October 8, 2010

To the Veterans and Principals:

I'm attaching a fun speech I gave last evening at the JFK Library in Boston at the 50^{th} anniversary of the Calvin Coolidge Memorial Foundation. (It's a long story!) Entitled "How Calvin Coolidge Could Guide Us Today," it includes a number of historical references that I think you'll enjoy.

Also attached is an article from *Bloomberg Business Week* on Vanguard's becoming the largest firm in our industry, essentially a summary of a much more extensive article on Bloomberg.com. Since this article is laced with some wonderful quotes from independent sources that I'm sure you'll enjoy, I've included it as well.

Not to be too picky, but the story substantially underscores our advantage in asset size, stated as Vanguard $1.31 trillion, Fidelity $1.24 trillion. In fact, the totals are Vanguard $1.39 trillion, Fidelity $1.17 trillion—an edge of $220 billion. Excluding money market funds and counting only stock and bond funds, the totals are: Vanguard $1.22 trillion, Fidelity $730 billion, a staggering edge of almost $500 billion.

Numbers are mere numbers, and size is only size. (And don't ever forget that "the bigger they are the harder they fall.") What remains important are the basic human values and the simple investment strategies established at our founding, which—despite the challenges engendered by our electrifying growth to industry preeminence—remain the primary basis for the enormous trust that investors have placed in all of us.

Best, always,

Jack

How Calvin Coolidge Could Guide Us Now

Remarks by John C. Bogle

Founder and Former Chief, The Vanguard Group

Before the 50th Anniversary Symposium of the

Calvin Coolidge Memorial Foundation

John F. Kennedy Presidential Library and Museum

Boston, Massachusetts

October 7, 2010

I'm deeply honored to offer these closing remarks at this 50th Anniversary Symposium honoring Calvin Coolidge. Earlier today, you heard from experts on his life and times, discussing his strategic vision, his political philosophy, his values, his political instincts, and even more. It would be presumptuous of me to tread again the ground trod by these experts, so let me take this opportunity to discuss some of what I see as Coolidge's wisdom, and how he might guide us were he living in this perilous era for our nation—an era nonetheless fraught with opportunity—in which we find ourselves as we gather this evening.

I've never thought of myself as a businessman, nor as an entrepreneur, but rather as one who's done his best to serve investors, and to force others who lead our giant investment institutions to do the same. In my modest sphere, I emulate—that is, to be clear, to *strive* to equal—the traits of character which we all associate with "Silent Cal" (although no one has *ever* called me "Silent Jack." To the contrary!). As your 2010 Memorial Foundation brochure describes these traits, President Coolidge was determined "to preserve the old moral and economic precepts" that led to America's prosperity, focused on the fundamental virtues of high character, integrity, hard work, honesty, idealism, self-discipline, and, above all, determination and persistence.

Note: The opinions expressed in this speech do not necessarily represent the views of Vanguard's present management

It is in this last context, paradoxically, that some seventy years ago I first learned about Calvin Coolidge. I was in my early teens, and sailing aboard an old lobster boat on Long Island Sound with my uncle, Clifton Armstrong Hipkins, long-time commodore of Connecticut's Riverside Yacht Club. On a small bronze plaque on the bridge of his boat, I read Coolidge's words, so familiar to many of you:

> Nothing in the world can take the place of persistence. Talent will not; nothing is more common than unsuccessful men with talent. Genius will not; unrewarded genius is almost a proverb. Education will not; the world is full of educated derelicts. Persistence and determination alone are omnipotent. The slogan "Press On" has solved, and always will solve, the problems of the human race.[1]

On the transom of my uncle's boat was its name: *Press On Regardless*. I'm not sure when or where or why "regardless" was added to the Coolidge quotation, but that phrase would become a sort a motto for our family. Whatever its derivation, the addition of "regardless" tells us of something that, deep down, we all know to be the reality of life.

For "Press On Regardless" is a profound reminder that we must press on, not only through our trials and tribulations, but under *all* circumstances. It means we should press on not only through bad times, but through good times as well; press on through stormy seas and calm seas alike; press on when we experience failure of course, but also when we achieve success; and press on when we meet both triumph and disaster (even as we honor Kipling's mandate to "treat those two imposters just the same").

Our Economy, Then and Now

[1] This classic Coolidge quotation continues to find its way into my life, sometimes in surprising forms. For example, I recently learned that Ray Kroc, founder of McDonald's, had the "press on" quotation posted on the wall of the office of the manager of every McDonald's restaurant. However, it was not signed "Calvin Coolidge." It was signed "Ray Kroc."

