Dear Mr. Bogle,

I must tell you that I have "seen the light" when I have read your excellent books ("Common Sense on Mutual Funds" etc. and I'm waiting the new "Little Book" from Amazon in March). Your books really opened my mind for investment mechanism. I learned that I have made all the possible mistakes during my past private investor career... and lost money. I would like to thank you very much for opening the road to go with my future long term investments.

Lately I have seen you hammering quite hard Index ETF's on your speeches and articles.
I would like to tell you that for me as living in Finland the ETF's are the only way to own total market indexes, like Vanguard one's from the US market.
Such things do not exist in Finland. With ETF's it's possible to do my investments thru the internet and have my share of market growth...

So (finally my question), used in the right way (total market index, buy and hold) ETF's can't be a bad thing, or how?

Thanks for your thoughtful note.

You're quite right. Used in the right way, ETFs can be wonderful investments--and surely provide a particularly great convenience to non-US investors. So buying and holding an all-market ETF (especially a very low-cost one!) is a good thing.

The problem I have with the ETF business (as spelled out in my brand-new "Little Book") is that the field is dominated (678 of 690 ETFs, to be specific) by narrowly-focused funds (single country, single industry group, sometimes leveraged) that are traded like hot stocks. A half-century-plus in this business has convinced me that such performance-chasing is a loser's game for investors (and, of course, a winner's game for brokers, managers, and marketing entrepreneurs).

So glad that my books have been helpful. "Stay the Course!"

One of my favorite books is Bogle on Mutual Funds. Even though it was published about 12 years ago the advice is timeless. The same can be said for Common Sense on Mutual Funds (somewhat more current).

I read bits and pieces that indicate that you may have made minor changes to your investment advice since Bogle on Mutual Funds came out. In some cases new products have emerged such as TIPS and the Inflation Protected Securities Fund. In other cases you have perhaps changed your preference for the Total Bond fund to Intermediate Bond Index. The pie charts used as examples in the book seem to place a value emphasis with large portions allocated to actively managed equity income funds as opposed to a straight Total Stock fund.

I would love to see other things addressed in an updated version of Bogle on Mutual funds including:

- *Whether your recommendations on International Funds have changed.*

- *Whether you feel REIT funds deserve a specific allocation.*
- *What portion of a bond portfolio should be allocated to TIPS.*
- *Comments on withdrawal percentages/strategies in the distribution phase. Whether the Trinity study should be used as a guide. Straight percentage vs. intitial percentage with inflationary increases.*
- *Whether actively managed funds should make up 50% of the domestic equities (as Vanguard planners currently recommend).*
- *Tax advantaged investment vehicles vs. non deferred investments. What mix best accomplishes current tax advantages vs. potential repercussions in the distribution phase.*
- *Your feelings on the new Target Retirement funds.*
- *Whether you feel immediate fixed annuities can/should play a part in asset allocation.*
- *How pension plans, annuities, and/or social security should impact asset allocation. Example: if one is fortunate enough to have basic needs taken care of with a combination of the three how should this impact asset allocation for stocks and bonds?*

I could list numerous other questions or things that I would love to see in an updated Bogle on Mutual Funds. Or an updated Common Sense on Mutual Funds if you prefer. I know you're very busy these days but you would be doing an <u>enormous service</u> by publishing your current views and advice.

If you decide to proceed with an update and would like additional questions or thoughts I would be happy to provide you with a more detailed e-mail.

If you would prefer to write a new book rather than update one of your classics I could see it entitled: "Bogle on Asset Allocation- How to invest at all stages of your life." Or, more selfishly: "Bogle on Retirement Investments- How Boomers can transition from accumulating assets to the distribution years."

As you can probably tell, I would enjoy reading anything that you write and take your wisdom very seriously.

Thanks so much for your incredibly thorough, thoughtful--and helpful--note.

With my new "Little Book" (my sixth) now in the stores, I'm thinking--but only vaguely; writing is hard, demanding work--about my next major project. I'm being pressed to do a new edition of Common Sense on MFs, though my heart (a different one than when I wrote it) belongs to Bogle on MFs. However it comes out, your suggestions for an update are right on the mark. ETFs and value-weighted indexes would also be on the list, though I cover both in the new book. ("Ay, there's the rub.")

When that particular d-day comes, I'll darn well call on those additional ideas you have, and deeply appreciate your offer.

As well as your generous appraisal of my work!

Jack:

First, congratulations on celebrating another birthday for your new heart. I wish you many more.

The reason I am emailing you is to introduce myself. I am on a quest to transform the mutual fund industry, much like you have spent your life doing.

