

EPISODE 567

Stock Pickers Keep Losing, Who's Winning?

Money for the Rest of Us • David Stein

moneyfortherestofus.com

Find the Easy Game

Mauboussin, The Investing Mind

“I wouldn’t spend my time getting better at poker, I’d spend my time finding easy games.”

– Uncle Wally

First question: “Who else will be there?”

Weak players

→ Pull up a chair

Sharks

→ Decline the invite

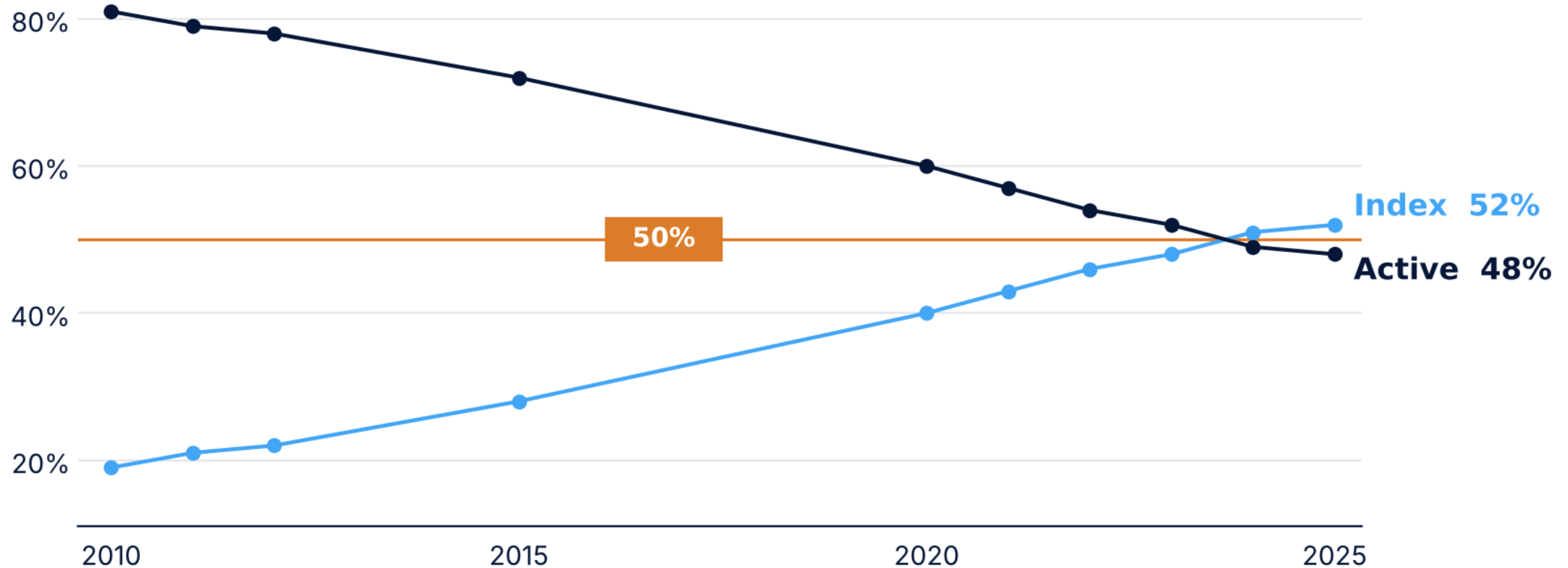
Paradox of skill: more skill leads to more luck.

When everyone is skilled, luck decides more of the outcome.

Source: Mauboussin, The Investing Mind (2026).

Index Funds Are the Majority

% of U.S. long-term fund assets, 2010-2025

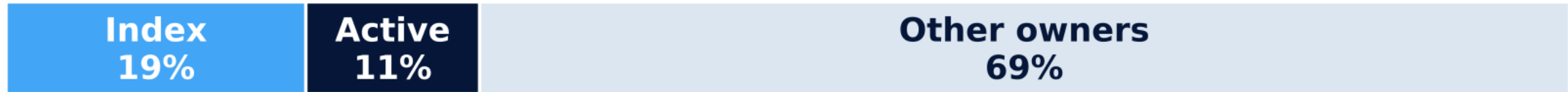


Source: Investment Company Institute. Mutual funds + ETFs, ex. money market.

