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A RANDOM WALK DOWN *Wall Street*

The Time-Tested Strategy *for* Successful Investing

BURTON G. MALKIEL

COMPLETELY REVISED *and* UPDATED

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FOR NANCY AND PIPER

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Part Four

A PRACTICAL GUIDE FOR RANDOM WALKERS AND OTHER INVESTORS

PREFACE

IT HAS NOW been over forty years since the first edition of *A Random Walk Down Wall Street*. The message of the original edition was a very simple one: Investors would be far better off buying and holding an index fund than attempting to buy and sell individual securities or actively managed mutual funds. I boldly stated that buying and holding all the stocks in a broad stock-market average was likely to outperform professionally managed funds whose high expense charges and large trading costs detract substantially from investment returns.

Now, over forty years later, I believe even more strongly in that original thesis, and there's more than a six-figure gain to prove it. I can make the case with great simplicity. An investor with $10,000 at the start of 1969 who invested in a Standard & Poor's 500-Stock Index Fund would have had a portfolio worth $736,196 by June 2014, assuming that all dividends were reinvested. A second investor who instead purchased shares in the average actively managed fund would have seen his investment grow to $501,470. The difference is dramatic. Through June 1, 2014, the index investor was ahead by $234,726, an amount almost 50 percent greater than the final stake of the average investor in a managed fund.

Why, then, an eleventh edition of this book? If the basic message hasn't changed, what has? The answer is that there have been enormous changes in the financial instruments available to the public. A book meant to provide a comprehensive investment guide for individual investors needs to be updated to cover the full range of investment products available. In addition, investors can benefit from a critical analysis of the wealth of new information provided by academic researchers and market professionals—made comprehensible in prose accessible to everyone with an interest in investing. There have been so many bewildering claims about the stock market that it's important to have a book that sets the record straight.

Over the past forty years, we have become accustomed to accepting the rapid pace of technological change in our physical environment. Innovations such as e-mail, the Internet, smartphones, iPads, Kindles, videoconferencing, social networks, and new medical advances ranging from organ transplants and laser surgery to nonsurgical methods of treating kidney stones and unclogging arteries have materially affected the way we live. Financial innovation over the same have materially affected the way we live. Financial innovation over the same period has been equally rapid. In 1973, when the first edition of this book appeared, we did not have money-market funds, ATMs, index mutual funds, ETFs, tax-exempt funds, emerging-market funds, target-date funds, floating-rate notes, volatility derivatives, inflation protection securities, equity REITs, asset-backed securities, "smart beta" strategies, Roth IRAs, 529 college savings plans, zero-coupon bonds, financial and commodity futures and options, and new trading techniques such as "portfolio insurance" and "high-frequency trading," to mention just a few of the changes that have occurred in the financial environment. Much of the new material in this book has been included to explain these financial innovations and to show how you as a consumer can benefit from them.

This eleventh edition also provides a clear and easily accessible description of the academic advances in investment theory and practice. Chapter 10 describes the exciting new field of behavioral finance and underscores the important lessons investors should learn from the insights of the behavioralists. Chapter 11 asks whether "smart beta" investment strategies are really smart. In addition, a new section has been added to present practical investment strategies for investors who have retired or are about to retire. So much new material has been added over the years that readers who may have read an earlier edition of this book in college or business school will find this new edition rewarding reading.

This edition takes a hard look at the basic thesis of earlier editions of *Random Walk*—that the market prices stocks so efficiently that a blindfolded chimpanzee throwing darts at the stock listings can select a portfolio that performs as well as those managed by the experts. Through the past forty years, that thesis has held up remarkably well. More than two-thirds of professional portfolio managers have been outperformed by unmanaged broad-based index funds. Nevertheless, there are still both academics and practitioners who doubt the validity of the theory. And the stock-market crash of October 1987, the Internet bubble, and the financial crisis of 2008–09 raised further questions concerning the vaunted efficiency of the market. This edition explains the recent controversy and reexamines the claim that it's possible to "beat the market." I conclude that reports of the death of the efficient-market hypothesis are vastly exaggerated. I will, however, review the evidence on a number of techniques of stock selection that are believed to tilt the odds of success in favor of the individual investor.

The book remains fundamentally a readable investment guide for individual investors. As I have counseled individuals and families about financial strategy, it has become increasingly clear to me that one's capacity for risk-bearing depends importantly upon one's age and ability to earn income from noninvestment sources. It is also the case that the risk involved in many investments decreases with the length of time the investment can be held. For these reasons, optimal investment strategies must be age-related. Chapter 14, entitled "A Life-Cycle Guide to Investing," should prove very helpful to people of all ages. This chapter alone is worth the cost of a high-priced appointment with a personal financial adviser.

My debts of gratitude to those mentioned in earlier editions continue. In addition, I must mention the names of a number of people who were particularly helpful in making special contributions to the eleventh edition. I am especially indebted to Michael Nolan of the Bogle Research Institute, to my Princeton colleagues Harrison Hong and Yacine Aït-Sahalia, and to my research assistants, David Hou, Derek Jun, Michael Lachanski, and Paul Noh. I am also grateful to John Devereaux, Francis Kinniry, Ravi Tolani, and Sarah Hammer of the Vanguard Group for important assistance in providing data.

Karen Neukirchen made an extraordinary contribution to this edition. She was somehow able to decipher my inpenetrable scribbles and turn them into readable text. She also provided research assistance and was responsible for many of the graphic presentations in the book. Sharon Hill added invaluable assistance in the final preparation of the manuscript. My association with W. W. Norton remains a superb collaboration, and I thank Drake McFeely, Otto Sonntag, and Jeff Shreve for their indispensable assistance in bringing this edition to publication. Patricia Taylor continued her association with the project and made extremely valuable editorial contributions to the eleventh edition.

My wife, Nancy Weiss Malkiel, has made by far the most important contributions to the successful completion of the past seven editions. In addition to providing the most loving encouragement and support, she read carefully through various drafts of the manuscript and made innumerable suggestions that clarified and vastly improved the writing. She continues to be able to find errors that have eluded me and a variety of proofreaders and editors. Most important, she has brought incredible joy to my life. No one more deserved the dedication of a book than she and her second-best friend, Piper.

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Princeton University
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Part One

STOCKS AND THEIR VALUE