February 22, 2012

To Principals and Veterans,

As one who wrote a book entitled *Enough.*, I'm wondering whether my mission to serve investors hasn't now gotten "enough" attention in this 60th year of my career.

I raise this (delightful) concern following the "JCB Legacy Day" celebration on Wall Street three weeks ago, for this morning I received a copy of the current issue of *Journal of Indexes*, devoted almost entirely to my work—"The Bogle Issue."

It includes comments from a wide range of industry participants about my role in making the financial world—and especially the mutual fund world—a better place for investors. Particularly interesting are the kind comments of our own Gus Sauter and Burt Malkiel, and the analysis of Chris Philips in "The Case for Indexing." (Thanks, group!)

I'm attaching just a few excerpts from the 64 pages(!) published in JOI, including the crossword puzzle (pretty exciting to have that!).

I'll get some extra copies of "The Bogle Issue" for those who want to see more of it . . . though I expect that most of you will find these attachments "enough."

Best,

Jack Bogle

Journal of Indexes

www.journalofindexes.com

the bogle issue

March / April 2012

Jim Wiandt
Editor

Tipping Our Hats

If one person can be credited with making the existence of this publication possible, it would be John Bogle. Yes, indexes have been around for over a century, but it wasn't until Mr. Bogle launched the Vanguard 500 and kick-started an entire investment phenomenon that they were viewed as anything other than measures of the market. So some 35 years after the advent of the first index fund, it makes sense to pay tribute to the man who started it all.

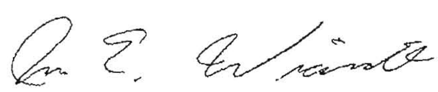
We open the issue with excerpts from Bogle's 1951 college thesis, "The Economic Role of the Investment Company." Some 60 years later, it remains a fascinating read, and you can easily tease out the premises that eventually evolved into Bogle's investment philosophy. We then fast-forward several decades for a recent interview with the man himself: Find out what Jack Bogle *really* thinks about our current investment environment, taxes, politics and his accomplishments.

Next is a roundtable that asks Bogle's friends and colleagues about his impact on them and the investing public. Gus Sauter, Burton Malkiel, William Bernstein, Rob Arnott, Don Phillips and others offer their personal impressions and thoughts, with additional commentary from David Swensen, Paul Volcker and the late Paul Samuelson. What follows is a sneak peek at Bogle's upcoming book, "The Clash of the Cultures: Investment vs. Speculation," which will be published this summer by John Wiley & Sons.

After that, Standard & Poor's Srikant Dash weighs in with his top 10 takeaways from a decade's worth of SPIVA reports and Persistence Scorecards—you might be surprised by some of his findings! And Christopher Philips offers the latest version of "The Case for Indexing," Vanguard's seminal research paper on why passive investment is the only sound decision. If anything, the argument has grown stronger over time.

Rolf Agather of Russell Investments takes a look at the history of indexing and the modern-day blending of passive and active strategies, offering suggestions on best practices for index providers in the current environment. Then David Blitzer chimes in with a look back at the original academic arguments underlying the advent of the index fund. Finally, Bruce Greig rounds out the issue with a crossword puzzle built around Bogle's career and influences.

Let's all raise our glasses to the marvelous, brutally honest and passionately sensible Jack Bogle!



