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John Bogle on Investing: The First 50 Years by John C. Bogle

John Bogle on Investing

The First 50 Years

John C. Bogle

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GREAT IDEAS

Dedicated to all of the human beings
who have meant so much to me
during the first 50 years of my career:
those loyal and steadfast members of the Vanguard crew
who together have made me look so much better than I am;
those millions of intelligent investors
who own the Vanguard Funds and The Vanguard Group,
and who have been willing to pay me a salary
for all the fun I've had and all the challenges I've faced;
and especially those "Bogleheads" of the Internet,
that dedicated and loyal cadre of Vanguard Diehards
who give me strength to carry on my mission.

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2015 INTRODUCTION TO THE CLASSIC EDITION OF *JOHN BOGLE ON INVESTING: THE FIRST 50 YEARS*

Has The First 50 Years *Become a Classic?*

Let me tell you the story, and then you can decide. First, you should know that *John Bogle on Investing: The First 50 Years* had an unusual conception. Following the 1993 publication of my first book, *Bogle on Mutual Funds: New Perspectives for the Intelligent Investor*, by Irwin Professional Publishing, that firm was acquired by the McGraw-Hill Companies, Inc.

When I decided to write a second book, I chose John Wiley & Sons as my publisher. That book, published in 1999, was titled *Common Sense on Mutual Funds: New Imperatives for the Intelligent Investor*, playing on the Benjamin-Graham-like theme of its predecessor. (In 2009, a fully updated 10th Anniversary Edition was published.)

McGraw-Hill's senior editor, Jeffrey A. Krames, was eager to earn back his firm's role as my publisher. In late 2000, Jeff came to me with a proposal to publish an anthology of some of the essays and speeches that I had written earlier in my mutual fund career, going all the way back, as it turned out, to 1971. The capstone of the proposed book would be the publication of my 1951 senior thesis at Princeton University, "The Economic Role of the Investment Company," a study of the past, present, and future of the then-infant U.S. mutual fund industry. Hence, *John Bogle on Investing: The First 50 Years*.

It was no easy task to select the essays for inclusion in the anthology. Some were focused on investment advice, some on history; some were irreverent; and there were some that I hoped would offer inspiration to readers. (There were more than 100 essays from which to choose.) But with the help of Jeff Krames, I selected 25 essays that seemed to be out-of-the-ordinary. I then organized the papers into five distinct parts:

I. INVESTMENT STRATEGIES FOR THE INTELLIGENT INVESTOR, focused on the returns, risks, and costs borne by participants in our stock and bond markets; and the selection of equity and bond mutual funds, with a focus on index funds.

II. TAKING ON THE MUTUAL FUND INDUSTRY, describing past trends and future prospects for the now-giant fund industry, including a discussion of the proper role of mutual funds in the corporate governance of the companies in which they invest. (Hint: I didn't much like what I saw happening in the industry.)

III. ECONOMICS AND IDEALISM, including "The Vanguard Experiment," reflections on the challenges I faced in 1974 when I created a mutual fund complex with a unique, heretofore untested, truly *mutual* structure; the building of the new firm; and the investment strategies and human values that would constitute its heart and soul.

IV. PERSONAL PERSPECTIVES, including five essays and speeches for general audiences, including my 1999 lecture at Princeton, "Changing the Mutual Fund Industry: The Hedgehog and the Fox." I also included my reflections on the heart transplant I received in 1999; and the three idealistic addresses that I delivered at academic commencements.

V. THE PRINCETON THESIS, the full text of my 1951 senior thesis, describing the role that I envisioned for a better mutual fund industry.

I did not ask others to comment my manuscript prior to publication (i.e., no "blurbs"). Rather, I decided to ask two of the most respected men that I knew—one in finance, one in law—to introduce the book to readers. One of these titans was Paul A. Volcker, long-time chairman of the Federal Reserve Board, international statesman, and (more recently) adviser to President Barack Obama. The other titan was William T. Allen, director of the Center for Law and Business, New York University, eminent jurist, then recently-retired Chancellor of the

Delaware Court of Chancery; and chairman of the Independence Standards Board that was established by the Securities and Exchange Commission in 1997.

Their reactions were overwhelmingly positive. Paul Volcker agreed to write a foreword, and Bill Allen offered an introduction. The words that they wrote suggested that maybe, just maybe, *The First 50 Years* could become a classic.