While I'm certain that the timeless virtues that Calvin Coolidge exemplified should remain our guiding stars today, I'm doubtful, alas, that his views of the role of our federal government in today's national affairs can offer much guidance that will help us through the financial mess in which our nation finds itself, so unlike the role of government in the era of remarkable prosperity over which President Coolidge presided.

Under Coolidge, our economy flourished, growing by 22 percent (in real terms) from 1923 to 1929. There was, literally, zero inflation; federal government expenditures held flat (really!); the U.S. debt was slashed; the top marginal income tax rate was cut from 43% to 24%; unemployment fell to 3.2 percent. In short, in the president's words, our citizens "reached a state of contentment seldom before seen." G iven that level of growth and prosperity, it is hardly surprising that Coolidge believed that government should try to get out of the way and leave it to the private sector—to rely on our citizens—to keep the momentum going. "I want the people of America to be able to work less for the government and more for themselves," Coolidge said. "I want them to have the rewards of their own industry. This is the chief meaning of freedom."

But in this recent winter of our discontent, it is only to state the obvious that America's growth has been hobbled and our prosperity limited. Our national product is no higher than it was three years ago, and unemployment, at 9.5 percent, is running at the highest levels of the past quarter century. Median family income is now actually lower than it was a decade ago, despite the enormous increase in incomes earned by the top 1/100th of 1 percent of the population. Our nation's wealthiest 15,000 families report an average annual income of $27 million, in contrast to the $31,000 average income of the lower 90 percent of our families, 135,000,000 in all, including nearly 9 million living below the poverty line of about $18,000 per year. Today's "state of contentment," then, likely applies to only a small fraction of our population.

Coolidge, I'm confident, would have worried about this growing disparity. Help for the disadvantaged was an important part of his political philosophy. "Government is not, must not be, a cold impersonal machine," he said, "but a more human agency, satisfying the heart, full of mercy, assisting the good, resisting the wrong, delivering the weak from any impositions of the powerful."

How would Coolidge deal with this obvious tension between fiscal probity and a compassionate state? Today we describe this tension in hyperbolic terms—"left wing" vs. "right wing," a caricature bereft of subtlety. More accurately, America's political parties are philosophically divided between a so-called liberal tradition favoring the use of the national government to foster equality and social justice, and a so-called conservative tradition favoring limited national government in the name of protecting liberty, freedom, and personal responsibility. But even that difference paints too extreme a picture. In this vastly different American economy of the present day, which way would Coolidge lean? We will never know. But it might help us to understand Coolidge's philosophy through the two great Americans who stand tallest in his pantheon, Alexander Hamilton and Theodore Roosevelt.

Alexander Hamilton

Alexander Hamilton didn't care much for these sharp distinctions. Here's how *New York Times* columnist David Brooks expresses Hamilton's philosophy: "Through much of American history there has always been a third tradition, now dormant, which believed in limited but energetic government in the name of social mobility and national union. This third tradition was founded by Alexander Hamilton, embraced by Henry Clay, taken up by Abraham Lincoln and brought into the 20th century by Theodore Roosevelt. . . . Hamilton came from nothing and spent his political career trying to create a world in which as many people as possible could replicate his amazing success. [He] saw a country destined to become the greatest empire of the earth, and sought to liberate and stir Americans to exploit the full range of their capacities. Hamilton believed in using government to enhance market dynamism by fostering more equitable competition. He believed government could usefully promote social revolutions . . . It was always the cause America represents—universal freedom—that was uppermost in Hamilton's mind, spurring individual initiative, but also gathering the fruits of that energy in the cause of national greatness."

Coolidge was basically a Hamilton Republican. He freely expressed his admiration, indeed his reverence, for the ideas of Alexander Hamilton:

> The great man is he who can express the unuttered opinions of his time, direct energy along profitable channels, divine the spirit of the people, and unify action under just and stable institutions of government. Such a man was Alexander Hamilton . . . Hamilton lived in the age which not only established the independence of our country, one of the most remarkable of achievements, but also saw the adoption of the federal Constitution and provided an economic system. These gave this nation liberty, order, and prosperity. His fame rests on the deep influence which he had in producing these results. When America ceases to remember his greatness, America will be no longer great. [2]

Theodore Roosevelt

Even more interesting, I think, was Coolidge's admiration for Theodore Roosevelt, perhaps surprising since in some sense, Theodore Roosevelt was Coolidge's antithesis. Roosevelt pressed for a graduated income tax[3] and a steeply graduated inheritance tax. With the passage of the sixteenth amendment to the Constitution, he got both. He broke the all-powerful business trusts that dominated America in the late 19th century. His activist, interventionist leadership of our nation also included negotiating the settlement of the Russo-Japanese war

[2] These quotations come from a speech Coolidge delivered in Chicago, honoring Hamilton, There were some 4,000 words in his speech, so likely nearly an hour in delivery and belying the "Silent Cal" caricature.

