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Warren Buffet once famously said “Rather than listen to the siren songs from investment managers, investors, large and small, should instead read Jack Bogle’s The Little Book of Common Sense Investing”.

Now this was an odd comment, made by a famous stock picker, because he appeared to be advocating the strategy of “Indexing”, made famous by the founder and former chairman of Vanguard – Jack Bogle.

Bogle argued that investors would be better off and make more profit if they were to simply buy index funds. (The funds offered by managers where they simply buy all, or at least most of the shares in a particular index and just hold them for as long as they remain in the index).

At this point it is important to remember that, when he first made this statement, he was promoting the launch of the world’s first index funds in 1975!

Thing is though, he was and is right if you compare the performance of the majority of funds across the world over the last 30 years. But, importantly, sometimes, index funds also underperform.

Although the statement was, in many ways a blatant attempt to pull down mainstream funds and promote his new venture, we have to remember that he turned out to be, in the main, right. The very fund managers that were very dismissive of the idea of indexing, vindicated Bogle in the end, by their own poor performance.

But it is too simplistic to say index funds are good, managed funds are bad. There is much more to it and here, we take a deeper look at the most important elements of investing that influence the likely outcome in returns.

Investing should be a winner’s game

Successful investing is all about common sense, but it’s important to understand how the stock market actually works.

When you buy shares in a company you are taking a part of the ownership of that company. You then hope the company is well run and sells a sought-after product. If this is the case, it will go up in value. As a further bonus some companies will pay dividends as well, giving you a bonus share of the profits twice a year, in addition to its actual increase in value.

In its simplest form, the value of a company is based on:

Its Assets – its liabilities. Assets include cash in the bank coming from profits.

<u>A company will increase in value for two reasons:</u>

1: Investors, private, institutional and traders all think that the company has potential for greater profits in the future. This thought is not based on fact, it is based on the perception of market participants that the company will prosper, become more popular and sell more products over the coming months and years, therefore making more profit and increasing its value.

2: The company is actually making profits that increase each year and is growing stronger, turning in to a major player in its marketplace. Increasing profits = increased asset value, which = increased share value.

So, it should follow that if you buy a good company that will prosper or is prospering the shares will go up in value and your investment will make a profit.

Having considered this, you should then factor in the stock market. The "Market" can alter the fortunes of a company share price in so many ways. Some include:

- analysts posting regular articles that suggest they believe a company share price will go up or go down.
- Institutional investors who will sell holdings simply to take profits may make the price fall as the market wonders why the institution is selling.
- A share in the FT250 index may go up in value just because it is about to enter the FT100 because its market value is increasing (its assets are going up in value). This increase could come just because FT100 index funds will need to own it, so more buying will push its price up because some participants will wonder if others know more about its prospects than they do.

So, if you can buy shares in a good quality company, stay on the right side of market activity, it should be easy to make a profit. But it isn't.

Who is stealing your profit?

First of all, the market participants will always be looking to buy shares at a bargain price and sell them at a higher price. Therefore, it is extremely important that you or your investment manager choose the best time possible to invest your money.

Timing the market is difficult, if not impossible, but there are better times to invest than others. For example, if you take a careful look at the general stock markets in the UK, Europe and US, in November, December of 2019 and January/February 2020, you can see there is something wrong. Lots of market indicators at those times were screaming "there is something wrong". All investment managers could see that.

The right thing to do at that point was not be a buyer of equities generally and to take defensive positions to prepare for some downside in case it came.

That way, a responsible investment manager would have protected your portfolio and not let you watch it plummet in value and then languish back again at levels we last saw in 2012.

So, an investment manager that does not take an active interest in portfolio management is allowing the market to steal your profit, but who are the biggest culprits?

Fund managers, advisers and platforms

Throughout the recent pandemic and stock market gyrations, many have been left with portfolios that are down in value in 2020 by 10% or more. But the fund managers, advisers and platforms that look after your money have all continued to show strong or record profits. Why?

Simply, as I have outlined before:

In 2019, a fund manager charging 1.5% per annum annual management fee, managing a fund worth £1 billion, will have earned £15 million.

The same manager in 2020, with a fund down in value by 20% will still have earned £12 million. You the investor will have earned **NOTHING**. You will have **LOST 20%** of your money!

If you add to that equation a financial adviser taking an additional 0.75% or a platform taking a further 0.25%, the number of people growing richer using your capital just gets bigger, while you the investor, providing the capital, lose money and are told – "it's just how the markets work, you have to be a long term investor."

People employ the services of an adviser or fund manager because they expect them to do better than they could by themselves. Fund managers have all the tools to do this on your behalf, but the sad fact is, most of them have found it's just easier to take fees from you, blame the market for performance and tell you have to invest for the long term!

So, while your portfolio may make a profit throughout a year, if it is not well managed, costs fees and charges will reduce your net profit, sometimes significantly. This reduction in your bottom line will be a great indicator of the value for money offered by your investment manager.

When indexing does not deliver

Indexing has its problems, the main one being how open it is to periods of bad returns.

Because an indexed portfolio will replicate the performance of the market index it is tracking, it will replicate the bad times as well as the good ones.

Advocates of indexing will tell you that it's "time in the markets, not timing that matters" but they miss out the fact that your investment horizon may not be able to cope with long periods of downturns and having to wait for a recovery.

As an example, if you had invested in 2005 for your planned retirement in May 2020 you would have watched your portfolio rise for 3 years, then lose 50% of its value, then recover, then lose 30% of its value in March 2020 to rest at around 10 to 15% down in value at the time of writing.

So, what do you do now? Accept a lower retirement fund or delay your retirement until the markets recover, which will take how long exactly? In the meantime, your index or passive fund manager will continue to take fees and compound the negative effect on your fund value.

So, indexing only delivers, if you are lucky enough to not need access to your capital until it's a good time in the markets to do so.

Conclusions

When you decide to employ an investment manager to look after your money, you expect value for money and that you will be the greater beneficiary. You have to consider the charges against the return you actually receive and you have to consider how prepared you are to accept the markets to dictate access to your capital.

If you want value for money, complete flexibility and to know that your money is being managed to **YOUR** advantage then a focussed active investment manager is the best option for you.