I have a problem. I'm addicted to high-fee mutual funds and believe I can spice up my returns with a few well-chosen technology stocks," is how you might begin.

The full 12 steps are outlined in the accompanying sidebar. They summarize 12 chapters of a remarkable new "coffeetable book" bearing the admittedly dull title, *Index Funds: the 12-step program for active advisors*.

The book arose with author Mark Hebner's personal experience as an entrepreneur and investor. In 1985, at age 32, he sold his pharmaceuticals distributing business (Syncor) for US\$6-million.

His subsequent unhappy experience investing that nest egg with actively managed mutual funds and big brokerage houses on Wall Street ultimately cost him US\$30-million — that's the wealth he estimates he'd have today if he had instead invested in the most aggressive index fund portfolio his 12-step program advocates.

Hebner's basic premise is "capitalism works" and retail investors can get the fruits of capitalism by investing in the various stock market indexes for the long term.

"The only time you should sell is if you come to the conclusion capitalism does not work, or if you need the money," he said in an interview.

Hebner nicely distills the basic message that passive investing, or "indexing," is less costly, more tax-efficient and ultimately more rewarding for long-term investors than the various approaches to "active" management. Successive chapters dismiss stock-picking, market-timers [he calls them "time pickers"], managerpickers and funds that change their investment styles ("style drifters.")

He also devotes a chapter to the "silent partners" who abscond with much of the return the financial markets would otherwise give investors: tax collectors, fee-collecting fund managers, commission-hungry stock traders, and even losses due to "cash drag."

The book includes a compelling graphic (on page 127) that depicts how an index-fund investor retains 87% of the return thrown up by financial markets, compared with just 47% for the average actively managed equity mutual fund.

This basic message has been articulated by a host of financial authors before him, such as John Bogle and Larry Swedroe. What Hebner brings to the party is to package the argument into a compelling and beautifully presented book.

Avid readers may not regard this as entirely new, since the book has been available free on the Web (www.ifa.com) for more than a year. However, accessing the graphics and deep layers of data on the site can be unwieldy.

As is the case with printed newspapers versus electronic equivalents, there's no substitute for a real print edition. The reproductions of 44 colour oil paintings by Russian artist Lala Ragimov and 250 more colour charts and graphics make the coffee-table book claim at least credible.

Hebner insists several readers have, indeed, accorded the book that honour in their living rooms. You could do worse than make a Christmas gift of this volume for a friend you know has

lost money due to a lack of understanding of the financial services industry. Amazon.ca charges US\$60 but if you order through Hebner's site the price is half that (not including the US\$10 shipping charge).

The real value is in the final five chapters, which focus on helping investors understand risk and create portfolios of index funds or exchange-traded funds (ETFs) that best match an investor's investment personality.

The Web site contains a quiz that lets investors decide which of 20 profiles best matches their investment temperament. These map to 20 colour-coded sets of index fund portfolios, which you can find in the book. They range from the bright red "Risk Capacity 100" (100% U.S. and global equities) to the ivory-coloured "Risk Capacity 5" (86% in fixed income).

Hebner narrows the field of approved index fund or ETF suppliers to just three: Vanguard Group, Barclays Global Investors (BGI) and Dimensional Fund Advisors (DFA) Ltd.

His own business — Irvine, Calif.-based Index Funds Advisors — consists of selling DFA funds on which he adds a 0.9% annual fee. DFA Canada set up shop in the last two years, although it doesn't yet sell all the funds mentioned by Hebner. In Canada, DFA funds are available through fee-based accounts or through traditional advisors who receive 1% trailers on the funds.

Hebner agrees do-it-yourself investors could take the 12 steps and bypass such intermediaries, but believes the average person needs an advisor. I'm inclined to agree. It takes a long time for the simple message to get hammered home.

It should by now be familiar: stay the course for the long haul, don't let emotions get the better of you when markets are down, and "rebalance" when certain asset classes get ahead of themselves. Most of us need this message constantly reaffirmed by financial advisors who have our best interests at heart.

Hebner uses plenty of space reviewing the academic literature behind DFA funds, notably its conclusion that indexed portfolios need to be "tilted" in the direction of Value and Small Caps.

But his approach can be modified and costs lowered further by combining DFA funds with ETFs, or just use ETFs, says Fred Kirby, president of Armstrong, B.C.-based Dimensional Investment Planning Inc. Kirby's firm has no connection to DFA, but helps investors construct portfolios similar to what Hebner advocates, but using mostly ETFs. (See www.dimensionalplanning.ca.)

Thus, many Hebner portfolios use both an all-market DFA fund along with a DFA value or small-cap tilt version. ETFs are also available in both small-cap and value versions. Many are based on Standard & Poor's Corp. indexes. S&P is improving its value and growth indexes based on a new six-factor model, says vice-president Steve Rive.

That should give investors the best of all worlds: the Hebner/DFA approach at even a lower cost.

Now repeat after me. "I'm Joe Blow and I'm a recovering active investor...."

jchevreau@nationalpost.com

1 2 S T E P S, A B R I D G E D

Step 1 Admit you are an active investor. Step 2 Separate fact from fiction. Step 3 Don't get wooed by star stock-pickers. Step 4 Ignore your market-timing alarm clock. Step 5 Don't leave your fate in the hands of a money manager. Step 6 Look for substance, not style. Step 7 Watch out for silent — but deadly — partners. Step 8 Understand the real risks of investments. Step 9 Use history as your guide. Step 10 Know thyself, investor. Get a handle on your investment IQ, net worth, income, savings rate and time horizon. Step 11 Don't be fooled diversity is a foolproof hedge against risk. Step 12 Invest, relax and stay balanced.