[3] Roosevelt's ideas echoed earlier comments by Andrew Carnegie who favored a progressive inheritance tax "designed to confiscate most of a decedent's estate, leaving only a modest inheritance to one's heirs."

(for which he won the Nobel Peace Prize) and protecting our nation's natural resources by placing some 230 million acres under federal jurisdiction.

Despite their differing philosophies of government, Coolidge also held Roosevelt in near-reverence: "One of the great men of American history—ambassadors of Providence . . . great captains, commanders of men; statesmen, ministering to the well-being of their country, inspirers of noble action, translating high ideals into the practical affairs of life . . . In all the criticisms that his zeal for the right, whatever the consequences, brought (Roosevelt), no one ever questioned his patriotism . . . In a distinctly commercial age marked by a consuming desire for financial success . . . (men) sought to increase the means for the production of wealth by great combinations which in some instances partook of monopoly. The man who finally brought the businessmen of the nation to see that their course was economically unsound, and therefore to be abandoned, and who roused the American people to the assertion again of their right to control their government for the public welfare, was Theodore Roosevelt. No man had done so much to destroy an unsound economic theory and to restore its true form of representative government since the days of Abraham Lincoln. (Roosevelt) reestablished a representative government of all the people, reopened the closing doors of opportunity, reawakened the soul of his country, and reinforced the moral fiber of America."

One other piece of guidance—one largely unobserved, I think—Coolidge might help us with today is the necessity of our nation's elected officials to bring people with brains and integrity and determination to positions of leadership. This audience is well aware of the contributions made by Andrew Mellon and Dwight Morrow during Coolidge's presidency, and perhaps many of you recall that it was Calvin Coolidge who appointed legendary Judge Learned Hand to the U.S. Court of Appeals for the Second Circuit, where he served with distinction for 27 years. Harlan Fiske Stone may top even that distinguished list. In 1924, in the wake of Harding's "Teapot Dome" scandal, Coolidge named Stone, his friend and classmate at Amherst, as attorney general. A year later, Coolidge named Stone to the U.S. Supreme Court, his only appointment during two terms as president. Stone's judicial record was so compelling that in 1941 Franklin D. Roosevelt named him as chief justice of the United States—a rare if not unique event in which a justice named by a Republican was named chief by a Democrat (or *vice versa),* a stirring tribute to Coolidge's selection of Stone based on his personal character and professional competence.

Our Nation's Financial System

This reference to Justice Stone gives me an opportunity to digress for a moment, and turn to the over-reaching of our financial sector in the recent era. Stone's masterful understanding of our financial system is reflected in an essay in the Harvard Law Review, written in 1934 in the aftermath of the Great Depression. See if you don't agree that it was eerily prescient in describing a major force in creating the economic problems we are facing today.

> . . . When the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that 'a man cannot serve two masters,' . . . The separation of ownership from management, the development of the corporate structure so as to vest in small groups control over the resources of great numbers of small and uninformed investors, make imperative a fresh and active devotion to that principle . . . Yet those who serve nominally as trustees, but relieved, by clever legal devices, from the obligation to protect those whose interests they purport to represent, corporate officers and directors who award to themselves huge bonuses from corporate funds without the assent or even the knowledge of their stockholders . . . financial institutions which, in the infinite variety of their operations, consider only last, if at all, the interests of those whose funds they command, suggest how far we have ignored the necessary implications of that principle. The

loss and suffering inflicted on individuals, the harm done to a social order founded upon business and dependent upon its integrity, are incalculable.

One of Coolidge's comments on our banking system affirms that he would have agreed with Justice Stone's harsh indictment. "A bank is not a private institution responsible to itself alone, or to a few," Coolidge said, "It is a public institution under a moral obligation to be administered for the public welfare." Our new-era banking system, a major contributor to the crisis America is now fighting her way through, hardly meets that standard of how a bank ought to operate.

How Would Coolidge Guide Us Today?

Were Coolidge and Hamilton and Roosevelt alive today, I believe that they would agree that we need to restore the integrity of our system of capitalism, and to rethink the nation's investment process. In their spirit, I continue to press on in that battle. In today's wrongheaded version of capitalism, corporate managers—agents of the shareholders—hold awesome power in their own hands and for their own purposes. These managers are in charge of our business wealth, virtually unchecked by traditional gatekeepers—directors, auditors, regulators, even their own shareholders. It doesn't help that our institutional money managers—who control corporate America through their holdings of some 70 percent of all shares of stock—are too heavily focused on the folly of short-term speculation on stock prices and too lightly focused on the wisdom of long-term investment—growing intrinsic corporate value—to concern themselves with challenging the domain of our corporate managers.