Paul Volcker:

> **[John Bogle's] great contribution—his single-minded mission—has been to insist that mutual funds should be managed, first and foremost, in a way truly to serve the interests of the investing public . . . I have enormously admired the force and eloquence with which he has set forth his thinking. It is thinking that I find fully persuasive as an analytic matter and entirely consistent with the public interest.**
>
> **This new volume happily makes that thinking easily available to a wider audience. John Bogle writes with unusual clarity and simplicity, clarity of the vision and simplicity of the written word. He has a rare ability to set out concisely and effectively the evidence to support his argument. A wry sense of humor can't quite disguise, and shouldn't disguise, his sense of frustration—even outrage—about some practices that permeate the industry that has been his life's work and personal passion.**
>
> **. . . the strong sense of fiduciary responsibility, the objectivity of analysis, and the willingness to take a stand—qualities that permeate all his writings—set high standards for all those concerned with the growth and integrity of our open and competitive financial system.**

William Allen:

> **. . . John Bogle's life reflects such a deep commitment to the concepts of duty, honor, candor, diligence, and service to others that the most complete summarization of the man is to say that he is a man of high virtue. In an age that sometimes seems to have tried to raise gratification of the self to the status of a virtue, his life reminds us that the value of a life is measured by how one affects the lives of others, not by either celebrity or by balance sheet.**
>
> **The speeches that are collected in this volume capture in vivid outline the core concepts of Jack's vision and inevitably disclose as well the outstanding character of the man. That these two elements—vision and character—are inextricably linked is**

possibly the most fundamental and basic lesson that Jack Bogle's career teaches those of us interested in finance and investing.

John Bogle on Investing was published with little fanfare. It was aimed only tangentially at educating investors to the hard realities of investing, and developing strategies to optimize their chances for the successful accumulation of wealth. At its core, the book's principal purpose was to offer reflections on investment philosophy, on idealism, and on human values. The editors of Amazon's vast library of books placed it in the "Mutual Funds" category, not necessarily where it belonged, and its ranking was undistinguished. However, three of my other books clearly belong there, and continue to hold dominant positions in this category. (Ever since its publication in March 2007, *The Little Book of Common Sense Investing* has been the #1 mutual fund book.)

While the readers' reviews on Amazon for *John Bogle on Investing* were hardly rife (seventeen in all), they were enthusiastic to a fault—my only book to average a 5-star rating. (My other books have generally been rated at 4¾-stars by readers.) But there was also something different about these reviews: *they were long*. The first was 49 lines, the second 15 lines, the third 21 lines, and the fourth, a hefty 92 lines!

The high appraisal of the readers was made vivid by the words that they used. A few excerpts:

Let John Bogle—a legend of American finance—illuminate and inspire your [investment] journey . . . Exceptionally well written and amazingly informative and entertaining . . . A remarkable book from a remarkable man . . . Bogle reflects integrity in a sea of doubt . . . One of the brightest minds of our century . . . His writing contains a deft mastery of mathematics [with] prose that is simple, concise, and often funny . . . No-nonsense book by one of the greats . . . The guardian angel to small investors, a man of integrity and wisdom.

Heady wine indeed! With such a sendoff from titans Volcker and Allen—reviews from the top—and such a reception by readers—reviews from investors who seek candor and unbiased advice—who, really, is to say that, like *Bogle on Mutual Funds* before it, *John Bogle on Investing: The First 50 Years* is not destined to become an investment classic?

A Retrospective on The First 50 Years

This classic edition of *The First 50 Years* gives its author the opportunity, almost 15 years after its original publication, to appraise his work in retrospect. Despite the recent era of wildly fluctuating markets, economic challenges faced by nations around the globe, continued violent warfare (fortunately, for those of us in the U.S., far from our shores), and deteriorating values in our financial system, my views have largely met the test of time. To the extent that any of the ideas in *The First 50 Years* went astray, I correct them here, falling back on the words of Supreme Court Justice Felix Frankfurter (cited in the preface to the book's original edition in 2001), "Wisdom too often never comes, and so one ought not to reject it just because it comes late."

Reviewing Five Key Chapters

So I'll cite not only areas in which I stand by my words, but also acknowledge areas in which my wisdom "came late." In this Introduction, I'll focus on five chapters, one from each part of *The First 50 Years,* and present my retrospective views. Of course, no father likes to single out any individual child for his attention. But I'll disregard that principle, and discuss the five chapters that I have selected. My basis for each selection, to be clear, is totally arbitrary.

Part I, Chapter 1: "Investing in the New Millennium: The Bagel and the Doughnut"

This essay is irreverent, fresh, even sassy. But it carries a profound message regarding the sources of returns on stocks, and I wanted to make it easy to understand. It began as a speech I delivered on January 5, 2000, the dawn of a new century, to members of The Sunday Breakfast Club, a conclave of the most active business, financial, and philanthropic persons in the Greater Philadelphia community.[1]

With the new millennium before us, my remarks centered on three subjects: (1) the outlook for the stock market; (2) the coming change in the mutual fund industry; and (3) the challenge faced by Vanguard, the mutual fund complex that I created in 1974. The members of the

1. The club was originally founded in 1932 to organize a systematic response to the terrible problems facing our community during the Great Depression. The members have continued to meet to this day (albeit for dinners on Wednesdays!), to hear from speakers who comment on current issues affecting our area.

audience were well-educated and successful, but came largely from non-investment backgrounds.

