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The Great American Rip-off

The financial industry loves to talk about long-term investing, but what is long-term? Well, according to the IRS, long-term is 12 months and 1 day. Anything less than that is considered short-term from a tax perspective and taxed at your ordinary income tax rate.

Think about when the calendar turns a new year. The investment community parades out all their strategists, analysts and economists with their predictions for the upcoming year. Which stocks, growth or value, which sectors, technology or healthcare, are going to outperform over the next 12 months. Where will the markets end the year, and what about interest rates. Rarely have I seen in my 37 years of experience predictions for the next five years, or decade, as to what they think will happen. Why is that? Maybe it's because, if you actually follow their predictions, you would realize just how wrong they are. LCM Capital Management likes to call them "annual guesses." The word "guesses" sounds unprofessional, but the reality is, that is what they are. Do yourself a favor and stop paying attention to them. They are no better at it than you or I.

The reason the financial industry does not believe in actual long-term investing is, in our opinion, because it tends not to generate enough fees and the resulting long-term performance is awful. When money is in motion, it generates fees and fees are good for business but not always good for the investor or client, especially long-term. Gene Hochachka, from Frontier Financial, recently published a report abstracting data from Morningstar looking at active mutual funds' turnover. Turnover is the percentage of a mutual fund's holdings traded annually. He looked at the data from 1991-2020, i.e., long-term. The average annual turnover for US Large Cap funds was 73%. To put this in perspective, 100% turnover means the portfolio is traded (turned over) completely in one year. So, 73% is approximately three quarters of the portfolio turned over every year. So why would they do this? You would think it is to improve performance. The manager is selling bad stocks and buying what they consider to be good stocks or selling ones that have gone up and buying the ones that have gone down. Yet Mr. Hochachka found that, "*any other relationships between turnover and returns are similarly not borne out consistently across the various categories over time. Over this* [30-year] *period, high turnover does not hurt fund performance. Nor, however, does it enhance performance*."[1] So why do it? To quote Rod Tidwell from Jerry McGuire, "show me the money" because it is all about the money, i.e. the fees. Our industry thrives on them and needs them to support their private islands.

Someone once said, the only way to make a lot of money on Wall Street is to start a mutual fund. Ever look at the Forbes 500 list of the wealthiest people in the world – you might be surprised to see how many hedge fund managers, money managers, private equity and venture capitalists are on the list. Why are their clients not on the list?

S&P Dow Jones Indices (SPIVA) recently came out with their 2024 performance report, or should we say underperformance report, showing how active mutual fund managers did versus their stated benchmark. Like the Forbes 500 list, the facts might surprise you.[2]

The reason our industry talks the long-term investing game, but does not walk the walk, is because, according to the SPIVA report, approximately 8% of all large-cap funds outperformed the S&P 500 over the 20-year period ending 2024. Not exactly something to be bragging about, wouldn't you agree?

So if trading within your mutual fund does not help performance, what does? Stock picking, market timing, risk adjusted returns?

You probably have heard the term "a stock pickers market" in your investing career or if you are just starting, you will at some point. It is especially true in volatile markets like we had over the last few years. According to the SPIVA report, only 35% of all active large-cap U.S. equity managers outperformed the S&P 500 in 2024. We should point out that's actually less than the previous year which was 40%, so the "stock pickers" are getting worse. But who invests for 1 year? What's also interesting to note is on a risk-adjusted basis, less than 5% of all large-cap funds outperformed the S&P 500 over the 20-year period ending 2024- so much for that sales point. Active underperformance is not a coincidence according to the report and underperformance rates typically rise as time horizons lengthen, a.k.a. long-term investing.

This dismal performance does not even take into account all fees and costs. Yes, while the performance figures from the report are adjusted to include fees, they do not reflect the mutual fund loads, if any, or the fees you are paying your advisor or broker? What about the impact of the taxes you paid if your mutual funds are not held in an IRA type of account? (Please see Vanguard Target Date Lawsuit 2021.[3]) If you add these fee components into the equation, LCM Capital Management would ask, now what's the underperformance of the active mutual funds against their benchmark, 99%? We can't say for sure, but in our opinion, clearly the odds are stacked against you.

So why is this the case? Academics have known for decades that active stock pickers underperform but that will not fill up the yacht or private jet's fuel tank. The reality is there are many reasons, which have been discussed within our industry for years, some of which are; too much trading (see portfolio turnover above), trying to time the market moves (market timing is impossible to do consistently over time), and the all-in mutual fund fees and related costs are too high. Jack Bogle, the deceased founder of Vanguard, once said, "Before costs, beating the market is a zero-sum game. After costs, it is a loser's game. Fund performance comes and goes. Costs go on forever."[4]

So what are investors to do? After reading this - LCM Capital Management thinks it is simple, do not ever buy an active mutual fund again, reduce your fees, do not try and trade (time) the market, and control your taxes. So how does one invest like this? That is simple too, call LCM Capital Management at 312-705-3013 or email us (lcm@lcmcapital.com) to set up a free portfolio review and analysis. Hopefully this article explains why in over 23 years of our firm's existence, we never have bought for our clients an equity or bond mutual fund.

We consider mutual funds to be the Great American Rip-off.

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[1] Hochachka, Gene; *US Mutual Fund Turnover and Returns, 1991-2020;* Frontier Financial Inc.; Dec. 10, 2021
[2] Ganti, Anu, Edwards, Tim, Didio, Nick, Di Gioia, Davide and Chapman. Florence; "SPIVA U.S. Scorecard Yea-End 2024;" S&P Dow Jones Indices; March 6, 2024
[3] Annie Massa and Claire Ballentine (with assistance by William Spada); *'I Put Faith in These Guys': Vanguard Clients Decry Tax Debacle;* Bloomberg.com; May 2, 2022
[4] Bogle, John C., *46 Best John C. Bogle Quotes*; Gracious Quotes; Jan. 23, 2021.