So here we are tonight, in an economic and political environment which is light-years away from the environment to which President Coolidge pointed with pride and pleasure, an environment in which his belief in small government, budget surpluses, and low taxes helped the private sector of our economy to flourish. What guidance would he offer? Cut taxes and slash social welfare? Raise taxes on all? On the wealthy? Fix Social Security? Undo the recent healthcare reform? Add to the so-called "stimulus," or stop it in its tracks? How would he balance the power of the Federal government with the needs of so many in our society? Or would he do nothing, and leave the solution to our private enterprise system? Even as many will predict with an air of complacent certainty how Coolidge would guide us on these matters today, the fact is that what he would do is utterly unpredictable. *We just don't know.*

Character Counts

But that hardly means that this remarkable President has no guidance for us. That his presidency was distinguished for character more than for heroic achievement is not a criticism, but a tribute. Indeed his guidance may well be eternal: Revere the Constitution and the Founding Fathers. Listen carefully to Hamilton (for "when America ceases to remember his greatness, America will cease to be good"). Demand persons of high integrity and high intelligence, without preconceived political agendas, to serve in the executive branch, in the legislative branch, and in the judicial branch of our government.

Even more important, never forget Calvin Coolidge's reminder that character counts. As the president told the National Council of Boy Scouts in 1926, "Character is what a person is; it represents the aggregate of distinctive mental and moral qualities belonging to an individual . . . good character means a mental and moral fiber of a high order, one which may be woven into the fabric of the community and state, going to make a great nation."

What's more, especially in these days in which pessimism abounds, he'd likely advise us to hold on to our idealism. President Coolidge said, "We make no concealment of the fact that we want wealth, but there are many other things we want very much more. We want peace and honor, and that charity which is so strong an element of all civilization. The chief ideal of the American people is idealism. I cannot repeat too often that America is a nation of idealists." (One of his predecessors, Woodrow Wilson, said, "Of course I'm an idealist. I am an American, and America is the most idealistic nation on earth." Some ideas transcend politics!)

We must also pay homage to our great American past, and resolve to honor more fully our nation's founding principles. The Declaration of Independence assures us "that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness." I share those values, and indeed wrote about them in my recent book, *Enough. True Measures of Money, Business, and Life.*

> While we all may be created equal, however, we are born into a society where inequality—of family, of education, and, yes, even of opportunity—begins as soon as birth takes place. But our Constitution demands more. "We the People" are enjoined "to form a more perfect Union, establish Justice, insure domestic Tranquility . . . promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity." These are not mere words; they represent the challenge of our age.

These thoughts were echoed by Coolidge: "When people begin to cherish plans for everything save *the common welfare*, the decay of that country has begun."