I needed a "catchy" theme, and I found it in a recently-published op-ed piece by *New York Times* columnist (and word maven) William Safire, entitled "Bagels and Doughnuts." Safire wrote:

> **These baked goods . . . are similar in shape but different in character. Bagels are serious, ethnic, and hard to digest. Doughnuts are fun, crumbly, sweet, and fattening . . . The triumph of bagelism in the 1980s and early 1990s meant that tough munching was ascendant; the decline of doughnutism meant that soft sweetness was in trouble.**

In the Stock Market Applying that analogy to the stock market, the investment returns on stocks (dividend yield plus earnings growth) are bagel-like, "reflecting their character," in Safire's words, "nutritious, crusty, and hard-boiled . . . almost inevitably productive." The speculative return, reflecting changes in the market's valuations of stocks (price/earnings multiplies) are doughnut-like, swinging back and forth "from the soft sweetness of optimism to the acid sourness of pessimism."

I told the audience that reasonable expectations for stock returns during the coming decade (2000–2009) suggested a huge drop in the staggering 17.7 percent average annual returns on stocks of the prior two decades.

When I announced my number for the decade ahead—5.2 percent per year—the crowd seemed in a state of shock. Yet even that figure proved optimistic. Nonetheless, my warning could hardly have been missed; tougher times in the stock market lay ahead.[2] And so it proved to be. The annual return to stocks during the subsequent decade actually proved to be *minus* 1 percent.

In the Fund Industry Turning to the mutual fund industry, I described its doughnut-like character: "In its frenetic search for sweet,

---

2. Most of my numbers were solid. As I predicted, the P/E multiple did fall from 30× to 20×, producing the *negative* annual *speculative* return of 4 percent that I expected. But I stupidly projected earnings growth at an overly optimistic annual rate of 8 percent. (I knew better!) With the initial dividend yield of 1 percent, and a more realistic earnings growth rate—say, 6 percent per year—the annual *investment* return expectation would come to 7 percent. Thus, my expectation for the stock market's *total* return including that 4-percentage-point annual loss in *speculative* return, would have been stated as 3 percent per year.

fattening returns, it levied heavy sales charges, charged excessive fees, spent too much on marketing, and failed to share the economies of scale with its investors." Taking into account those direct costs, and adding the indirect costs incurred by funds (transaction costs on high portfolio turnover), and the extra taxes that funds inflicted on fund shareholders, I calculated a performance lag of 5.7 percent per year over the previous 15 years. Stock market annual return, 18 percent; net annual return of the doughnut-like equity funds, 12.3 percent.

In this case, the bagel was the S&P 500 Index Fund. Compounded for the 15-year period—and bereft of nearly all of the extra costs incurred by its traditional doughnut-like rivals—the value of an initial investment of $10,000 in the average fund would have grown to $52,000; the same investment in the S&P 500 Index Fund would have grown to $100,000.

This huge disparity made it easy to forecast that, in the years ahead, the actively-managed mutual fund doughnuts "will find themselves in a bad way."And so it was to be. The share of the doughnut-like active equity funds plummeted from 99 percent of U.S. equity fund assets in 1984 to 67 percent in 2015. The share of bagel-like passive indexers has increased from 1 percent to an all-time high of 33 percent. Case closed.

At Vanguard In the new millennium, I argued, the momentum of the fund industry would swing to the bagelism of indexing. As it turned out, the triumph of indexing was at hand. The firm whose future I had staked on our unique mutual (shareholder-owned) structure, combined with our then near proprietary strategy (indexing), would emerge as by far the largest mutual fund firm on the face of the globe—$3 trillion in assets, and a record 20 percent market share of the assets of all U.S. stock and bond mutual funds.

I could easily have said, again, "case closed." But as I spoke, I was entering a new chapter in my career. At the end of 1999, the Vanguard directors saw fit to remove me from the board, eliminating my title as senior chairman. I had stood down as CEO in 1995 to await the heart transplant that I would finally receive in 1996. In 1996, I was also removed as chairman of the board. (It's a long story.)[3]

---

3. As my formal ties with Vanguard concluded, Vanguard agreed to my request to form and fund a separate independent unit, to be named Bogle Financial Markets Research Center. I continue to serve as its president, with the aid of a small

I did my best to assure the audience (laced with Vanguard shareholders whom I knew, and who had trusted me) that I had little concern about Vanguard's future, for I had inculcated at Vanguard those bagel-like characteristics, and I expected that our new managers would stay that time-tested course.

