

Bogle's Folly

The Vanguard 500 Index Fund celebrates its 50th birthday this year. In 1976 it became the first index fund available to non-institutional investors. It tracked the S&P 500 Index and started an investing revolution. The Vanguard Group, under the stewardship of John Bogle, was just 16 months old at the time. Bogle believed that it would be difficult for actively managed mutual funds to outperform an index fund once management fees, operating expenses, sales commissions, taxes, and portfolio transaction costs were subtracted from returns. His goal was to offer investors a diversified fund at minimal cost that would give them what he called their “fair share” of the stock market’s return.

Bogle hoped that the new fund would attract \$150 million in its initial public offering. Unfortunately, the fund brought in only \$11.3 million, which wasn’t enough to purchase all the stocks in the S&P 500 Index. Soon, Vanguard’s competitors began calling the fund “Bogle’s Folly”. The phrase captured the prevailing belief of active fund managers who thought that investors would never invest in a fund that, by its very nature, could never outperform the market.

But the genius behind Bogle’s innovation was its low cost. By tracking the S&P 500 rather than employing teams of analysts and traders, the fund had much lower expenses than its active competitors and this allowed Vanguard to charge lower management fees. Over time, the lower fund expenses provide a major performance advantage for index fund investors. Today, the Vanguard 500 ETF (VOO) is the largest ETF (\$1.5 trillion) and with its miniscule 0.03% expense ratio - \$3 for every \$10,000 invested - it has outperformed 91% (585) of the 643 funds in its asset class over the past 15 years, according to Morningstar (as of 3/31/2026). Decades of evidence show that low-cost index investing with its miniscule costs, tax efficiency, fund transparency, and low turnover is a simple strategy that is hard to beat over the long run.

Some critics of index fund investing claim that it is really a non-strategy, an “I give up” strategy. They assert that to be a successful investor you must constantly tinker with your portfolio in response to today’s headlines (or what you believe tomorrow’s headlines might be). They provide no evidence for this fallacious, yet common assertion. In 2023, Morningstar chief ratings officer Jeff Ptak conducted research that looked at what would have happened if the holdings in large-cap equity mutual fund portfolios had been frozen in time, with no further changes over the past decade. He discovered that the fund portfolios that assumed no further adjustments tended to beat the returns of the actual portfolios, which reflected the fund managers’ ongoing trading activity. In other words, the funds would have performed better had the managers “given up” and stopped trading. Wise investors understand that it’s foolish to expect a return greater than what the market freely offers, making low-cost index investing their strategy of choice. Saying “I give up” in your quest to outperform the market isn’t a non-strategy or an expression of futility, it’s a rational response to investing reality.

Fortunately for investors, Bogle was not deterred by the ridicule thrown his way and today even critics of index funds admit that Bogle’s Folly permanently changed the fund industry. Today, according to the Investment Company Institute, about 20% of all money invested in domestic stocks is invested in Bogle’s Folly and its descendants, more than is held in active funds. But index funds’ trading activity is only 5-10% of daily trading volume. Price discovery is dominated by traders, hedge funds, arbitrageurs, and a wide variety of market actors whose objectives have nothing to do with your financial goals. These numerous active traders are so talented, capable, and hardworking that it is difficult for any of them to outsmart and outperform their peers. In other words, as the skill of the average fund manager increases, the harder it becomes to outperform. This is known as the “paradox of skill”. This is not a problem for index fund investors who never experience “manager risk”, the unnecessary risk that you will invest in a fund with a manager who underperforms the market.

No longer can actively managed funds just offer a diversified portfolio of securities -- they need to outperform index funds to validate their higher costs. But stock fund managers do not have the same investment time horizon as you do. They live and die by annual performance, and you have a multi-decade time horizon. They don’t consider your tax consequences when they do their frenzied trading. They know that if they can produce market beating performance long enough to attract media attention, they’ll attract thousands of new investors. Thus, they’re likely to own riskier stocks, hold concentrated, undiversified portfolios, trade frequently or engage in speculative trading strategies. Undiversified portfolios increase risk because a few bad picks can ruin fund performance. Most fund managers believe that they’re up to the “beat the market” challenge, but an honest observer must conclude that most have failed to do so. If their funds

outperform, they take all the credit, never acknowledging Lady Luck for her help. If they underperform, they'll insist that they were fundamentally right but just off in terms of timing or betrayed by Lady Luck. Then they go on espousing ideas and predictions hoping that no one asks to see a scorecard of their past performance.