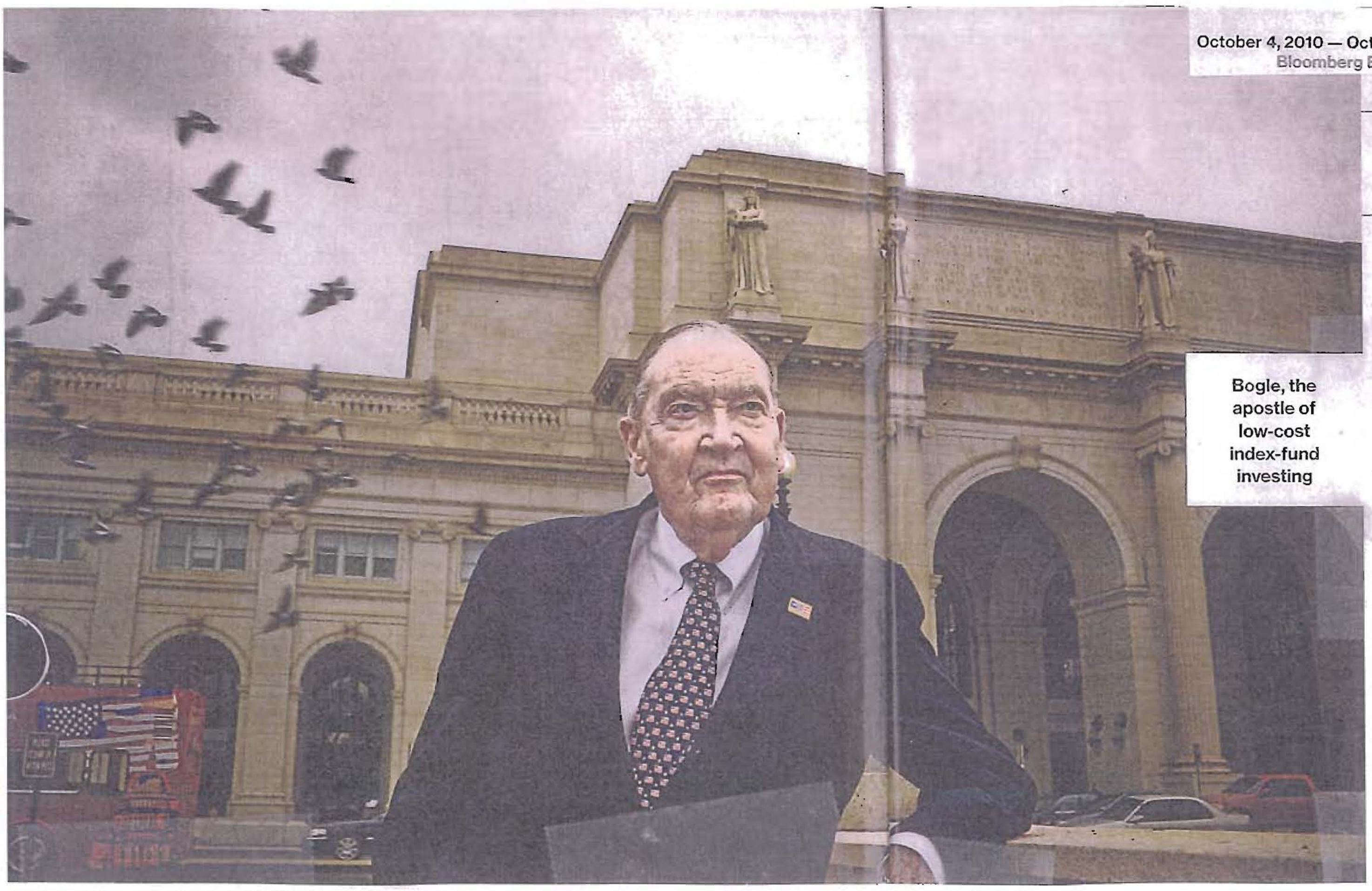
It's been a special delight for me to see so many parallels between my own humble work and the solid, traditional and conservative values of President Calvin Coolidge. Here's how he summed them up,

> Material resources do not, and cannot, stand alone. They are the product of spiritual resources. It is because America, as a nation, has held fast to the higher things of life, because it has had a faith in mankind which it has dared to put to the test of self-government, because it has believed greatly

in honor and truth and righteousness, that a great material prosperity has been added unto it.

I too have spent most of my recent decades focused on character and values, the homespun elements that come down to moral conduct, integrity, and honor. Tonight, let's pledge never to forget them. And, yes, let's hold our persistence and determination high, more than ever in the challenging global environment which demands the active participation of our entire citizenry. In President Coolidge's timeless words with which I opened these remarks: "The slogan 'Press On' has solved and always will solve the problems of the human race."

Thank you for your attention, ladies and gentlemen. And press on—Press On, Regardless.



Bogle, the apostle of low-cost index-fund investing

Mutual Funds

Indexing Helps Vanguard Top Fidelity

- It passes the home of Magellan as investors lose faith in managers
- "People do not want...stockpickers who have not earned their keep"

John Bogle has preached the virtues of low-cost indexing since the 1970s, arguing that it doesn't make sense for investors to pay higher fees for big-name money managers at firms such as **Fidelity Investments**. His advocacy of investors' interests earned him the nickname "Saint Jack," and his persistence paid off this year when **Vanguard Group** unseated Fidelity as the largest U.S. mutual fund company by assets, a distinction the Boston firm had held for more than two decades.

Bogle, 81, founded the Valley Forge (Pa.)-based firm in 1975 with the idea that most professionals can't beat the market, so it's not worth paying them to try. Edward "Ned" Johnson, 80, took over Fidelity two years later and built the family business by betting on star stockpickers such as Peter Lynch. Index funds mimic the benchmarks they are designed to track, while active managers pick securities based on research. In the 10 years ended Aug. 31, domestic equity index funds posted an annual loss of 2 percent, Morningstar data show, while actively run stock funds returned 0.9 percent a year. Many active managers, of course, returned less than the average.