But I did close my remarks with these warnings, verbatim from the original Safire article, as a caution, not only to the audience, but to our new management:

1. **When you score a breakthrough and surge far ahead, never forget the reason for your success. In the bagel's case, that reason was a certain quality of tasty toughness against a crumbling opposition of sustained sweetness.**
2. **When you open up a long lead against the competition, never let up and freeze the case, lest hungry runners-up eat your lunch.**
3. **When greed for an ever-growing market share causes you to sacrifice your authenticity and compromise core principles, repent and take a stand—or your flavor will disappear into the mealy maw of moderation.**

As William Safire concluded, "Let doughnuts be doughnuts, let bagels be bagels. Character counts. Authenticity attracts."[4] I believe that Vanguard's present management is striving to stay true to our founding principles, but I remain ever-vigilant to do my utmost to ensure that those values endure.

PART II, CHAPTER 13: "CREATING SHAREHOLDER VALUE: BY MUTUAL FUNDS . . . OR FOR MUTUAL FUND SHAREHOLDERS?"

Even before I transitioned into the "Bully Pulpit" phase of my career, I began receiving invitations to speak before a whole variety of organizations and audiences. I had to be selective, usually choosing securities analyst (CFA) societies, industry groups college students, business schools, public-interest organizations, regulators, even congressional committees.

(three-person) staff. Our research is focused on the stock and bond markets and the mutual fund industry.

4. I sent a copy of my remarks to Mr. Safire. He responded with a wonderful accolade, saying that the talk was a superb reflection on his original "Bagels and Doughnuts" piece.

As you'll see in this selection from Part II of *The First 50 Years* ("Taking on the Mutual Fund Industry"), I had become skeptical of the fund industry's direction. So, when I received an invitation to give the keynote speech at the annual conference of the highly-respected Investor Responsibility Research Center (IRRC) in October 1990, I jumped at the opportunity. I traveled to Washington, D.C. and spoke to their huge audience. As it turned out, the topic I chose to express my views, "Creating Shareholder Value," remains a hot topic to this day.

Indeed, as recently as December 2014, James Montier of esteemed institutional money manager GMO wrote an extensive white paper that condemned the concept of shareholder value maximization (SVM) as "the world's dumbest idea,"a conclusion inspired by former GE chief Jack Welch.[5] Montier, backed by a mountain of data, concluded that "only by focusing on being a good businessman are you likely to end up delivering decent returns to shareholders."

"Dumb" . . . or Not! Early in 2015, Cliff Asness, founding principal of institutional money fund manager AQR, expressed his dissent in no uncertain terms. Asness, no shrinking violet, fired back: "Maximizing shareholder value . . . is imperfect, as all things are, but it's not even a little bit dumb! . . . One maximizes the stock price by creating value, great products, a truly beneficial mission, satisfied customers or clients." In short, Asness argues that markets are rarely wildly inefficient, and "the market's long-term record, warts and all, is superb."

While the debate between GMO's Montier and AQR's Asness came almost two decades after my IRRC speech, I remain satisfied with the position that I expressed at IRRC, which left me somewhere in the middle of the Montier-Asness debate. (A rare position for a firebrand like me!) "It all depends," I argued. Yes, "the mission of the Board is to achieve long-term economic growth for the shareholder . . . created by earning returns . . . which are higher than the cost of capital, usually reflected in total return to shareholders."

But the idea is to focus on the *short run*, I argued, "the investment fundamentals that drive corporate return (earnings growth and dividend yields) can easily be overwhelmed by the deafening noise of

5. When Mr. Welch departed as CEO of GE in September 2001, the market capitalization of GE, inflated by aggressive accounting practices, was $573 billion, tumbling to $90 billion in March 2009. In early 2015, GE's market cap is $254 billion—a 12-year net loss of $319 billion of wealth for GE's shareholders.

speculation," a focus on momentary market valuations and stock prices. Yet "in the *long run*, market returns represent the triumph of (those) investment fundamentals over speculation in the market's valuation of these returns." Today, I see no reason to abandon that, well, wisdom.

People Who Live in Glass Houses . . . I then turned to the role of institutional investors in corporate governance matters, noting that these money managers then held about 70 percent of U.S. stocks. (Incorrect! According to Federal Reserve data, the actual number in 1998 was 56 percent.) Today's holdings now total 72 percent. I berated *private* retirement funds for their absence from the fray, and applauded *public* retirement plans for being, "dare I say, in the vanguard of corporate activism."

