

funds (divvied up by the size and priciness of their stocks), indexers beat at least 50% of active managers last year. For the 10 years ended in December, the indexers won in every category, beating an average of 74% of active funds. So the bottom line is that indexing still works, but not all indexes are created equal. In periods when smaller stocks zoom ahead, an SUV-style index like the S&P 500 will seem sluggish.

But there's a simple way around that: For your core holding, choose a stock market index fund tied to a broader benchmark like the Wilshire 5000. You can buy one from Fidelity, Vanguard or others. You will get a full fleet of large, mid-size and small stocks. No matter what does well, you'll own it. If you want more small and mid-size stocks, which can grow faster but are riskier than big stocks, put 15% of your equity allocation in a small-cap index, 25% in a midcap index and 60% in an S&P 500 index, though I prefer the easy, one-fund strategy.

Finally, recall that other fable, the one about the tortoise and the hare. Indexing may plod in the short run, but it will prevail in the end. Nobel laureate William Sharpe outlined this logic in a classic 1991 article (www.stanford.edu/~wfsarpe). Since the whole can't be greater than the sum of its parts, the average fund can't beat the market average. Any other result, Sharpe argued, can be caused only by "improper measurement."

This brings us back to Christopher Carosa, whose article likened index funds to the emperor who had no clothes. Carosa runs a stock fund called Bullfinch Unrestricted. Over the past five years, Bullfinch beat the S&P 500 by a royal sum. It bested similar funds, according to fund researcher Lipper, by a much narrower margin. And Morningstar says Bullfinch lagged its benchmark badly.

The moral of our story: To turn the frog of active management into a prince, it pays not to look very closely. **\$**

ADDITIONAL REPORTING BY JANET PASKIN

the answer guy

BY GEORGE MANNES



Shares in Northwest Airlines, now less than \$1, are looking cheap. **Could that stock have any value after Northwest emerges from bankruptcy?** —Todd Olness, Shakopee, Minn.

Answer Purchasing a bankrupt company's stock so you can profit when the business exits Chapter 11 is like playing the lottery. In either case you could snag a treasure for mere pennies, but your odds of success are ridiculously low. When a company emerges from bankruptcy, its shares are canceled and worthless. The reorganized company's stock belongs to bond-

holders and other creditors. Original shareholders get no stake in the reorganized company unless it can first pay off its debts. And, of course, if a company could pay off its debts, it wouldn't have filed for bankruptcy protection in the first place.

Original shareholders have emerged with a profit only a handful of times over the past 20 years, says bankruptcy newsletter

publisher Peter A. Chapman. The chances that an airline would be next are slim, given the industry's talent for burning shareholders. Northwest is losing money, and its liabilities outweigh its assets by more than \$4 billion. "Once a company is in bankruptcy and liabilities exceed assets," says Chapman, "if you're a shareholder, you're just fantasizing."



My grandmother gave me stock she bought years ago. **Can I sell these appreciated shares, now worth \$30,000, to help fund college for my kids (ages three and seven), and avoid paying capital-gains tax?**

—Mark Nosek, Roscoe, Ill.

Answer Probably not.

If your kids were 14 or older, you could give them the stock and they would most likely pay a 5% tax on any sale, rather than the 15% you would pay. But since they're younger than that, they'd be subject to the "kiddie tax" on unearned income and would end up essentially paying your rate.

Of course, they could capture the lower rate by waiting until age 14 to sell the shares. But delaying a sale for seven years to save on taxes really isn't a great idea, says Gary S. Williams, a financial planner in Columbia, Md. You don't want a big chunk of college savings tied up in a few stocks that could collapse,

so Williams advises that you sell, take the tax hit and then reinvest the money in one of the diversified funds available in the Illinois 529 college savings plan. Couples can even claim a state income tax deduction for up to \$20,000 in contributions, which could lessen the sting of your capital-gains pain.

Looking for some answers? MONEY wants your questions about investing. E-mail answer_guy@money.com.