Fidelity Magellan, run by prominent managers including Johnson, Lynch, and Jeffrey Vinik, was once the world's largest mutual fund, peaking at $110 billion in August 2000. It is now one-fourth the size of the $87 billion **Vanguard 500 Index Fund**. Vanguard has benefited as the stock market floundered, says Michael Miller, a managing director at the firm. "People pay more attention to costs when returns are less," he says. Fidelity spokesman Vincent Loporchio says his firm's "focus has never been on being the largest company, but on providing the best products and services for our customers."

"It is possible investing has changed for good," says Jack Ablin, chief investment officer at Chicago-based Harris Private Bank, which manages $55 billion. "People don't want to rely on stockpickers who have not earned their keep." Stock index funds charge an average of 29¢ per $100 invested, compared with 95¢ for active funds, data from research firm Lipper show.

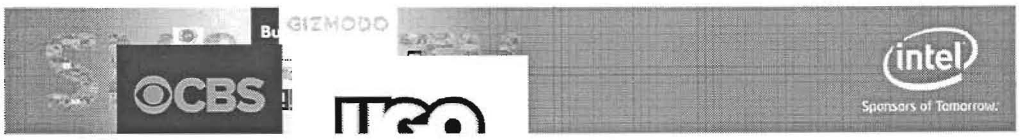
Vanguard snatched the No. 1 ranking from Fidelity in March and has maintained it. Vanguard had $1.31 trillion in fund assets as of July 31, compared with $1.24 trillion for its main rival, according to the most recent data from the Investment Company Institute, a trade group. Fidelity has topped the list at the end of each year since 1988, when the firm overtook **Merrill Lynch**.

In the 10 years ended Dec. 31, Vanguard's stock and bond funds took in $440 billion, compared with $101 billion for Fidelity, Morningstar estimates. This year through August, Vanguard drew $49 billion while Fidelity had withdrawals of $2.8 billion. Almost 80 percent of the money flowing to Vanguard's stock and bond funds this year went to indexing, according to Morningstar.

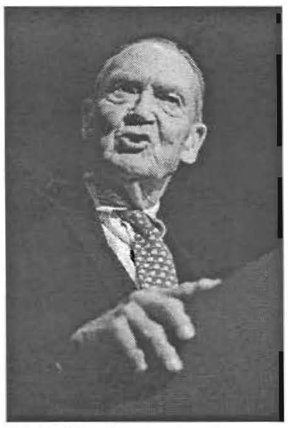
The tally includes stock, bond, and money market funds. The figures do not count exchange-traded funds, a variation of index funds whose prices change as they trade through the day like stocks. Vanguard had $113 billion in ETF assets at the end of August, according to State Street. Fidelity has largely ignored that business. Vanguard also benefited from the popularity of its bond funds, which pulled in $134 billion from Jan. 1, 2008, through Aug. 31, 2010, a period in which Fidelity's attracted $33 billion.

Bogle has long criticized the financial industry for its supposed excesses, says Nancy Koehn, a professor at Harvard Business School. "The world has changed profoundly," she says, "and Vanguard is sitting right where the market has arrived." —*Charles Stein*

The bottom line *The growing popularity of low-cost index funds, a Vanguard specialty, has helped the company overtake Fidelity, known for stockpicking.*



Fidelity Loses Top Mutual-Fund Spot to Bogle's Indexing


John "Jack" Bogle Sr., founder of Vanguard Group. Photographer: Ken Cedeno/Bloomberg

John Bogle has preached the virtues of low-cost indexing since the 1970s to investors willing to pay higher fees for big-name money managers at firms such as Fidelity Investments.

His persistence, which earned him the nickname "Saint Jack," paid off this year when Vanguard Group Inc. unseated Fidelity as the largest U.S. mutual-fund company by assets, a distinction the Boston firm had held for more than two decades.

A decade bookended by bear markets has sapped U.S. investors' faith in the ability of money managers to protect them from losses, spurring a rush into cheaper index funds pioneered by Vanguard. Bogle, 81, founded the Valley Forge, Pennsylvania-based firm in 1975 on the idea that most professionals can't beat the market, so it's not worth paying them to try. Edward "Ned" Johnson, 80, took over Fidelity two years later and built the family business by betting on star stock pickers such as Peter Lynch.

"It's the triumph of indexing over active management," Daniel Wiener, editor of Independent Adviser for Vanguard Investors, a New York-based newsletter, said in an interview. Index funds mimic the makeup of the market benchmarks they are designed to track, while active managers pick securities based on research.

Fidelity Magellan Fund, run by a prominent list of managers including Johnson, Lynch and Jeffrey Vinik, produced middle-of- the-pack returns in the past decade. Once the world's largest mutual fund, Magellan is now one-fourth the size of the $87 billion Vanguard 500 Index Fund.