But the meat of my impassioned remarks: corporate governance and shareholder value issues in the mutual fund industry itself. Given the deeply-flawed governance system of mutual funds themselves, "people who live in glass houses shouldn't throw stones. . . . We may not mind being the artillery of shareholder activism, but we don't want to be its target."

Linking my themes of shareholder value, institutional ownership, and the structure of the mutual fund industry, I noted the obvious: Because of the heavy costs involved in fund ownership (and ultimately, the ownership of the stock market itself), "*the failure of mutual funds to earn their own cost of capital is inevitable*."

My closing challenge: "It is high time for this issue to be raised, and high time that we focus on the principle of earning the maximum possible portion of our cost of capital for our shareholders. They deserve no less . . . for they are our owners." Yesterday's wisdom, then, must come to prevail tomorrow, and we must make sure that it continues to prevail in the years ahead.

PART III, CHAPTER 19: "THE LENGTHENED SHADOW, ECONOMICS, AND IDEALISM"

I simply couldn't resist the temptation to select this talk for this retrospective. It hit all of my "hot buttons"—financial history, Vanguard's founding, Princeton University (of course!), Adam Smith, and U.S. President Woodrow Wilson. Wilson's philosophy, idealism, and high-flown rhetoric all seemed remarkably similar to my own, and so did his stubbornness, which stood in the way of accomplishing some of his highest goals (i.e., the League of Nations). It's a fun narrative (like my

own) of both success and failure and the unwillingness to compromise one's principles.[6]

This speech was presented in September 1999 to a Princeton audience at Woodrow Wilson House in Washington, D.C. I compared my dictum that *Cost Matters* (cited, in those days, in almost every speech that I delivered) to the dictum of the orator Cato when he ended each of his speeches in ancient Rome. When I asked the crowd to call out Cato's words, several responded immediately: *Carthago delenda est*. "Carthage must be destroyed." As a businessman who in 2014 was named one of the world's ten greatest "disruptive innovators"—destroyers of the status quo—by CNBC, that link between the Great Cato and the Little Bogle still gives me a smile.

The honor of presenting the lecture at Wilson House was the product of my earlier lecture at Princeton University in May 1999. There I received the Woodrow Wilson Award for exemplifying "Princeton in the Nation's Service," one of but a handful of businessmen to receive that high honor. My acceptance speech was entitled, "Changing the Mutual Fund Industry: The Hedgehog and the Fox."[7] At the ceremony at Princeton, I focused on a fragment of writing by the Greek philosopher Archilochus: "The fox knows many things. But the hedgehog knows one great thing."

> **I contrasted the many financial foxes in the money management field—often brilliant, clever, and wily, vulpine to a fault—who trade stocks constantly in a futile effort to beat the stock market, only to be destined finally to failure, dragged down by the heavy costs of their active investment approach. The one great idea of the hedgehog, on the other hand, is simply to buy a diversified list of stocks and hold them, well, forever. It is the driving force in Vanguard's success: The passively managed market index fund.**

In the audience that day was a U.S. ambassador who promptly invitied me to give the Wilson House Lecture in the autumn of 1999. In those remarks, I spoke of President Wilson's enormous impact on the

6. I almost chose "Deliverance," a 1971 speech to my Wellington partners in which I first suggested the then-novel idea of "mutualizing" Wellington Management Company. I said that "by 1976 . . . we may well be a *different* company than we are now." Prophetic! In 1974—just three years later—Vanguard began as a mutual, shareholder-owned company, "spun-off," as it were, from Wellington.

7. Note the obvious parallelism between "the hedgehog and the fox" and "the bagel and the doughnut."

fields of finance and business. In 1913, he succeeded in pushing through legislation that created the Federal Reserve Board, the first central bank in the U.S. since Andrew Jackson abolished the Second Bank of the United States in 1836. Wilson's stated determination, as I described it, "was to create an environment in which free enterprise and unfettered competition could prevail." To that end, he championed tariff cuts, global commerce, and the Federal Trade Commission Act of 1914.

A Passion for Free Enterprise and Unfettered Capitalism But the main attributes that have always drawn me to Woodrow Wilson are the power of his idealism and his remarkable use of the English language. His passion for free enterprise and unfettered competition was hardly hidden. Wilson sought to restore . . .

> **. . . that ancient time when America lay in every hamlet, when America was seen in every fair valley, when America displayed her great forces on the wide prairies, ran her fine fires of the earth, and eager men everywhere captains of industry, not employees . . . America stands for opportunity. America stands for a free field and no favor. America stands for a government responsive to the interests of all.**

The fact is that Vanguard's economics, like Wilson's, were in important measure, shaped by idealism. For what distinguishes Vanguard from the typical business enterprise is our mission: To place the interest of our investors before our own commercial interests. Our truly *mutual* mutual fund structure is unique in the fund industry: The funds' management is controlled by the fund shareholders, not by an outside management company, and is operated on an "at-cost" basis, not for a hefty management fee.