Source: The Motley Fool/Index Funds: The 12-step program for active investors



LALA RAGIMOV Mark Hebner's book features reproductions of 44 colour paintings by Russian artist Lala Ragimov, including the one above.

The only time you should sell is if you come to the conclusion capitalism does not work, or if you need the money

— Mark Hebner, author, *Index Funds*



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As with the first step of similar programs, Hebner offers a checklist and fund suggestions if you find admitting you have a problem.

"You see how and I have a problem. I'm addicted to high-fee mutual funds and believe I can spice up my returns with a few well-chosen technology stocks" is how you might begin.

The full 12 steps are outlined in the accompanying advice. They range from 12 chapters of a remarkable new coffee-table book bearing the admirably odd title, *Index Funds: The 12-Step Program* (Dutton, \$24.95).

The book arose with author Mark Hebner's personal experience as an entrepreneur and investor. In 2001, at age 27, he sold his pharmaceutical distribution business (Spencer's Distribution).

His subsequent unhappy experience lowering that nest egg with actively managed mutual funds and big brokerage losses on Wall Street ultimately cost him \$1.6 million — that's the wealth he estimates he'd have today if he had instead invested in the most aggressive index fund portfolio in the 12-step program.

Hebner's last possible "hospitality works" and retail investors can get the fruits of capitalism by investing in the various art market indexes for the long term.

"The only time you should sell is if you come to the conclusion capitalism does not work, or if you need the money," is written in his intro.

Hebner clearly distills the basic message that passive investing, or "indexing," is less costly, more tax-efficient and ultimately more rewarding for long-term investors than the various approaches to "active" management. Six concise chapters discuss stock picking, market time (he calls them "time policies") management and funds that changed his investment style (see sidebar).

He also devotes a chapter to the "least partners" who abandoned with much of the return the financial markets would otherwise give investors: tax collectors, fee-dripping fund managers, even so-called hungry stock traders, and even losses due to "hasty trading."

The book includes a compelling graphic (on page 127) that depicts how an index fund investor returns 6% of the



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return thrown up by financial markets, compared with just 4% for the average actively managed equity mutual fund.

The basic message has been articulated by a host of financial authors before him, such as John Bogle and Larry Swedroe. What Hebner brings to the party is to package the argument into a compelling and beautifully presented book.

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paintings by Lisa and Lark Engler, and 200 more color charts and graphics make the coffee-table book a visual feast.

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There's also a list of the last five chapters, which focus on helping investors understand risk and create portfolios of index funds or exchange-traded funds (ETFs) that best match an investor's in-

vestment personality.

The Web site contains a quiz that lets investors decide which of 20 portfolio strategies fits them best and temperature of their risk. The top 100 of the 100 best of index fund portfolios, which you can find in the book. They range from the highly rated "Risk Capacity 100" (100% U.S. and global equities) to the lower-ranked "Risk Capacity 7" (10% index fund).

Hebner stresses the kind of aggressive index fund or ETF supplies is just a few Vanguard Group, iShares Global Investors (IGI) and Dimensional Fund Advisors (DFA) Ltd.

His own business — Irvine, Calif.-based Index Funds Advisors — consists of selling DFA funds on which he adds a 0.5% annual fee. DFA Canada set up

12 STEPS, ABRIDGED

- Step 1: Ask if you are a serious investor.
 - Step 2: Ignore fact from fiction.
 - Step 3: Don't get woefully star-struck.
 - Step 4: Ignore your market timing star's dict.
 - Step 5: Don't blame your fate on the hands of money manager.
 - Step 6: Look for mistakes, not style.
 - Step 7: Watch out for silent — but deadly — partners.
 - Step 8: Understand the real risks of investments.
 - Step 9: Do the history you are given.
 - Step 10: Know your options. Get a clue from your investment IQ, not word, income, or capital gain the bottom.
 - Step 11: Don't let the index diversity be a foolproof hedge against risk.
 - Step 12: Invest, relax and enjoy retirement.
- For more: *The Money Fix* (Dutton, \$24.95) or *The Money Fix* (Dutton, \$24.95)

step in the last two years, although it doesn't yet sell all the funds mentioned by Hebner. In Canada, DFA funds are available through the two of accounts or through traditional advisors who receive commissions on the funds.

Hebner agrees that yourself an investor could take in 12 steps and bypass each one one-by-one, but believe the average person needs an advisor. He is inclined to agree it takes a long time for the simple message to get through to most.

It should be no surprise, says the author for the long haul, don't let emotions get the better of you when markets are down, and "balance" when certain asset classes get ahead of others. Most of us need this message constantly reaffirmed by financial advisors who have the best interests at heart.

Hebner uses plenty of space in writing the academic literature behind DFA funds, notably his conclusion that indexed portfolios need to be "tilted" in the direction of Value and Small Caps.

But his approach can be modified and even lowered further by combining DFA funds with ETFs, or just use ETFs, says Paul Kirby, president of American, DC-based Diversified Investment Planning Inc. Kirby's firm has no connection to DFA, but helps investors construct portfolios of index funds that Hebner advocates, but using mostly ETFs. (See www.dinvesting.com.)

Thus, many Hebner portfolios use both an all-cap stock DFA fund along with a DFA value or small-cap tilt version. ETFs are available in both small-cap and value versions. Many are based on Standard & Poor's Corp. indexes. S&P is improving its value and growth indexes based on a new six-factor model, says vice president Steve Kow.

This should give investors the best of all worlds: the 12-step DFA approach with a lower cost.

Now repeat after me: "You see how and I have a problem..."

Photo: AP/Wide World

J. J. O'Connell is a freelance writer in St. Louis.