I started a money management business that piggybacks off the work that you have done, and sprinkles in some of Buffett's tenets as well.

I started my career by earning an MBA at Columbia Business School, and then worked on a six billion dollar large cap value. While working there, I learned first hand why the majority of mutual funds underperform the index. I learned that mutual funds don't underperform due to lack of intelligence or hard work. They underperform because they are structured to do so. Warren Buffett has said that as he looks back over the course of his investing career, he gets around one good idea per year. A typical mutual fund, on the other hand, typically has 100 or so ideas at any one time. Factor in market efficiency, and the majority of those ideas are mediocre at best. Trading in and out of mediocre ideas is a quick way to underperformance. On top of that, mutual funds are usually well diversified, which flies in the face of Buffett's insistence on circle of competence. It is very rare to find a manager, or a team of managers, who are both experts in every sector and who are also good investors. Thus, mutual funds are usually investing in sectors where they do not have an edge. Again, investing outside of your circle, in an efficient market, is a recipe for underperformance. There are some other reasons, such as cash holdings, but you know the drill.

What I learned:

I learned that I get just a small handful of good investment ideas per year. These are ideas where I find myself saying "Holy cow! I can't believe the stock market is acting like this." Again, these are rare moments for me, but they do come. In my quest to beat the market indexes (which is the only way to provide value for my clients, as I believe that many money managers are foregoing their fiduciary duty by managing money as they do), I have combined the brilliance of the index with selective active management. In a nutshell, I start by placing 100% of client funds in the index itself. For this service, I do not charge a management fee (how can I charge someone for doing what they can do themselves?). From there, I search long and hard for an exceptional investment. When I find one, I determine the correct allocation (ballpark around 3% of assets) for the newly found security. If I believe 3% is the right position size, I sell 3% of my index holdings, and place the funds in the new security. I then continue to search for more stocks to buy. I launched my fund in November of 2005, and currently I have 3 active positions which make up a little over 10% of my fund. The rest of the assets are in a S&P 500 index fund. I charge my clients if and only if I outperform the S&P 500. If I do outperform, I take 33% of the outperformance. While 33% may sound steep, it would take a truly monster year to garner the 1%+ that most mutual funds charge, and they are charging even if they underperform. As of December 31, 2006, I have returned 20.22% vs 18.80% for the index, after fees (inception date is 11/03/05).

One more thought: Selling a stock is a big problem for most money managers. When they wish to sell off a position, they need a new idea on-call. New ideas are hard enough to come by, but needing them on-call as a place to invest the sale proceeds is very difficult, and often leads to poor investments, further depressing returns. For my fund, I always have a place to invest sales *proceeds, and that is in the index itself. In theory, my worst investment should be the index, which will outperform most active managers.*

Anyway, I thought you would like to know how your work and ideas have influenced me, and my work.

Now that my heart is 36 years plus one month old, it's probably time to answer your wonderful note!

I love your investment philosophy. While I'm pretty much entirely indexed (all Vanguard, including our index-like muni funds), I recognize that few investors will follow that narrow strategy. Indeed I basically endorse what you're doing (perhaps a bit too cynically!) on page 202 of my new "Little Book." (I shold quickly that the "yes" regarding commodities on page 203 is a typo. I wrote "no" and the printer--doubtless a commodity speculator!--reversed it. To be fixed in the next printing.)

As Warren B notes about waiting for the outstanding investment opportunity, it's like being a batter in a baseball game where no balls or strikes are ever called--you just until that poor, tired pitcher ("Mr. Market," in a sense) finally throws a ball that you can hit out of the park.

Your reinvestment strategy is all common sense, and your fee structure is a model of fairness and fiduciary attitude.

I'm confident that you'll serve your clients well. "Press On, Regardless!"

Dear Mr. Bogle,

I'm a young man in my mid twenties, and I have an entrepreneurial dream of erasing financial complexity. I started a blog not long ago, Removing Complexity (http://removingcomplexity.wordpress.com/), in the hopes of sharing various points on personal finance that I know and am also learning as I continue my own education on the subject, and also because I found a lack of discourse in an industry that thrives on confusion and misinformation. I arrived at your blog because I share many of your views, and was hoping I missed, and might find through some connection to you, some forum of conceptual or directional conversation about where the industry should go. However, I'm still left with the question, "where is the public discourse?"