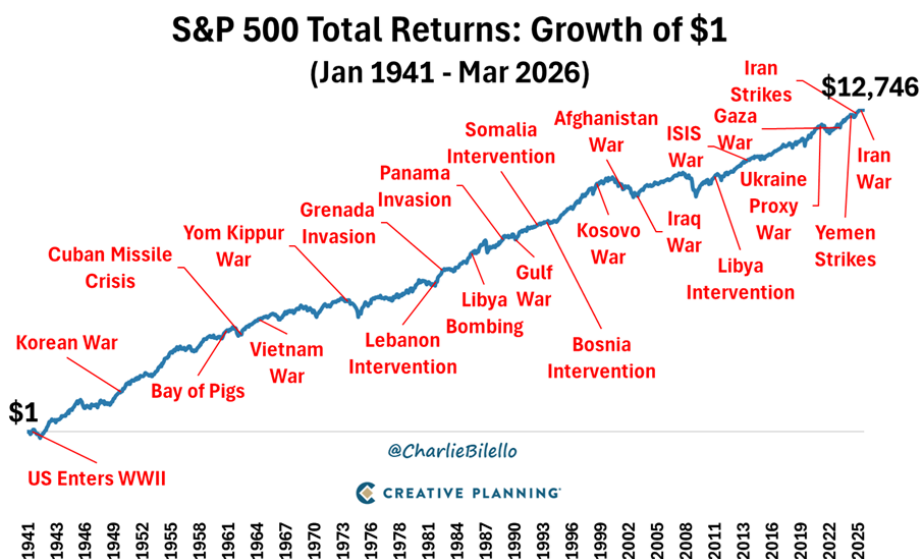
Fortunately for investors, S&P is keeping score. Their year-end 2025 *Standard & Poor's Indices Versus Active Fund (SPIVA) Scorecard* serves as the de facto scorekeeper of the active versus passive debate. For the ten years ending December 31, 2025, 86% of large-cap, 81% of mid-cap and 76% of small-cap actively managed domestic stock funds underperformed their S&P benchmark index. In addition, 90% of all active funds underperformed the S&P 1500 Total Stock Market Index over the past decade. What may be even more disheartening is that 35% (870) of the 2,456 domestic stock funds available to investors on January 1, 2016, no longer existed by year-end 2025. Performance results for international funds were just as bleak with 90% of international funds underperforming the S&P World Ex-US Index for the ten years ending 12/31/2025.

Low-cost index funds have driven down costs across the entire industry, benefiting even those who still choose active management. What began as a controversial idea is now a cornerstone of modern portfolio construction, helping investors focus on what matters most: diversification, cost control, and staying invested for the long term. Today investors can purchase shares of tax efficient, low-cost index funds in almost every global asset class of stocks and bonds. The ultimate stock index fund just might be the Vanguard Total World Stock Index Fund ETF (VT) which holds 9,900 individual stocks that make up 98% of the global stock market - for an annual management fee of 0.06% - \$6 for every \$10,000 invested. According to Morningstar - "The ETF has delivered impressive historical performance, outpacing the category average by nearly 2 percentage points annualized for the decade through December 2025."

So why, despite the evidence, do so many investors still buy actively managed funds? The primary reason is that most investors are unaware of the dismal performance of most active funds. Certainly, no commissioned broker who promotes active funds mentions the *SPIVA Scorecard*. Another reason is that we fall victim to the illusion of control. We think that someone who pays attention to markets and the economy every day should be able to outperform an index fund. Additionally, many investors seek investment ideas from sources of entertainment - social networks, blogs, fund advertisements, and the news media. These sources reinforce the misconception that achieving market beating performance is not only exciting but easily achievable. Investors discuss investments with friends, neighbors and coworkers and these interactions tend to promote active investing. Social media and YouTube videos are rife with unverified claims of investment successes. This bragging rarely includes any mention of investment losses, likely exaggerates stated gains, and provides no way to verify the claims.

Investors need comprehensive financial planning that focuses on preparation and protection, not predictions or performance. Planning that helps clients organize their lives and assets to achieve their goals with the least amount of risk exposure. Combined with passive index investing, it's not an exciting message. But for most investors it has proven to be more rewarding than embracing Wall Street's ongoing attempts to outperform the market. Wall Street's representatives never mention what John Bogle often said - that average market returns have been sufficient for most investors to meet their financial goals. Bogle's Folly or a fool's errand. It's your choice.

Charts of the Month



Volatility in the stock market isn't necessarily the result of bad news - it's the result of uncertainty, the fear that the news will be worse than expected. If you're waiting for the "perfect" time to invest - when the world is calm and headlines are quiet - you'll be waiting forever. From geopolitical issues to the direction of the economy and the stock market, neither bulls (the optimists) nor bears (the pessimists) have a monopoly on argument or data. Both sides present their opposing facts, making the picture permanently murky, even without war thrown into the mix. Forecasters find eager listeners who are trying to lessen the uncertainty in their world. But truth be told, most predictions are nothing more than sales pitches

