Index Funds: A Review of Books by Hebner, Bogle & Malkiel

Murray Coleman
Published: Monday, February 12, 2024

In the modern landscape of highly cited investment literature, a select class of books have reached critical acclaim — both in terms of mainstream appeal and academic acceptance — for chronicling the rising popularity of index funds.

In particular, two stand out to IFA's investment committee:

- John Bogle's "The Little Book of Common Sense Investing."
- Burton Malkiel's "A Random Walk Down Wall Street."

Both are included in our online Book Library. (You can search by title and/or author by clicking here.) It's also worth noting that a host of industry scholars like to recommend for investors another work:

- Mark Hebner's "Index Funds: The 12-Setp Recovery Program for Active Investors." The 10th edition, which came out in 2023 and marked its 20th year in print, can be found here.

Of course, Hebner is the Chief Executive Officer at Index Fund Advisors. Even so, comparing his 321-page book to the best-selling works of Bogle and Malkiel isn't borne out by a desire to give homage to our founder. In fact,

earlier editions of "Index Funds" have been praised by a range of financial experts and academic luminaries.

After it first came out, for example, Bogle called Hebner's book "incredibly handsome and wise." Likewise, Malkiel agreed that "Hebner gives good advice presented in a very appealing manner." (See table below.)

Comparative Features	Bogle's "The Little Book of Common Sense Investing" (2017 edition)	Malkiel's "A Random Walk Down Wall Street (50th Anniversary Edition)	Hebner's "Index Funds: The 12-Step Recovery Program for Active Investors" (20th Anniversary Edition)
Full-color pages			✓
Convenient Size	✓		✓
Custom Paintings			✓
Tailor-Made Colored Charts			✓
Commissioned Portraits of Investing Luminaries			✓
Decades of Industry Experience	✓	✓	✓
"Don't Take My Word for It" (Practical References to Quotes, Perspectives of other Luminaries)	✓		✓
Investable Portfolio Data			✓
Independent Fiduciary and Wealth Advisor (as Opposed to Vanguard Exec./Director)			✓
Achieved Industry "Sainthood"	✓		
Documentary Film Version of Book			✓
Demonstration of probability theory (as Applied to Investing) using the Galton Board with Pascal's Triangle			✓

Nobel laureate Paul Samuelson has referred to "Index Funds" as "a valuable reference" for investors. Positive recommendations have also come from the likes of Harry Markowitz, who is often described as the "Father of Modern Portfolio Theory," and Dimensional Fund Advisors' Executive Chairman and Founder David Booth.

In our view, all three of these books — by Bogle, Malkiel and Hebner — are unique and significant in terms of making important contributions to the study of passive investing. As a result, we thought it might be worthwhile to review different ways each author tries to engage and educate investors.

Chronicling Advances in the Financial Sciences

All of these books are similar in that each author attempts to put scientific advances in the field into a realistic perspective for today's fund investor. However, they approach such a challenge in differing chronological order.

As background: Bogle rose to prominence after founding the Vanguard Group, which in 1975 created the First Index Investment Trust. It later became known as the Vanguard 500 Index Fund, the first index mutual fund for mass consumption.

Like dozens of others that followed over the next several decades, Bogle's retail offering was designed to primarily capture a single dimension of return — what's known as the market risk premium. That's measured by the excess return of a broad equity market portfolio relative to a risk-free rate.

The Importance of Risk in Portfolio Management

Understanding risk is a fundamental tenet of modern portfolio management. Indeed, the scientific groundwork for defining market risk is credited to a pair of key developments: The empirical work in the 1960s made possible by the establishment of the Center for Research in Security Prices (CRSP); and creation of the Compustat database for collection of stock-related

information. Such advances in research led to formulation of the Capital Asset Pricing Model (CAPM) as a theory of how expected returns should be determined.

In 1970, University of Chicago professor Eugene Fama published the Efficient Market Theory (EMT) in "Efficient Capital Markets: A Review of Theory and Empirical Work." His research found that equity markets consistently incorporate all available information into stock prices. Likewise, Fama concluded that trends in capital markets can't be identified in advance.

The renowned economist Malkiel became "a leading proponent of Fama's efficient market hypothesis," Hebner noted in his book. In the Princeton professor's 1973 classic, "A Random Walk Down Wall Street," Hebner wrote that Malkiel "challenged the financial services industry to provide the investing public a better way to invest."

In the 50th anniversary edition of his book, Malkiel observed, "The investment advice of the original edition was very simple: Investors would be far better off buying and holding a broad-based index fund than attempting to buy and sell individual securities or actively managed mutual funds."

At the same time, he pointed to a growing wave of academic research showing that "any information affecting the prospects for individual companies would be quickly reflected in the prices of their shares."

Taking Risk Modeling to the Next Level

Subsequently, Fama and Kenneth French —his frequent research partner — wrote a paper in 1992 that expanded on the Nobel Prize-winning research of Harry Markowtiz and William Sharpe that developed the Modern Portfolio Theory.

In their research piece, "The Cross-Section of Expected Stock Returns," Fama and French built a foundation for the so-called Fama/French Three-Factor Model.

This expanded model advanced CAPM's reliance on market risk, commonly measured by the beta coefficient, to add risk factors related to size (by market capitalization) and value (using a stock's book-to-market ratio). Such additions were critical, according to Hebner, since MPT research tied higher returns to a portfolio's increased exposure to risk.

The Rise of Multi-Factor Funds

The Fama/French Three-Factor Model heightened development of multi-factor funds. By contrast, the Vanguard 500 Index Fund and the initial wave of index funds brought to market by Bogle — and popularized by books such as "The Little Book of Common Sense Investing" and Burton Malkiel's "A Random Walk Down Wall Street" — were constructed as single-factor funds.

Fama went on to become a Nobel laureate in 2013. Working with French, he later expanded the three-factor model to include measures of profitability and investments in average stock returns.

Establishment of the Fama/French Five-Factor Model "explains between 71% and 94% of the cross-section variance of expected returns for diversified portfolios of five factors in equities," Hebner wrote in his book. (For more, read Step 8 "Riskese.")

A Modern-Day Perspective

While Bogle and Malkiel do raise issues related to the Fama/French Three-Factor model — and other key academic findings of significance to today's asset allocator — such literary works are more concerned with strategies

aimed at taking advantage of market beta, according to Michael Humbert, a Dimensional investment strategist.

"In the one sense," he said, "Mark explicitly calls out for investors the relationship between different types of risk and what that means in terms of expected returns." He added:

"It's certainly something other celebrated authors have done in the past. But Mark's 'Index Funds' book focuses on the practical means to use the evolution of modern market theories and models born from the likes of Fama and French."

Humbert credits earlier editions of "Index Funds" with helping him come to a realization that working as an active portfolio manager in the private-equity field wasn't the type of investing that he wanted to do for his career.

"It was like a Rosetta Stone moment for me," he said. "This book gave me clarity about the power of markets and the enormous difficulties that active stock pickers face. After reading his book, I realized how much ego it took to assume that you could beat the market by betting against prices, which reflect our collective wisdom."