With the substantial profits normally earned by the management company eliminated, this mutual structure has been the major contributor in generating aggregate savings for our investors—and hence added returns—that now approach *$15 billion* annually. The other contributor has been our deep, assiduous, slavish, passionate dedication to providing prudent stewardship to the shareholders who have entrusted their resources to our care at *rock-bottom* operating costs; that is, "in the most economical way possible" (i.e., *cost matters*).

Idealism Finally, my idealistic view—for which I offer no apologies—is that the central principle of the mutual fund firm should be "of the clients, by the clients, and for the clients." Their interests should

triumph over the financial interests of the manager-entrepreneur, providing a service of stewardship to the human beings who place with the firm their assets and their trust alike. And low costs and high efficiency are so central to that view that, even as in Wilson's case, the idealism that I've invested in Vanguard leads to its economics. As President Wilson said in his Princeton inaugural address:

> **. . . there are other things besides material success with which we must supply our generation. It must be supplied with men who care more for principles than for money, for the right adjustments of life than for the gross accumulation of profit. The problems that call for sober thoughtfulness and mere devotion are as pressing as those which call for practical efficiency.**

President Wilson closed that address with this ringing peroration, with which I closed my own remarks on that September evening in our nation's capital:

> **I have studied the history of America. I have seen her grow great in the paths of liberty and of progress by following after great ideals. Every concrete thing she has done has seemed to arise out of some abstract principle, some vision of the mind. Her greatest victories have been the victories of peace and of humanity. And in days quiet and troubled alike, Princeton has stood for the nation's service.**

Continuing his vision—remember, this address was given in 1902, more than a century ago—he added this profound prophecy:

> **A new age is before us, in which we must lead the world . . . the spirit of the age will lift us to every great enterprise, but the ancient spirit of sound learning will also rule us . . . and the men who spring from our loins shall take their lineage from the founders of the republic.**

And so, I concluded, "in the United States of America, the spirit of the age remains, this very evening."

* * *

When you read those wonderful words, perhaps you will better understand why I'm such an admirer of Woodrow Wilson.

Part IV, Chapter 22: Personal Perspectives: "The Majesty of Simplicity"

Selecting this essay for a retrospective was not an easy choice. I agonized before eliminating "Changing the Mutual Fund Industry: The Hedgehog and the Fox," my 1999 lecture at Princeton, which I have just described in my review of Chapter 19. I also reluctantly eliminated "Telltale Hearts," which contained two related stories about heart transplants. One of those two stories was about friends of mine who donated their son's heart following his 1995 murder by bandits in a foreign land; the other was about my own experience as the recipient of a heart transplant in 1996. I continue to bask in the glory of—and gratitude for—what has now been 19 extra years of life.

Finally, I chose, "The Majesty of Simplicity,"a short (but, I hope, sweet) acceptance speech that I delivered when I received the honorary Degree of Doctor of Laws from the University of Delaware in October 1999.

I was introduced by University of Delaware trustee William T. Allen, whose remarks were later incorporated into his introduction to *The First 50 Years*. My acceptance speech came at a singular time in my life, for, after receiving my heart transplant in February 1996, the transition to my earlier good health and vital energy was complete. I was back at work full-time, enjoying my family, and again playing squash. It was also a singular time in my career, for, as I reported in my Delaware remarks, Vanguard's assets had recently crossed the $500-billion mark, just 25 years after our founding in September 1974.

I suppose that we thought we were "hot stuff" in those days. Our fund assets had grown 500-fold(!) from just over $1 billion when Vanguard was founded. We had become the second largest firm in the fund industry, rapidly creeping up on Fidelity, our far larger rival then managing $800 billion of fund assets. By 2006, Vanguard had surpassed Fidelity as the largest mutual fund complex with both firms at about $1.1 trillion. In early 2015, assets managed by Vanguard exceed those of our main rival by some $1.4 trillion: Vanguard, $3 trillion; Fidelity, $1.6 trillion.

How did this remarkable turnabout come to pass? Primarily because, as I said in that 1999 acceptance speech, "our defining quality is our recognition of the majesty of simplicity." Quoting Tolstoy: "There is no greatness where there is not simplicity, goodness, and truth."

Simplicity, of course, is the defining characteristic of the index fund, even then rapidly becoming Vanguard's stock in trade. (Then, index funds represented 49 percent of the stock and bond assets under

Vanguard's aegis. As 2015 begins, that penetration has soared to 72 percent.)