This is a question you yourself asked in one of your recent speeches that you posted on your blog, "The Battle for the Soul of Capitalism: Doing Your Part to Begin the World Anew." I'm not so much looking for an answer as continuing some discourse on the subject, which you started by posting your speech on your blog, by offering some of my own thoughts. Additionally, I am publishing this email to you on my blog, along with a link to your site and the speech, where my readers and others might participate as well. I hope and would appreciate if you had the time to read this and respond as your schedule might allow, but in any event, thank you for putting your thoughts out there already.

I agree with most everything in your speech, however, I think a couple points were missed, and I'll propose some changes that are required in turn. In your Battle for the Soul of Capitalism speech, you highlight the distinction between a past owners' capitalism and today's agency *capitalism - the pathological mutation. I would agree that this agency model has produced companies that "came to be run to profit its managers" (p4, a quote by William Pfaff) and that this is bad for investors. However, I think this move away from a traditional owners' capitalism to an agency model has produced much social value. Additionally in another speech, you connect this agency model of capitalism to a rise of the expectation market - a move away from the real intrinsic value market. Again, though, I would disagree that this is wholly bad, and there are some lessons we can learn from these situations.*

We have the agency model today thanks to the continued expansion of investment options and the growing availability of those to the general public. Your own contribution of creating the index fund and providing it through Vanguard has greatly helped as it addresses a number of the cost and manager compensation problems in the mutual fund industry (although index funds are still vastly under appreciated and unknown as my own parents didn't know what they were until I convinced them to move their investments into index funds from Vanguard). That openness and inclusion of a large portion of the population has been a wonderful benefit to capitalism. However, these people are starkly different from those who participated in the past ownership model.

While, in your speech, you hope for a return to the ownership model, you also acknowledge that it won't happen. Additionally, you criticize the expectation market connected with the move to an agency model, but I think you misunderstand the inherent benefit in that for these new investors. These new investors, which include baby boomers like my parents, don't care about actively tracking investments and understanding the real intrinsic market. They have an expectation of return from the market, but benefit little from taking the process much further then buying diversified mutual funds, especially broad market index funds. That expectation is derived from at least a basic understanding of the real market, though, and they put faith in the expectation of overall return. In that sense, the expectation market is good for these new investors who prefer minimum interaction with portfolio management.

The problem that you note, though, is that of "short-termism," which I believe is a direct product of the expectation market. However, we've arrived there because these new investors preferred minimum interaction with their investments, and preferred the mutual fund managers as the established experts. These professionals then saw the value in fighting for more investors and larger funds, and have driven the mostly unaware public into a frenzy for greater than market returns (which Jonathan Berk and Richard Green [2002] have shown kill a fund's returns). Mutual funds learned that they could prosper if they became more like salesmen and marketers, and less managers of investors' money, and in doing so, they're listening to these new investors and speaking to them in their own words (albeit confusing investors more than clarifying, but this only drives them deeper into managers' pockets).

What needs to be done is not return to the old ownership model, but an education of future managers, beyond relearning "trust and being trusted," and include an education on these new investors - what they care about, how they communicate, and how to build relationships with them. They must learn to speak not in investment terms, but the terms of those disinterested in investments beyond providing a better and more solid retirement or other goal, and the first step in doing so is throwing out the very term investor. Investors take care to understand the intrinsic value of the markets, and find ways to make money in that real business world. The new investor, the indexer, or casual investor, is tired of being confused by current fund salesmanship. They themselves must be spoken to in plain terms that help them understand the value of low cost, long term in the face of chasing higher returns. Academic studies and discussions at universities don't help foster that any better than pundits discussing politics helps clear the air.

As people like Doc Searls, a coauthor of the Cluetrain Manifesto, and Hugh MacLeod, known for the Global Microbrand, have helped redefine the communication between media and companies in general for the benefit of both consumer and company, the personal finance and investment industries need to learn and draw lessons from that situation, and reconnect properly in open dialogue with old investors and new about their values. We cannot accept the current environment, but must push forward in improving our relationships with all parties.

Thank you for reading this. Any comments or thoughts would be much appreciated.

What a fine and thoughtful letter!

Its special beauty was that you began to answer my poignant question by providing a thoughtful, thorough, and rational discourse on the issues raised in my Battle book and related speeches. The first evidence I've seen, other than Randy Rothenberg's reflections at my speech to the Aspen Institute at breakfast a year ago. (Both are available on my website.)

Time does not permit me to respond to all of the well-taken points in your letter, but I continue (especially in my new "Little Book") to try to simplify, simplify, simplify (after Thoreau), trying to bring common sense to the average investor, even if only one investor at a time. I do think that the fact that indexing is almost an article of faith with most of our finance and MBA professors is sending out into the world a whole new breed of apostles--perhaps only for their own investments and those of their friends and family--even though many will plunge into careers in money management that, in the aggregate, will increase the costs incurred by investors all the while reducing their net returns. The monster must be slain!

