Achieving Greater Long-Term Wealth Through Index Funds

AAII Journal

John Bogle (JB): Let’s start off with the obvious. Imagine a circle representing 100% of the U.S. stock market, with each stock in there by its market weight. Then take out 30% of that circle. Those stocks are owned by people who index directly through index funds. The remaining 70% are owned by people who index collectively. By definition, they own the exact same portfolio as the indexers do in aggregate, so they will capture the same gross return as the direct indexers. But by trading back and forth, trying to beat one another, they will inevitably lose by the amount of their transaction costs, the amount of the advisory fees they pay, and the amount of all those mutual fund management costs they incur: marketing costs, processing, technology investments, everything. When we look at the big picture of the costs of investing, including sales loads as well as expense ratios and cash drag, it is a foregone conclusion that active investors, in aggregate, will under perform index investors. It’s the mathematics.

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