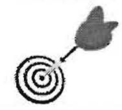
Attention to Costs

Vanguard has benefited as the stock market foundered, said Michael Miller, a managing director at the firm. The market in 2009 came through its first full decade of losses since the 1930s, and U.S. bond yields are near record lows this year.

"People pay more attention to costs when returns are less," Miller said in a telephone interview.

The shift may be more than temporary, said Jack Ablin, chief investment officer at Chicago-based Harris Private Bank, which manages $55 billion.

"It is possible investing has changed for good," he said. "People don't want to rely on stock pickers who have not earned their keep," and active managers will have to "demonstrate that they have an edge that is worth the management fee they charge."



On a dollar-weighted basis, stock-index funds charge an average of 29 cents per $100, compared with 95 cents for active funds, data from Denver-based research firm Lipper show.

Power of Marketing

Some of Vanguard's success can be attributed to the "miracle of marketing," said James Lowell, editor the FidelityInvestor.com, a Needham, Massachusetts, newsletter. The firm has sold investors on the benefits of indexing even though the strategy has yielded lackluster performance, said Lowell, who helps oversee $1.2 billion, mostly in active funds.

In the 10 years ended Aug. 31, actively run domestic stock funds returned 0.9 percent a year compared with an annual loss of 2 percent for index funds, data from Chicago-based Morningstar Inc. show. Fidelity's equity funds returned an average of 2.1 percent a year versus 1.2 percent for Vanguard's, according to Lipper.

Investors took a net $301 billion out of actively run equity funds in the U.S. from the start of 2008 through August, Morningstar estimates, while stock-index funds attracted $113 billion. The global financial crisis sent the S&P 500 sliding 57 percent from its peak October 2007 to its 12-year low in March 2009.

Vanguard also benefited from the popularity of bond funds. From Jan. 1, 2008, through Aug. 31, 2010, the company's fixed- income portfolios pulled in $134 billion while Fidelity's attracted $33 billion.

Passing Fidelity

The shift into index funds helped Vanguard snatch the No. 1 ranking from Fidelity in March. Johnson's firm has topped the list each year since 1988, when it overtook Merrill Lynch & Co.

Vanguard had $1.31 trillion in fund assets as of July 31, compared with $1.24 trillion for its main rival, according to the most recent data from the Investment Company Institute, a Washington-based trade group.

Vanguard's climb may also have been aided by its unusual business model. The company is owned by its mutual funds, which are owned by their investors.

"The ownership blueprint holds costs down and keeps the folks at Vanguard thinking like their customers," Nancy Koehn, a professor at the Harvard Business School in Boston, said in an e-mailed response to questions.

Lynch Legacy

Fidelity is privately held, with 49 percent owned by the Johnsons and the rest by employees. The firm, while also offering cheap index funds, has been known for stock selection since the days of Lynch, who gained 29 percent a year before stepping down in 1990. From 1993 to 2007, funds led by stock pickers lured almost four times as much money as those that track benchmark indexes, Morningstar data show.

As the largest U.S. manager of money-market funds, Fidelity was also hurt as investors abandoned the short-term vehicles when yields fell below 1 percent last year.

Fidelity oversaw $442 billion in money funds as of Aug. 31, compared with $165 billion at Vanguard, according to Crane Data LLC in Westborough, Massachusetts. Fidelity's money-fund assets fell 13 percent in 12 months.

"Our focus has never been on being the largest company, but on providing the best products and services for our customers," Vincent Loporchio, a Fidelity spokesman, said in a telephone interview.

Edward C. Johnson II, the late father of the current chairman, took over the original Fidelity Fund, which is still operating, in 1943. Three years later, Fidelity was created to act as an adviser to the fund.

Fidelity's Evolution

Once mainly a mutual-fund company, Fidelity now is "one of the world's largest providers of financial services," Loporchio said. The firm has expanded into stock trading, retirement plans and institutional money management.

In 2009, Fidelity reported operating income of $2.52 billion on revenue of $11.5 billion. The firm doesn't report net income based on generally accepted accounting principles. Vanguard doesn't release financial results.

In May, Fidelity named Abigail Johnson and Ronald O'Hanley to top roles after splitting responsibility for running the company. Abigail is Ned Johnson's daughter. O'Hanley previously headed money management at Bank of New York Mellon Corp.

Vanguard had been catching up with Fidelity for at least a decade, since the bursting of the technology stock bubble in 2000 led to market declines through 2002.