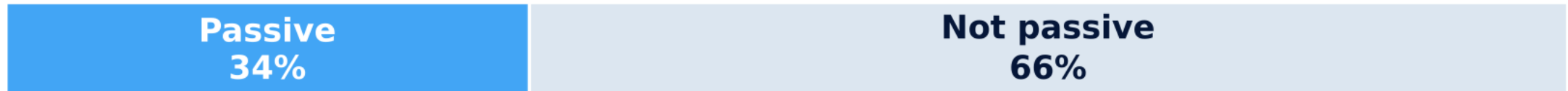
Passive Is Not the Majority

Who owns the U.S. stock market

Fund ownership (ICI, 2025)



All passive investors (Chinco & Sammon, 2021)



Other owners include:

- Households and insiders
- Foreign investors
- Pensions and 401(k) trusts
- Insurance companies
- Hedge funds and endowments
- Global and balanced funds

Sources: ICI 2026 Fact Book; Chinco & Sammon (2024).

The Arithmetic of Active Management

William Sharpe (1991)



- 1 Before costs, active earns the market
- 2 Gross alpha sums to zero
- 3 After costs, active must trail

Source: Sharpe, *Financial Analysts Journal* (1991).

Why Sharpe's Arithmetic Can Break

Pedersen: even passive investors must trade

The market changes. Passive must trade for:

New shares

Buybacks

Index additions

Index deletions

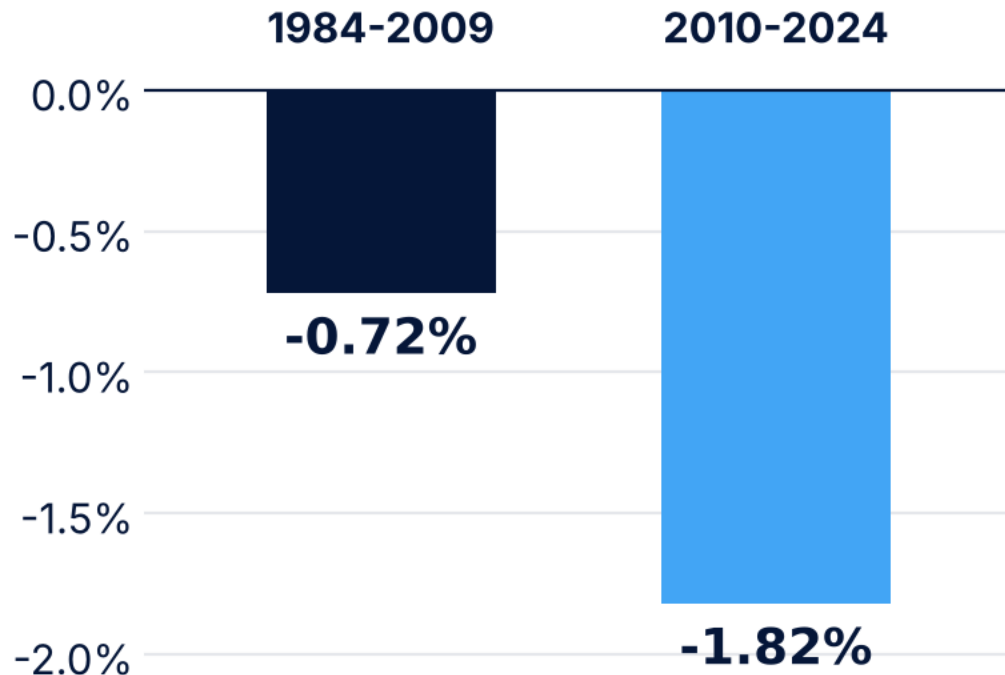
They may trade at worse prices, so:

- Active managers can add value in aggregate
- Issuance is how markets raise capital

Source: Pedersen, Financial Analysts Journal (2018).