But I was hardly above taking Tolstoy's other words to heart: "Our . . . internally managed structure . . . would provide a measurable *goodness*, if you will, to investors." As Jeremy Bentham might have described our strategy, "the greatest good for the greatest number."

And *truth*, too, played a part in our growth. As Vanguard "can not only honestly report *what* our past returns were, but also explain *why* and *how* they happened." It's easy to tell shareholders that the returns that they earn from our equity index funds will continue to provide them with substantially all of the returns—bad as well as good—that are generated in the stock market in the future. The portfolio managers of actively-managed mutual funds, on the other hand, can only guess at what future returns they will be able to generate. Summing up, I closed my brief remarks with these words:

> **I believe that the investment ideas and human values with which I've endowed the firm that I founded 25 years ago, those I've sketched out today, are not only enduring, but eternal.**

Part V, The Princeton Thesis: "The Economic Role of the Investment Company"

John Bogle on Investing marked the first publication of my 1951 senior thesis, 116 pages in length. One might expect that retrospective reflections on an academic thesis written 64 years earlier—based as it was on a pile of historical information, financial data, legal commentary, and research on a subject little known all those years ago—would bring emendations, corrections, apologies, and a rethinking of the central conclusion of the original work.

But such an expectation would *not* be the case. The fundamentals set forth in my thesis have stood the test of time. Indeed, 23 years after the presentation of my thesis to Princeton's Department of Economics, it could be argued that the thesis provided a design for the new mutual fund complex—Vanguard—that I created in 1974. (I'm not so sure!)

Rereading my 1951 senior thesis back in 2001 brought back many memories of my college years and my early views of the then-tiny mutual fund industry, as did rereading it again in early 2015. (And, I confess, a couple of times in between!) My first reaction was that I wasn't much of a writer! My second reaction was that it was: pretty well-written for a kid—and not the smartest kid in the world—who, when he began writing his thesis, was but a year beyond teen age.

In retrospect, however, it's clear that I succeeded in capturing the very essence of what we needed to do to make the investment company industry—then a $2½ billion infant—live up to its great promise. Future events would seem to bear out my ideas, for I hit most of my targets with remarkable accuracy.

- **Industry Growth.** When I wrote my thesis in 1951, mutual funds were but an afterthought in financial circles. Compared with the massive amounts of money invested in life insurance ($63 billion) and U.S. savings bonds ($58 billion), mutual funds were tiny. While I described the great opportunity for mutual funds to grow in importance, the industry has become even more dominant than I could have dreamed. Today, the mutual fund industry is America's largest financial institution, holding some $15 trillion of investor assets.
- **Fiduciary Duty.** I was right in my citation of the industry's ideal goal: Mutual funds must "not in any way subordinate the interests of their shareholders to their other economic roles. *Their prime responsibility must always be to their shareholders*" (italics added). No, we're not there yet. But the power of that idea is growing.
- **Shareholders First.** I am no less idealistic today than I was as an undergraduate. I still believe that mutual funds should exist primarily to serve their shareholders. As I said in the conclusion to the thesis, mutual funds should serve "the needs both of individual and institutional investors . . . serve them in the most efficient, honest, and economical way possible. . . . Providing advantages to the investor . . . is the function around which all others are satellite."
- **The Index Fund.** While almost a quarter century would pass from the time that I wrote my thesis until I created the world's first index mutual fund, I hinted in the thesis at the powerful idea of indexing. After presenting data comparing the returns of the (then) Standard & Poor's 90-Stock Average to those of some of the leading mutual funds of the day, I concluded, "funds can make no claim to superiority over the market averages."
- **The Role of Financial Capitalism.** The final sentence of the thesis succinctly stated the ideal role for the mutual fund industry: "To contribute to the growth of the economy, and to enable

individual as well as institutional investors to have a share in this growth."

Those ideal characteristics of mutual funds are well along the road to realization; five pretty solid hits. But I also made at least three significant errors, setting forth expectations that the industry has failed to realize.

- **Fund Costs.** I predicted that "future industry growth can be maximized by concentration on a reduction of sales charges and management fees." But fund costs have soared to far higher levels than those of the early 1950s. Managers have arrogated the staggering economies of scale in the field of money management to themselves rather than to their fund shareholders. Vanguard alone took heed. Since our founding in 1974, Vanguard's truly mutual structure has allowed us to continually slash both the advisory fees and operating costs that our shareholders incur. And in 1977, we eliminated all sales loads on our funds.
- **Corporate Governance.** I was optimistic that the fund industry would come to serve as an effective counterbalance to corporate managers who lavish excessive compensation and perquisites on themselves at the expense of shareholders. I seconded the SEC's hope that mutual funds would serve "the useful role of representative of the great number of inarticulate and ineffective individual owners." I also suggested that the industry not "refrain from exerting its influence . . . on corporate policy." Alas, mutual funds have almost completely abdicated their role as corporate America's watchdogs. Fund directors, as I noted earlier (à la Warren Buffett) were expected by federal regulators to behave as Dobermans, but they have behaved as tail-wagging Cocker Spaniels.
- **Venture Capital.** I foresaw the need for fresh equity capital in the development and expansion of our nation's businesses, and suggested that mutual funds—particularly closed-end mutual funds—could help to satisfy that need. I concluded that investment companies "may prove to be of economic use in supplying venture capital to new business and in providing additional capital to established firms." While there is a thriving market for venture capital funds (estimated at $200 billion), mutual funds have rarely played a role in funding venture capital investments.

