

I Don't Know, I Don't Care

Indexing let's you say those magic words

By Jason Zweig | *Senior Writer for Money Magazine*

I didn't always believe in indexing. As a fledgling business reporter at Time Magazine in the mid-1980s, I got interested in sector funds and the first fund I ever bought was Fidelity Select American Gold on my hunch that gold stocks were cheap. I sold a few months later, feeling quite proud of myself for turning a quick 10 percent profit (before tax). The fund promptly went up 40.5 percent in 1987. Oops -- guess I sold too soon.

Next I bought Twentieth Century Select Investors (now American Century Select). Attracted by its great record -- it had beaten the S&P 500 in nine out of the 10 years from 1978 through 1987 -- I pumped 50 bucks a month into it for years. I kept contributing after I became Forbes' mutual funds editor in 1992. By the time I got out a year or two later, I had barely broken even after taxes. Hmm. Where had I gone wrong? Time to do more homework.

Some academic research I read showed "conclusively" that, over time, small stocks would outperform big ones, value stocks would beat growth stocks, and companies that paid dividends would have better returns than non-dividend payers.

So Royce Equity-Income Fund seemed like the Holy Grail: It bought small stocks with low valuations and high dividend yields, and it was run by the redoubtable Chuck Royce. I bought in. But the fund went nowhere and its assets dwindled until Royce had to shut it down in 1997.

A few things were beginning to sink through my thick skull: I wasn't very good at fund-picking, and beating the market is amazingly hard.

Most depressing of all, the "superstar" fund managers I encountered in the early 1990s had a disconcerting habit of fading from supernova to black hole: Rod Linafelter, Roger Engemann, Richard Fontaine, John Hartwell, John Kaweske, Heiko Thieme. I soon realized that if you thought they were great, you had only to wait a year and look again: Now they were terrible.

Meanwhile I had been doing more research. The evidence was overpowering: After the expenses of researching and trading stocks, the odds that a fund will beat the S&P over time seemed to be no better than one in four. After tax, the odds went pretty close to zero. Scariest of all, as Nobel Laureate Bill Sharpe showed, these odds are virtually a mathematical certainty.

So, in 1994 -- a year before I arrived at MONEY -- I threw in the towel and opened my Vanguard 500 Index account. Every month since, I've added more money, and I've never looked back. (If I had it to do all over again, I would have chosen Vanguard Total Stock Market Index, which tracks the broad Wilshire 5000, but that fund was new then, and I would face a huge capital gains tax if I were to switch now.)

I do own some actively managed international funds (bought before Vanguard launched its total international stock index offering), some bond funds and in my 401(k), a bunch of AOL stock. But I no longer own any non-index U.S. stock funds, and I haven't traded a stock in years. And it feels great.

The ultimate beauty of index funds is that they get you utterly out of the business of guessing what will happen next. They enable you to say seven magic words: "I don't know, and I don't care."

Will value stocks do better than growth stocks? I don't know, and I don't care -- my index fund owns both. Will health care stocks be the best bet for the next 20 years? I don't know, and I don't care -- my index fund owns them. What's the next Microsoft? I don't know, and I don't care -- as soon as it's big enough to own, my index fund will have it, and I'll go along for the ride.

With an index fund, you're on permanent auto-pilot: you will always get what the market is willing to give, no more and no less. By enabling me to say "I don't know, and I don't care," my index fund has liberated me from the feeling that I need to forecast what the market is about to do. That gives me more time and mental energy for the important things in life, like playing with my kids and working in my garden.

SOURCE: CNN MONEY ONLINE

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