Fewer Rivals, Worse Results

Avg. fund alpha per year, after fees



Theory predicted

Fewer rivals and weak funds exiting should improve results.

What happened

Alpha got worse, even as fees fell and funds kept making big bets.

Source: Unterberg, "Passive Flows, Active Woes" (2026).

Passive Flows, Active Woes

Hannah Unterberg (2026)

How do index flows hit active returns?

FINDING

Best ideas sold, avoided stocks bought

ACTIVE FUNDS

Lose returns to flow pressure

WHO WINS

Index investors, lifted by their own inflows

Source: Unterberg (2026).

Where \$100 of Flows Lands

When money moves from active to index funds

**Active fund sells \$100
of what it owns**

**Index fund buys \$100
at index weights**

Megacap the manager avoids

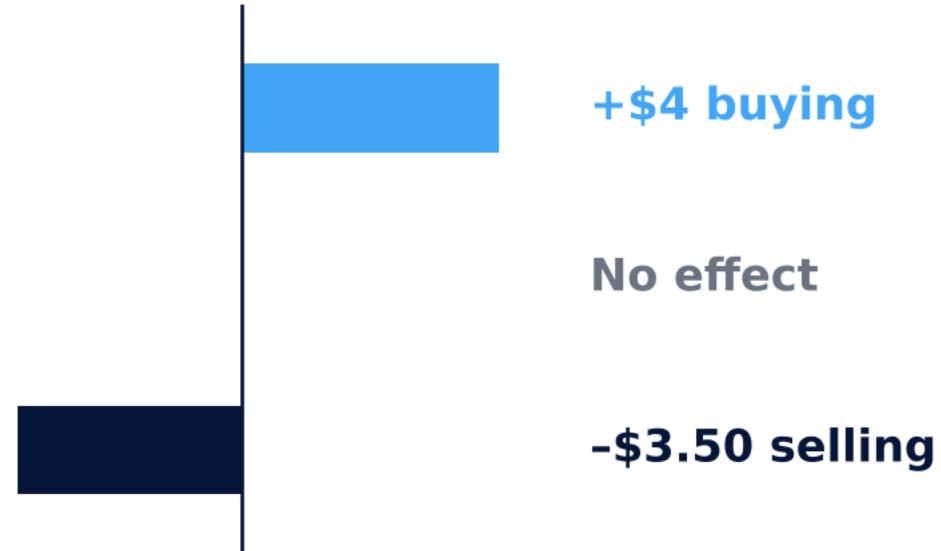
Active 3% vs. Index 7%

Stock held at index weight

Active 2% vs. Index 2%

Manager's favorite mid-cap

Active 4% vs. Index 0.5%



Best ideas get sold. Avoided stocks get bought.

Hypothetical weights. Concept: Unterberg (2026).

Do Managers Sell Their Best Ideas?

The FT Alphaville critique

“It doesn’t seem obvious that active managers will necessarily be paring back their more favoured overweights when they suffer outflows.”

Robin Wigglesworth, FT Alphaville

The evidence:

- 1 Selling a slice of everything still hits overweights
- 2 Outflows force near one-for-one selling
- 3 Active Share barely moved, so the bets were there
- 4 Most active funds lag when 401(k) cash arrives

Sources: Unterberg (2026); Lou (2012).

Who Sells to Index Funds?

Of every 100 shares index funds add

The company
~70

Short
sellers ~30

Companies create shares via

- Employee stock pay
- Convertibles, warrants
- Stock offerings

Not selling to them

- Active funds
- Pension funds
- Insurers

Source: Sammon & Shim (RFS, forthcoming).

How Does It End?

