

physicianspractice.com

---

# Is There a Smarter Way for Docs to Buy Index Funds?

---

by Steven Podnos, Md, Cfp • April 18, 2016 • 1 min read • [original](#)

Whether self-investing, or using an advisor, the physician should have a basic understanding of what his money is being used to invest in.

In a prior column, I discussed the introduction and high level of success with the introduction of passive index mutual funds. We reviewed the fact that buying an index outperforms active stock pickers (using that index) the vast majority of the time.

However, about 20 years ago, academics in finance began to question why index funds should all be based on market capitalization (the size of the company in the index). There was the belief that this type of index would over concentrate investments in those companies "doing the best" and being the largest, and at the same time relatively ignore smaller and value type companies.

This led to many trying other ways to organize stocks in various indexes. Some of the early trials used company size, profitability, momentum (picking stocks that moved faster upwards than the general market), and low volatility. The researchers were surprised to find that every one of these "factors" seemed to add performance over long periods of time against the traditional market cap index funds.

This information slowly percolated into the investment world, which was still concentrating on actively managed funds. But with the rise of fee only planners and

fee-based accounts, performance began to trump commissions.

Over the last five years, we have seen a virtual explosion of investments using these and many other factors. We are seeing funds (and exchange traded funds) that use combinations of the factors as well.

There is reason to believe that some of this type investing (if at reasonable cost) may reduce volatility and add to long term returns when compared to traditional market cap only index investing.

As one specific example, take a typical S&P 500 index fund. As we noted, it is heavily weighted towards the largest and most expensive companies in the index. The biggest five companies (think Apple, Exxon) make up about 14 percent of the index and its movements. So, \$500 invested in the fund buys \$70 of the largest five stocks with the rest spread out. If instead you buy an “equal weight SP 500 fund,” you put one dollar into each of the 500 component stocks—ending up with proportionally much more money in smaller companies and those with value type characteristics.

It is hard to go much further without getting into intricate details, but you may indeed notice these “smart beta” or “smart factor” type investments in your portfolios. Know that there is some deep science and some history in using these vehicles and ask your investment advisor to tell you more about them. What we don’t know yet is whether using a combination of these factors or just certain ones give the best outcome.

---

**Original URL:**

<http://www.physicianspractice.com/there-smarter-way-docs-buy-index-funds>

