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BOOK REVIEW

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THE INDEX REVOLUTION – WHY INVESTORS SHOULD JOIN IT NOW

Charles Ellis Wiley, 2016
(*Reviewed by Javier Estrada, IESE Business School, Barcelona, Spain*)

Readers of this journal are unlikely to need a long introduction to Charles Ellis, a legend in the finance industry and prolific writer of both articles and books. In fact, his last book, *The Index Revolution – Why Investors Should Join It*, is the most instructive and useful book I remember reading in a long time. Period.

First things first. Ellis' book does not aim to provide a comprehensive investment approach for investors. You will not find in the book detailed advice on asset allocation, or rebalancing, or risk assessment, to name but a few topics that every investor needs to be familiar with. The book zeroes in on the distinction between active and passive management, and the many advantages of the latter over the former from the investors' perspective.

The book is divided into two parts. The first part is just one long chapter that describes Ellis' journey in the finance industry. It provides an insider's account of some critical trends that resulted in the markets we have nowadays. I found the account of his long journey both entertaining and very instructive, particularly when Ellis addresses why when he entered the industry active managers as a group were able to achieve alpha but today they are not.

In a nutshell, Ellis' argument is that, back in the day, the market was largely populated by individual investors that were taken to the cleaners by a small group of professional investors; positive alpha for the pros, negative alpha for the rookies. The composition of the market, however, changed dramatically over time, becoming a market almost exclusively populated by professional investors that are bound to take returns from each other; so there goes the group's alpha. Worse, because these pros are all very smart, very well informed, and work very hard, winners and losers alternate over time; and there goes investors' ability to pick the winners and avoid the losers.

The second part has eleven chapters, ten of which are reasons for which investors should index, at the rate of one reason per chapter, with the last chapter being the opinion of experts advising investors to index. This last chapter includes quotes from the usual suspects, including Warren Buffett, Jack Bogle, David Swensen, and

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Burton Malkiel (and, perhaps surprisingly, Peter Lynch).

So, why should investors index? I will not go into all ten reasons, or into many details, but again the reasons are more or less the ones you would suspect. Investors should index because passive investing beats active investing; passive investing is far less costly and minimizing costs (fees and taxes) is critical; passive investing helps investors avoid many typical mistakes; and so forth. You get the picture. No surprises here, but still well documented and well worth reading.

I purposely left out of the previous book description the introductory chapter. I tried to think about one word to describe it but I failed, so here go a few words: Extraordinary, outstanding, amazing, remarkable, . . . you get the picture. In very few pages Ellis condenses so much wisdom that as soon as you finish the chapter you will feel you want to read it again. That is what I did, by the way. This introductory chapter does not only give a heads up about the issues to be discussed later in the book but also articulates them in a broad, concise, and easy-to-read way. Ellis previews the ten good reasons for which investors should index, and he also goes further by discussing nine silly (his word) reasons for not indexing. These reasons include the misguided feeling of being average, the supposed high exposure to overpriced stocks, the potential return to success of active managers, and more. In my view, this chapter alone is worth a lot more than the price of the whole book.

An interesting fact that comes across is that, while strongly recommending investors to go passive, Ellis shows great respect for active managers. He never puts them down for consistently underperforming their benchmarks, or by doing so by a substantial margin. Quite the opposite. In fact, his argument is that this is the inevitable result of these managers being so good. In his words: "The world's active managers are now so good and compete so vigorously to excel that almost none of them can expect – after fees and expenses – to beat the consensus of all the other experts on price discovery."

I conclude this review with a personal note. It happened too many times to count while reading Ellis' book: I thought I was listening to myself! Many of the arguments I have been repeating to audiences for the last several years were here, in Ellis' words, which sounded pretty much like mine. His thinking on these issues precedes mine, of course, but I formed mine over many years and after combining the wisdom of many giants in practice and academia. This led me to one conclusion: Ellis' thinking has deeply influenced many, many people, that in turn deeply influenced me.

In short, then, do not even think twice about it. Get the book, read it as soon as possible (it will not take long), and by all means implement Ellis' advice. Soon you will conclude that being average may be boring, but it still a lot better than being below average.

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