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Viewpoint

The Evolution and Success of Index Strategies in ETFs

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Abstract

Taking issue with John Bogle's description of how investors use index strategies that are based on exchange-traded funds (ETFs), I explain why and how ETFs are a significant innovation propelling further growth in indexing with respect to both tactical and strategic investment strategies for institutional and retail investors.

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I would like to acknowledge the pioneering contribution of John Bogle in translating the call to action by Dr. Paul Samuelson into the 1975 launch of the Vanguard 500 index

fund. This fund represents one of the most significant financial innovations of the last 50 years by providing individual investors access to the favorable relative performance of index investing with low fees. I would also like to thank Executive Editor Stephen J. Brown for suggestions on the direction and content of this Viewpoint.

Notes

[1] John C. Bogle, “The Index Mutual Fund: 40 Years of Growth, Change, and Challenge,” Financial Analysts Journal, vol. 72, no. 1 (January/February 2016): 9–13.

[2] Bogle, “The Index Mutual Fund,” 9.

[3] Bogle, “The Index Mutual Fund,” 11, 12.

[4] Bogle, “The Index Mutual Fund,” 13.

[5] Bogle, “The Index Mutual Fund,” 12.

[6] For more information on ETF features and strategies, see Joanne M. Hill, Dave Nadig, and Matt Hougan, A Comprehensive Guide to Exchange-Traded Funds (ETFs) (Charlottesville, VA: CFA Institute Research Foundation, 2015).

[7] William F. Sharpe, “Capital Asset Prices: A Theory of Market Equilibrium under Conditions of Risk,” Journal of Finance, vol. 19, no. 3 (September 1964): 425–442.

[8] Bogle, “The Index Mutual Fund,” 10.

[9] Eric Balchunas, “The ETF Files: How the U.S. Government Inadvertently Launched a $3 Trillion Industry,” Bloomberg Markets (7 March 2016).

[10] US SEC, The October 1987 Market Break, SEC Division of Market Regulation (February 1988): 18.

[11] Most and Bloom took their idea to Bogle with the intention of using the S&P 500 Vanguard mutual fund as the basis for a basket-trading vehicle but were rebuffed; they then turned to custodian and index manager State Street. For Bogle’s account, see Bogle, “The Index Mutual Fund,” Note 4.

[12] Email from James Ross to Joanne Hill (10 February 2016).

[13] Greenwich Associates, “Institutional Investment in ETFs: Versatility Fuels Growth” (Q1 2016).

[14] Greenwich Associates, “Institutional Investment in ETFs,” 15.

[15] Bogle, “The Index Mutual Fund,” 13.

[16] Joanne M. Hill, “Alpha as a Net Zero-Sum Game,” Journal of Portfolio Management, vol. 32, no. 4 (Summer 2006): 24–32.



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