* * *

Reflections on What Makes a "Classic"

In my 2015 retrospective review of my first book, *Bogle on Mutual Funds: New Perspectives for the Intelligent Investor*, the big question that crossed my mind was: "What makes a book on investing a *classic*?" Here's how I answered it:

> **To achieve "classic" status, a book must espouse sound principles and sound advice that have met the test of time and have endured through a wide variety of conditions in the financial markets. Positive endorsements by respected experts begin a classic's journey through time, and strong reader support is another vital element. The book also ought to be well-written, and comprehensible to the audience to whom it is directed.**
>
> **Singularity also gives a big boost to the achievement of classic status. What might distinguish such a book? Perhaps substantial data—simply presented—that reinforces the message. Perhaps an unusual typographical treatment, one that breaks up the otherwise unrelieved monotony of standardized text. Getting off the beaten track with information that surprises the reader is also a plus, and contrarian views that dispute the conventional wisdom of the day (assuming that those views are later validated) often represent the determining factors in earning classic status.**

As appropriate, not very many investment books meet these standards. But it's easy to pick a few whose status would be difficult to challenge: *Security Analysis* by Benjamin Graham and David Dodd (1934) and *The Intelligent Investor* by Graham (1949, although I happen to believe that the 1973 edition, edited by Warren Buffett, is far more useful to today's investor). Many commentators have also singled out *Bogle on Mutual Funds* as a classic. Reviewing it twenty-two years after its 1993 publication, it seems to have measured up to the standards cited above.

What about *John Bogle on Mutual Funds: The First 50 Years*? In 2015, fourteen years after its publication in 2001, this book did not enjoy the same widespread enthusiasm from readers as did *Bogle on Mutual Funds*. However, unanimous high appraisal from readers must count for *something*? (Among all my books, it is the only one with an average 5-star rating on Amazon.)

Further, including in *The First 50 Years* the text of my 1951 senior thesis at Princeton University added to its eminence. During the almost 64 years since I wrote that thesis—a span of time that few books

on investing have surpassed—its foresight has been validated. The (dare I say) immature prose of that ancient thesis has been succeeded by, I think, a more flowing, readable, interesting style. (Practice, while it may not make perfect, is a demanding teacher.)

Coming Full Circle

What a joy it has been for me to take this retrospective look at *The First 50 Years*. Here I am, almost 15 years later, reveling in its simple structure; its sound advice that has clearly met the test of time; and its endorsement by readers, from the brilliant and experienced to those hard-working citizens who may follow thankless careers but nonetheless have the gumption to put money away to ensure their families' long-term wealth. We're all, finally, in this game together, doing our best to cope with the demands of our daily lives. Investing sensibly and simply gives the honest-to-God, down-to-earth human beings of our citizenry a fair shake.

For me, I'm still here! The heart challenges that I had faced since my first hospitalization while I was just thirty years of age got worse, then got better, and then worse again. The right half of my damaged heart stopped beating, and it took a heart transplant in 1996 to restore my health. The choice of *The First 50 Years* for my title left the not-so-subtle implication that a later volume titled *The Second 50 Years* might be forthcoming. Don't doubt it! After all, my heart donor (bless his soul!) was but 26 years of age when he left our midst, and, 19 years later, his (my?) heart is still beating away. My heart, then, is but 45 years old. To reach the second 50 years, we need to endure until 2051 (36 more years), when the "new me" will be a mere 81 years of age.

The investment message that I sent in *Bogle on Mutual Funds* in 1993 was reiterated in the first edition of *Common Sense on Mutual Funds* in 1999, continued with *John Bogle on Investing: The First 50 Years*, and was reaffirmed in 2009 in the 10th anniversary edition of *Common Sense on Mutual Funds*. Each of these volumes has provided consistent, objective, fact-founded advice. We shall see if that simple advice works as well in the years and decades that lie ahead. If it continues to work—and I assume that it will—who can really deny that we may have another classic on our hands? We shall see.

Valley Forge, PA
February 6, 2015

John C. Bogle