At the end of 1999, Fidelity had $857 billion in mutual funds, 59 percent more than Vanguard, ICI data show. The tally comprises stock, bond and money-market funds. Each is priced at the end of the trading day based on the value of its assets.

$440 Billion Infusion

The ICI numbers do not include exchange-traded funds, a variation of index funds whose prices change as they trade through the day like stocks. Vanguard had $113 billion in ETF assets at the end of August, according to Boston-based State Street Corp. Fidelity has largely ignored that business.

In the 10 years ended Dec. 31, Vanguard's stock and bond funds attracted $440 billion, compared with $101 billion for Fidelity, Morningstar estimates. This year through August, Vanguard pulled in $49 billion while Fidelity had withdrawals of $2.8 billion, according to the research firm.

Fidelity isn't the only manager of actively managed stock funds to suffer at the expense of indexers. Investors at American Funds, run by Los Angeles-based Capital Group Cos., took out $29 billion this year while Baltimore-based Legg Mason Inc. had redemptions of $2.6 billion, Morningstar data show.

Wellington Fund

Indexing doesn't explain all of Vanguard's success. About 49 percent of the firm's assets are in actively run funds, Rebecca Katz, a Vanguard spokeswoman, said in a telephone interview.

Among the firm's active offerings are the $48 billion Wellington Fund and the $18 billion Vanguard Health Care Fund, the best-performing U.S. mutual fund over the past 25 years, according to Morningstar. The fund averaged annual returns of 15 percent, compared with 9.7 percent for the S&P 500, Bloomberg data show.

Still, almost 80 percent of the money Vanguard's stock and bond funds attracted this year went to indexing, Morningstar said.

Indexing drew Kent Grealish, a financial adviser in San Bruno, California, outside San Francisco, to Vanguard in 2004. Grealish said he spent most of his career as a believer in stock selection. Over time, "I changed my attitude about my ability and the ability of others to beat the market," he said in a telephone interview.

Industry Critic

His clients now essentially match the market's performance at a low cost, he said. Vanguard's biggest index fund, the $113 billion Total Stock Market Index Fund, charges clients as little as 7 cents for every $100 they put in, according to the firm.

For decades, said Harvard's Koehn, Bogle has been touting his company's simple approach and criticizing the financial industry for its supposed excesses.

"The world has changed profoundly, and Vanguard is sitting right where the market has arrived," Koehn said in a telephone interview.

Bogle, who ran Vanguard until 1996, has stayed in the public eye by publishing articles and books and making media appearances. Bogle didn't return a call seeking comment.

Fidelity developed a reputation for innovative products, solid customer service and for bringing mutual funds to a wider audience, said Russel Kinnel, director of fund research for Morningstar.

Lynch ran Magellan from 1977 to 1990, when his yearly gains were almost twice the S&P 500's 15 percent. His books "One Up on Wall Street" and "Beating the Street" became best-sellers.

Mediocre Returns

More recently, the firm's stock performance has been "mediocre," Kinnel said. Fidelity's equity funds beat 57 percent of their peers in the decade ended Dec. 31, Morningstar data show.

Magellan lost an average of 3.7 percent annually in the 10 years ended Aug. 31, compared with a decline of 1.8 percent for the S&P 500, Bloomberg data show. The fund's assets have fallen to $20 billion from a peak of about $110 billion in 2000.

Fidelity still has some of the industry's best-known managers.

Joel Tillinghast, who runs the $28 billion Low-Priced Stock Fund, topped all but one diversified U.S. mutual fund, Robert Rodriguez's FPA Capital, over the past 20 years with gains averaging 14 percent, Morningstar data show.

Broader Business

Fidelity's bond performance has been strong, said John Bonnanzio, editor of Fidelity Insight, a newsletter based in Wellesley, Massachusetts. Even so, the company has struggled to compete for investor attention with Pacific Investment Management Co., he said in a telephone interview.

"Fidelity doesn't have the marketing zing Pimco can bring with Bill Gross," Bonnanzio said.

Pimco, based in Newport Beach, California, has brought in $54 billion this year, the most among fund companies, according to Morningstar. Gross, named in January as Morningstar's fixed-income manager of the decade, runs the world's largest bond fund, the $248 billion Pimco Total Return Fund.

Fidelity operates a so-called fund supermarket that lets investors choose from more than 5,000 funds, most of them run by competitors. Its 401(k) business, the nation's largest, offers both Fidelity and non-Fidelity funds to its 11 million accounts. The firm owns a discount brokerage that sells stocks, bonds, exchange-traded funds and other financial products.

"They have been preparing for the day when their funds couldn't outperform," Bonnanzio said.

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