Aaron Brown, former AQR head of market research

- No leverage, so no margin call
- A slow leak as boomers start withdrawing
- Outperformance pulls money back to active

But two things have to happen:



Money moves to active funds, slowly

Withdrawals alone sell every stock at index weights



Someone takes the other side

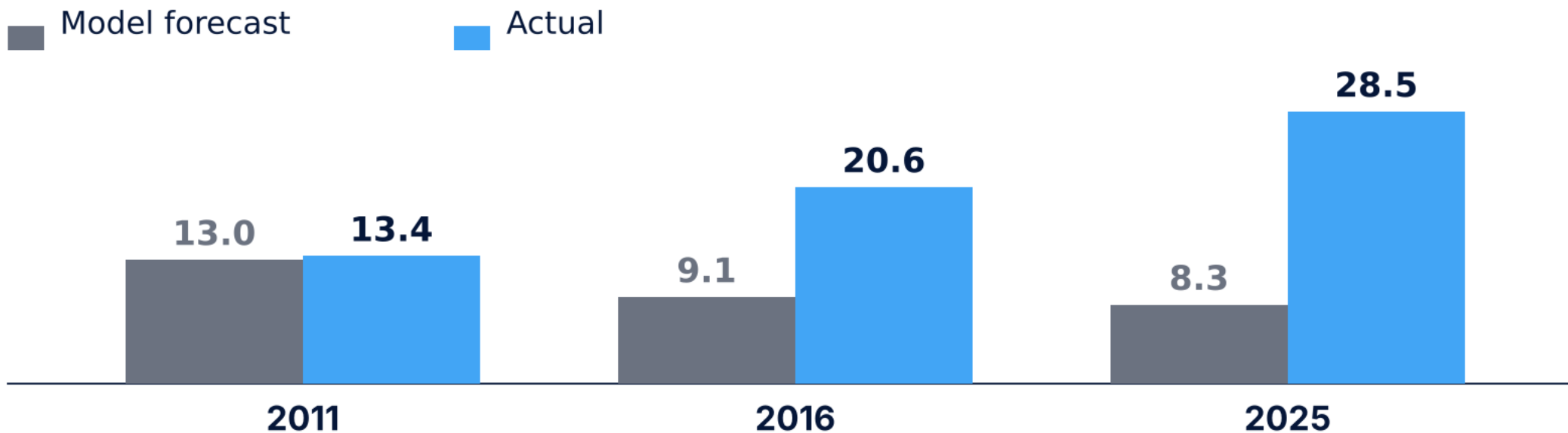
Buybacks, active managers, or individuals must buy

Sources: Brown, Bloomberg (2026); Sammon & Shim.

The Boomer Forecast That Missed

San Francisco Fed, 2011 and 2018

S&P 500 P/E: model forecast vs. actual



2018: the link “has disappeared”

Timing of any boomer effect “highly uncertain”

Sources: Liu & Spiegel, FRBSF (2011, 2018); Shiller data.

Show Notes

Lasse Heje Pedersen, “Sharpening the Arithmetic of Active Management”

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2849071

Aaron Brown, “We Now Know Who Really Benefited from the Index Revolution,” Bloomberg Opinion

<https://www.bloomberg.com/opinion/articles/2026-08-21/index-funds-channel-investor-gains-to-companies-and-insiders>

Michael J. Mauboussin, The Investing Mind (Harriman House, 2026)

<https://theinvestingmind.com/>

Marco Sammon and John Shim, “Who Clears the Market When Passive Investors Trade?”

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4777585

Hannah Unterberg, “Passive Flows, Active Woes: Passive Investing and the Decline of Active Mutual Fund Alpha”

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=6902444

Zheng Liu and Mark M. Spiegel, “Boomer Retirement: Headwinds for U.S. Equity Markets?” FRBSF (2011)

<https://www.frbsf.org/research-and-insights/publications/economic-letter/boomer-retirement-us-equity-markets/>

Liu and Spiegel, “Is Boomer Retirement Still Weighing Down U.S. Equity Markets?” FRBSF (2018)

<https://www.frbsf.org/research-and-insights/blog/uncategorized/2018/03/05/boomer-retirement-weighing-down-us-equity-markets/>

Related Episodes

546: Do Retiring Baby Boomers Actually Move Markets? And How Much Do Demographics Really Matter

<https://moneyfortherestofus.com/546-demographics/>

504: Indexing Bubble and Asset Class Returns Still Revert to the Mean

<https://moneyfortherestofus.com/504-mean-reve/>

To Learn More
moneyfortherestofus.com
