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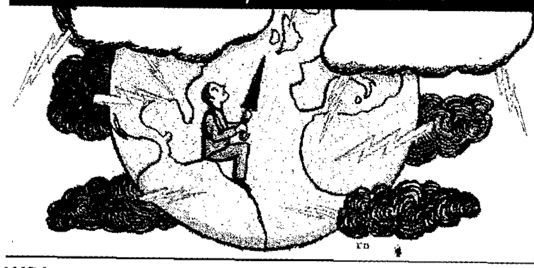

BUSINESS & FINANCE

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THE INTELLIGENT INVESTOR

Why a Legendary Market Skeptic Is Upbeat About Stocks

By Jason Zweig

With economic growth at a standstill, Europe a financial disaster area and the U.S. stock market tanking, who better to turn to for advice than John C. Bogle?

Mr. Bogle founded **Vanguard Group** in 1974. Two years later, he launched the first index mutual fund, enabling investors to bet on broad baskets of stocks at low cost. Along the way, he has been a tireless, though critics have said sanctimonious, crusader against overpaid money managers, ineffective policy makers, short-term-fixated investors and financial professionals corrupted by conflicts of interest.

Mr. Bogle's forecasts of stock and bond returns, while hardly perfect, have been more accurate than most. In the early 1990s, he predicted double-digit-percentage annual gains for stocks over the coming decade. (He was correct.) In 1999, Mr. Bogle foresaw low-single-digit returns for the next decade. (He should've been even more pessimistic.)

Mr. Bogle, 82 years old, has survived at least half a dozen heart attacks since 1960, a heart transplant in 1996, three days in a coma in 2009 and four broken ribs when he took a spill two months ago.

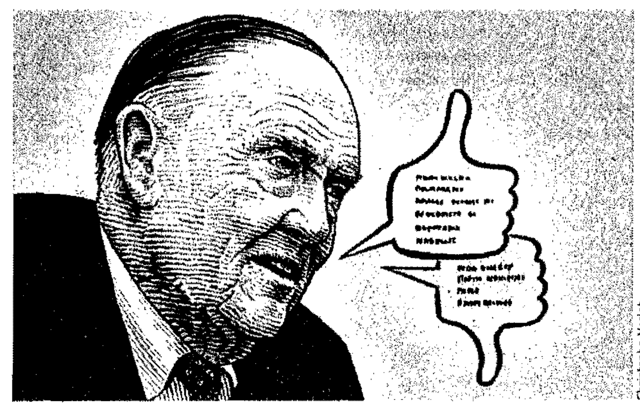
Yet the ravages of Mr. Bogle's body seem to have toughened his mind. While he is frustrated at governments around the world for bungling financial policy and at speculators for hijacking the markets, he is optimistic that future stock returns will be better than many people expect.

I visited Mr. Bogle on Wednesday in his office at Vanguard's headquarters near Philadelphia. We spoke first about the growing cadre of investors who believe that diversification is unnecessary, and buy-and-hold investing is foolish, in an era of low returns. Such investors cite the last, "lost" decade as evidence of the failure of traditional investing advice like Mr. Bogle's.

Mr. Bogle stuck to his decades-long view. "Diversification is not only the first important thing investors should think about, but the second and the third, and probably the fourth and fifth, too," he said. He explained that it is worth taking the risk of betting against the collective judgments of other investors only when you know far more than they do about an investment.

For the buy-and-hold philosophy to work, it must be applied not just to stocks but across an entire portfolio, including bonds and other assets, he said. That is because the stock market is, above all else, "spasmodic," he said.

As for the double-digit annual gains of the 1980s and 1990s, Mr. Bogle said, "the idea that that could recur again is something to do with insanity." But Mr. Bogle noted that the returns of the past three decades, averaged together, come close to stocks' long-term average annual gains of nearly 10%.



Christophe Vorlet

Over the next decade, Mr. Bogle said stocks are likely to generate an average annual return, including dividends, of around 7%. "Your money will double in 10 years," he said. "How bad is that? People ought to get over the illusion [of higher expectations] and realize that they may have to invest for longer time periods, start earlier and save more."

Has indexing—the automated strategy of buying all the securities in a market benchmark—gotten out of hand? "Unequivocally yes," he said. "It has been bastardized."

Mr. Bogle is irked by the proliferation of exchange-traded funds, many of which are narrowly focused. Some ETFs use leverage to multiply a market's return, and thereby raise risk. While some investors may be using narrow ETFs to fill gaps within an otherwise diversified portfolio, Mr. Bogle says ETFs often "are just great big gambling, speculative instruments that have definitely destabilized the market."

Mr. Bogle's own portfolio consists of roughly 80% bonds, mostly tax-free, and about 20% stocks. All of his stock funds consist of holdings traded on U.S. exchanges.

Mr. Bogle admitted that he was almost bitten by the gold bug recently. "Maybe I ought to try a little," he recalled thinking then. Unlike bonds that pay interest or stocks that generate dividends and earnings growth, "gold has no internal rate of return" and is "the ultimate speculative investment," he said. Mr. Bogle said he had no regrets about not buying.

He added, with a laugh: "Of course, I'm assuming there will be no apocalypse. And that's almost always, if not quite always, a good assumption."

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