# A Problem with Jack Bogle? I Don’t Think So!

by Jay D. Franklin Tuesday, September 11, 2012

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For anyone who works in the investment advisory business, particularly on the passive side, John (Jack) Bogle is a name held in the highest esteem. A pioneer in the realm of indexing, the founder and longtime CEO of Vanguard brought low-cost investing to countless investors, liberating them from the shackles of Wall Street brokerage firms. In the years following his retirement from Vanguard, Bogle has remained a tireless advocate for the investing public. This is why a *Kiplinger’s* article written in May of 2006 by hedge fund manager Andrew Feinberg, “My Jack Bogle Problem”,[1] really irked me. Feinberg’s “problem” with Bogle is summarized in the byline and concluding sentence, “Some of us can beat the dickens out of the market if we try—and we should be encouraged rather than told we are on a fool’s errand.” Feinberg does not stop with simply claiming that some managers can beat the market. He ascribes to himself the power to identify these managers in advance by saying, “I find it very easy to select fund managers who will beat the market consistently.” As proof, Feinberg names ten active mutual fund managers[2] including his brother, Kenneth Feinberg, and interestingly enough, Jack Bogle’s son, John Bogle, Jr.

Now that we have six solid years of data on the managers named by Feinberg, we put his claim to the test. Specifically, we identified 33 mutual funds managed by these managers, and we calculated the alpha (the excess return above or below the Morningstar analyst-assigned benchmark) over the six- year period ending June 30th, 2012. The results are not encouraging. Of the 33 funds, only 10 (or 30%) had positive or zero alpha, and the average alpha among all these funds was about -1.3%, meaning that an investor would have been better off simply buying the index-equivalent of all these funds, as Bogle

would have recommended. Following a slightly different strategy, if an investor had allocated an equal dollar amount to each manager and captured each manager's average alpha, the investor's overall alpha would have been even worse at -2.1%. Only one manager of the ten had an average alpha above 1% (1.02% to be exact), and it was not statistically significant. Four of them had negative alphas of 2% or worse, or as Feinberg would say, "They stank up the room." So much for "beating the dickens" out of the market! As the chart below shows, none of the managers named by Feinberg conclusively demonstrated the presence of skill over the last six years (t-stat of 2 or greater). Although 2 of the 33 funds had a t-stat greater than two, both were from managers that had multiple funds and a negative average alpha among all their funds.

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Undoubtedly, the managers named by Feinberg had positive (although perhaps not statistically significant) alpha at the time he was looking at their records. Unfortunately, they experienced a reversion to the mean, a phenomenon identified by Bogle for which

Feinberg chastised him as dismissing all possibility of the presence of skill. Ironically, Feinberg himself made this startling observation[3] just a few months ago while explaining his own lackluster performance in 2011: "Mutual fund managers who beat the market for a time have a nasty habit of reverting to the mean." In my opinion, the reversion to the mean does not indicate a lack of talent or ability but rather should be seen as evidence of the high level of efficiency of the financial markets and the very large role that luck plays in the determination of returns. When selecting mutual funds, most investors are poorly served by any efforts to distinguish luck from skill. Even Eugene Fama, the father of modern finance, and Ken French admitted that they could not do it even despite their access to data that is unavailable to most investors.[4]

Feinberg's failure at manager-picking provides a cautionary tale to individual investors who do not possess anything close to Feinberg's financial knowledge and expertise. If they attempt to beat the market, they are indeed on a fool's errand, and if they search for a manager to beat the market for them, they are playing a mug's game. Long live Saint Jack!

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[1] http://www.kiplinger.com/magazine/archives/2006/05/feinberg.html

[2] The managers named in the article are: Kenneth Feinberg, David Dreman, Ronald Muhlenkamp, Robert Rodriguez, Bill Nygren, Bill Miller, John Calamos, Bill Danoff, Marty Whitman, and John Bogle, Jr. Wherever possible, Class A shares were evaluated, and no adjustment was made to the yearly alphas for the impact of front-end loads which range from zero to 5.75%.

[3] http://www.kiplinger.com/columns/promisedland/archives/hedge-fund-manager-recent-performance.html

[4] Fama, Eugene F. and French, Kenneth R., Luck Versus Skill in the Cross Section of Mutual Fund Returns (October, 2010). The Journal of Finance, Volume 65, Number 5, 1915-46.

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