Perhaps someday we'll have the opportunity to continue this discourse. But thanks for starting it!

Mr. Bogle,

In researching your work I don't understand one point.
If everything you say is true regarding the relationship of fees to investment performance, where did you come up with the statistic that "passive" investing beats 90% of the active managers?

I would think it would beat 99% of the managers!!!!!!!!

Thanks for writing. The percentage of managers outperformed by the broad market index is, well, time-dependent. On a given day, it's likely about 55%; over a year maybe 60-65%, over a decade perhaps 75-80%, and over 50 years . . . well, there's no data (yet!) on that!

But the probability statistics suggest that over a 50-year period, some 98% of managers will lose to the market index. There's a nice chart on page 124 of my new "Little Book" that makes this point, with accompanying discussion.

But beware of all data. (Always a good rule!) While the convention is to say "all investors" or "all active managers," the simple and obvious reality is that we're actually speaking of all invested dollars in the same discrete universe as the passively-managed index itself, not the number of investors or mangers.

Hope I haven't told you more than you want to know.

Dear Mr. Bogle:

Is there any risk that Vanguard could someday change its structure, or behavior, in a way that could work against current shareholders? I am not familiar with the organizational details, but I have the perception that ever since Herb Allison (formerly President and CEO of Merrill Lynch) was hired as CEO of TIAA-CREF, that the organization is not as consumer-friendly as it once. I know that David Swensen lauds both in his book, but my sense is that TIAA-CREF has slipped relative to Vanguard. Is that true, and could something similar happen at Vanguard?

I'm enjoying your blog!

Your question is a good one. Of course there's always a risk that leopards can change their spots. Times have a way of changing, and personal financial ambitions, especially in this new age, seem boundless.

But I think that a change in Vanguard's structure is highly unlikely. It would have to be approved by our independent directors, and by you and other shareholders--who, I hope, would "see through" the proposal and would not endorse the higher fees that would necessarily be entailed.

As to a change in management behavior, who can really be sure? Certainly the change at TIAA-CREF is surprising and disappointing, but perhaps will send a message to our board about the importance of being ever vigilant in recognizing that Vanguard was built on values, character, and reputation, and that losing them would be a tragedy, not only for our owners, but for our firm.

And as long as I'm around, I'll continue to do my utmost to maintain those values, that character, and our reputation.

Dear Mr. Bogle,

I'd just like to say thanks.

I read your book - Bogle on Mutual Funds - about ten years ago.

And, even better, I followed your advice as shown in the model portfolios chapter.

Now, as I approach retirement, it looks like I'll actually have enough money to retire.

Again, thanks for your book and the advice.

PS: Just as a point of information, I've bought and read a number of your books and articles - and even your senior thesis - since then. But if there had only been one book, Bogle on Mutual Funds would have been enough.

Belatedly, I extend thanks for your kind and encouraging note. Of course I'm delighted that your investment program did just what it's supposed to do. And I've heard the same wonderful news from many other investors.

I agree with you that BOMF would be "enough" for most investors. The messages in my next four books added to that advice, but largely at the margins. And my sixth book--the "Little Book" that was published in eary March--is focused, laser-like, on indexing, but is written in a breezier, more (as they say) "accessible" style. But the central message has never changed . . . and never will.

Would you mind offering your dispassionate analysis of the principles that inform DFA investing?

I'm a firm believer in all-market indexing—owning the entire U.S. stock and/or bond market, overweighting or underweighting no particular style or sector, and holding it forever. This strategy, executed at minimal cost, will guarantee that you earn your fair share of whatever returns our financial markets are generous enough to provide. The DFA approach is, in some respects, different. DFA has, I suppose, been a pioneer in offering index funds that cover niche benchmarks that it regards as providing excess returns (i.e. value, small-cap, etc.).

Some financial advisors whom I respect greatly utilize DFA funds, and they believe that overweighting small and value stocks will continue to boost your returns as it has in the past. But I know that we *all* can't do so. And wiser heads than mine will have to determine how much exposure US investors need to something like small Japanese or international value stocks.

Minimal cost is an important part of any investment strategy, and all-market index funds can be acquired with no sales loads and minimal annual operating expenses (as low as less than 0.10 percent). Most DFA funds cost considerably more—with expense ratios in the 0.50 percent range, plus a fee of perhaps 1 percent to the advisor who sells the funds. Will their funds' performance be able to overcome this cost handicap in the years ahead? Well, time will tell.