Great new indexing tool just needs a better wrapper

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ARROYO GRANDE, Calif. (MarketWatch) -- Titles and headlines sell stuff. In fact, my old marketing professor told us that they are 88% of the reason why people read an advertisement or a column or pick up a book. You gotta "GRAB!" your reader or customer. Make them stop in their tracks.

No grabber? No stop? No readers. No sale! Well, I just got a review copy of a new book by financial adviser Mark T. Hebner, a colorful high-graphics beauty, loaded with fabulous charts, tables, data and research. But the title is "Index Funds." I set it aside.

"Freakonomics!" Now that title's a show-stopper! The new "Bogleheads Guide to Investing!" Gotcha! A must-read! But plain-vanilla "Index Funds?" Dull. Boring. A snoozer. So stick with me and read: For this review I'm retitling Hebner's book "The Freakoindex Guide to Winning Portfolios!"

Folks, there's actually a big connection between the two: Freakonomic research says "experts" have an "informational advantage" and use it against their clients. Which sure hints why index funds will never be more popular than a mere 8% of the $8 trillion fund world, even though indexing consistently beats actively managed funds. Index funds will always be the minority because the "experts" will invent jazzier titles and headlines to sell nonindex funds that make more money for the "experts!"

So the media has a responsibility to get the indexing message out. And I believe Hebner's giving American investors a great resource. Yet many will miss it because it lacks a jazzy "88%" title. And it's pricey. But we've got a big surprise for you. After we review it we're going to show you how to get it for free! So here's our summary of what we call "The Freakoindex Guide to Winning Portfolios:"

Step 1: Passive investors win

The game's fixed. Active investors try to pick the winners from among thousands of stocks and funds. But prices are news-driven. And news is random and unpredictable. Worse yet, "experts" like Wall Street brokers, portfolio managers and traders have an "informational advantage" that makes it impossible for Main Street to beat them. They take advantage of naïve investors blindly throwing money at news tips.

Step 2: Nobel economists win

Hebner has the best survey I've seen of research by Nobel Prize-winning economists and other academics. Unlike Wall Street plugging an IPO client or some brokers hustling commissions, they're objective and unbiased. All this research proves conclusively that indexing and simple asset allocation are the best way to win.

Step 3: Stock pickers lose

Wall Street brags about the stock-picking talents of active managers. Yet research says only 3% of them beat their benchmark, and it's mostly luck. Stock-picking success is random. And today's winners are rarely on top tomorrow.

Step 4: Market timers lose

Market timing is a fool's game. Over a 10-year period, 88% of your returns will come from a brief 40 up days. Nobody can predict which 40 days. An academic study of 15,000 predictions by 237 timers concluded: There's "no evidence that [market-timing] newsletters can time the market."

Step 5: Picking managers loses

Forget about picking next year's hot managers. You can't. The S&P 500 beat 97% of mutual fund managers for a 10-year period ending October 2004. In two 30-year studies, the S&P 500 outperformed 97% and 94% of the managers. And only 12% of the top-100 managers repeated.

Step 6: Style drifters lose

Active managers love playing with your money, churning portfolios. They're gambling, it's fun. Their average salary is more than $400,000 annually, even when they lose your money. One study proves that 40% of all funds drift from their stated objective. Reported holdings are months old, so you never really know what's in any fund, or in your portfolio!

Step 7: Silent partners win

Before you make a dime invisible partners skim money off the top! They're silent because the SEC doesn't require funds to disclose details about who's skimming: expenses, commissions, fees and taxes. In one 15-year study of taxable accounts, actively managed funds returned 50% of the gross, while index funds returned 85% to investors.

Step 8: Risk blindness

The sad truth is, most American investors don't know that what they're doing amounts to gambling. They chase short-term returns, follow hot tips, never really understanding the impact that timing and risk-taking have on their after-tax returns.

Step 9: History exposes

Managers come and go. Performance drifts unpredictably over the short term. Indexes are your only reliable source going back 80 years. Raw indexes, not actively managed funds, are the best measure of long-term portfolio risks.

Step 10: Risk capacity

What's your risk profile? Your risk "capacity" is a combination of five factors: Personal tolerance for risk (anxiety level!), your investment IQ, net worth, income and savings rate, plus time to retirement or any special withdrawal needs. This book has a ton of information on how to determine your risk profile!

Step 11: Risk exposure

Over 90% of a portfolio's returns are a function of asset allocation and not the specific funds, stocks and bonds. Active management has a negative effect on returns, draining off a third or more. Over a 50-year period, studies show that a diversified index portfolio will outperform the S&P 500.

Step 12: Invest and relax

Hebner says index and relax: The best way to maximize your returns is to avoid active trading, market timing and actively managed funds. Create and build a portfolio of index funds that works for your unique risk profile. Set it and forget it. Buy quality, rebalance periodically. And relax.

Now the best news of all: Hebner's hard copy is a museum piece, a work of art that ought to be on your coffee table or framed on a wall. But if you think it's a bit pricey at $29.99, get it online free, right now! See the virtual book.

You can return to this fabulous resource any time you need research, data (yes, Hebner's team does update statistics regularily) and inspiration about investing, asset allocation and portfolio management. So get it: "The Freakoindex Guide to Successful Portfolios" is perfect for America's 94 million Main Street investors! Even if you only call it "Index Funds."