Chapter One

The Investment Industry

The U.S. investment industry is the largest and most profitable in the world. A 2013 study by the United States Consumer Financial Protection Bureau reported the following: "The total amount spent annually by financial institutions and other financial service providers on consumer financial products and services, including both awareness advertising and direct marketing, is approximately *seventeen billion dollars*." (Italics mine.) This money comes out of the pockets of the industry's customers and goes into the pockets of company owners, brokers, financial advisors and others seeking to make a profit at the expense of investors.

Rick Ferri, CFA, a former stock broker, retired financial advisor, and author of eight financial books, wrote: "Let's face it: Most investment companies are in business to make money *from* you, not *for* you. Every dollar you save in commissions and fee expenses goes right to your bottom line."

Just as the gambling industry wants people to think they can beat the casino, the investment industry wants investors to think they can beat the market. Of course, a few lucky gamblers do beat the casino, but MOST DON'T. It is the same for investors: Some will beat the market, but MOST WON'T.

Why do some investors outperform the market while others don't? Princeton professor Burton G. Malkiel, who co-inspired my "light switch on" moment, mentioned in the Preface, with my reading of his timeless, *A Random Walk Down Wall Street*, offers this explanation: "A blindfolded monkey throwing darts at a newspaper's financial pages could select a portfolio that would do just as well as one carefully selected by experts."

This, of course, means that in a room full of monkeys, as in a room full of mutual fund managers, there will be winners. Unfortunately—for monkeys, managers *and investors*—the winners are unlikely to repeat.

Bill Miller is a perfect example. Mr. Miller was the manager of Legg Mason Value Trust (LMVTX). His fund is the only mutual fund that was able to beat the S&P 500 Index 15 years in a row. Miller became a celebrity in the mutual fund world, and investors eagerly poured their money into his fund. Unfortunately, like many winning mutual funds, LMVTX plunged to the *bottom 1%* of its Morningstar category over the next 15 years. Remember: Reversion to the Mean, like gravity, does bring us all back to earth.

Many in the financial services industry hate indexing because it is difficult for them to make money selling low-cost index funds. The industry spends billions of dollars attempting to convince us that they can help us beat the market by choosing winning individual stocks, bonds and mutual funds for us. (Fact: They cannot.)

In the 35th anniversary edition of the *Hulbert Financial Digest*, publisher Mark Hulbert wrote that, when he began tracking newsletters in 1980, there were 28 of them. Of those 28, only 9 have survived. The rest are gone. Of the 9 newsletter survivors, only 2 have ever beaten the market (measured by the Wilshire 5000 Total Market Index) on a risk-adjusted basis. Just 2 out of 28; those are pretty poor odds.

The benefits of low-cost index funds and exchange-traded funds (ETFs), which Bogleheads have been preaching about for nearly 20 years, are now becoming more widely known and accepted. The evidence of the superior performance of index funds has become so overwhelming that, in April 2017, the *New York Times* reported that, "thanks to the power of its index funds, Vanguard is pulling in more money than all of the other fund companies in the business."

Bogleheads Speak Out

"The more I struggle to perfect and tilt my portfolio with ever smaller adjustments, the more apparent the inherent wisdom of the 3-fund portfolio becomes. It is a marvelous, straightforward solution to a complex issue. Dare I say, it is a supremely elegant solution."

—TT

"After hours & hours of reading, the light bulb came on. You have probably saved me thousands of dollars & quite literally could make me millions of dollars more."

—SN

"After years of actively 'managing' my own investments, and now nearing retirement, I've decided to take the more passive approach of the three-fund portfolio. After extensive reading on this subject, and from my own personal investing experience, I have become a believer. Its simplicity and long term results are a thing of beauty."

—NY

"Taylor, Thank you for the 3-fund portfolio. At 56 I have been thru 2 advisors, then 5 years of my own efforts chasing alpha, and the light bulb went off last Fall. I moved everything to Vanguard and now I am using the 3-fund portfolio."

—DA

Bernstein's Big-If Paradox

Bill Bernstein, who left his career as a neurologist and became a financial advisor to millionaires, has written a short, 45-page booklet, *If You Can*, intended for millennials but applicable to all investors. He writes,

> Would you believe me if I told you there's an investment strategy that a seven-year-old could understand, that will take you fifteen minutes of work per year, that will outperform 90% of financial professionals in the long run, and that will make you a millionaire over time? Well, it's true. That's it, *if* you can follow this simple recipe throughout your working career, you will almost certainly beat out most professional investors. More importantly, you'll likely accumulate enough savings to retire comfortably.

Bernstein's recipe: Start by saving 15% of your salary at age 25, putting the funds into a 401(k), an IRA, or a taxable account (or all three). Divide your savings into just three different mutual funds:

A U.S. Total Stock Market Index Fund
An International Total Stock Market Index Fund
A U.S. Total Bond Market Index Fund

This great little booklet is currently available as a free PDF at: https://www.etf.com/docs/IfYouCan.pdf.