Jim Wiandt
Editor

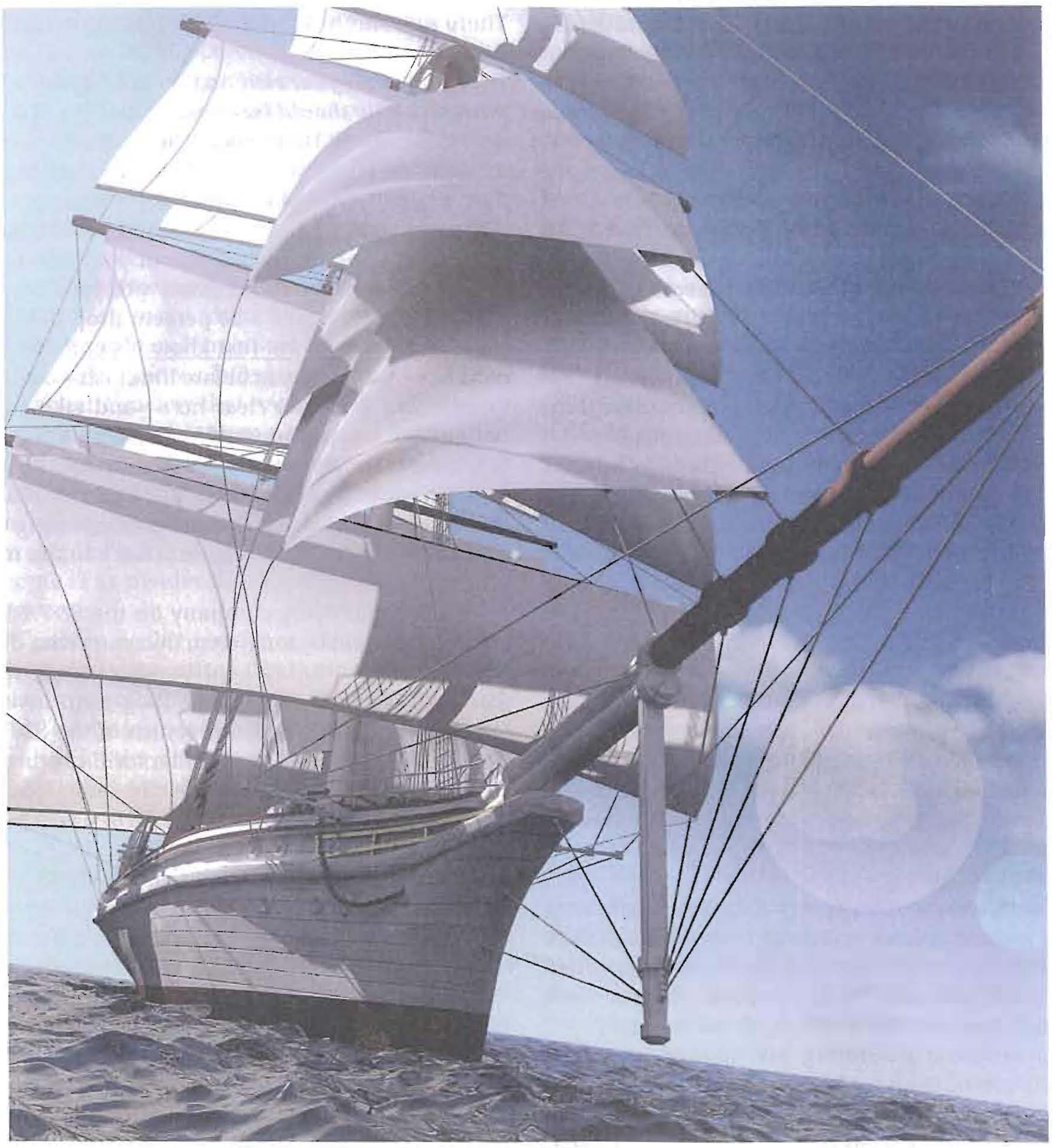
The Economic Role Of The Investment Company

Excerpts from the author's 1951 college thesis

By John Bogle

The Bogle Impact: A Roundtable

Colleagues and friends offer their thoughts



In his long career, John Bogle has influenced countless financial professionals and investors. The *Journal of Indexes* reached out to some of his best-known colleagues, rivals and friends to ask them about how his advocacy has affected them and its lasting impact on how Americans invest.

Gus Sauter, CIO, Vanguard Group

JoI: What impact has John Bogle had on you as an investor and financial professional?

Sauter: I entered the industry with a more theoretical approach to investing, and Jack helped me understand the practical side. Indexing works, not because markets are efficient, but because it doesn't have the high cost burden of active management.

JoI: What is your current long-term market outlook? Do you think traditional buy-and-hold index-based investing has a place in that market scenario?

Sauter: There's always a possibility for just about anything to happen, but the stock market has reasonable valuations, and so historical rates of return are quite possible over the long term. Bond yields are extremely low, so the longer-term prospect for bonds is likely to be less than historical returns.

JoI: What do you think John Bogle has gotten wrong?

Sauter: Jack and I agree on many things, but we also disagree about certain topics, including the use of ETFs. I believe they can be used as a very effective way for many advisors and direct investors to gain low-cost, indexed exposure to the market. Let's just say Jack disagrees with that view.

JoI: What do you think John Bogle's lasting impact will be on investing and investors?

Sauter: Not only did Jack create a company solely dedicated to the interests of investors, but he also created indexing in the mutual fund industry. Many, many investors are much better off today because of Jack's contributions.

William Bernstein, Principal, Efficient Frontier Advisors LLC

JoI: What impact has John Bogle had on you as an investor and financial professional?

Bernstein: Two big things. First, he has taught me the importance of institutional structure and culture. He did that not so much through his words, which are powerful enough, but through his deeds. His biggest deed was of course his donation—there's no other word for it—of Vanguard itself to its fund investors. It's almost as if Ford or Procter & Gamble issued shares to the people who bought their cars and soap, or if Bill Gates had given away a piece of Microsoft to each purchaser of Windows. Vanguard's culture is thus entirely different from that of any major corporation, and especially from any financial corporation. The typical bank, brokerage or mutual fund company would have you believe that the best interests of its customers and owners are the same. If we have learned anything during the recent financial crisis, it is that this is a fiction.

Second, he's shown me that you never stop moving, never stop striving. Most people in his position would have long since gone to the beach, done the odd charity gig. He's still learning, still trying to improve the world, still making a difference, still reaching out and helping people with an almost superhuman vigor.

JoI: What is your current long-term market outlook? Do you think traditional buy-and-hold index-based investing has a place in that market scenario?

Bernstein: I only know what Jack taught me, which is what I call "the Bogle modification of the Gordon Equation," that long-term return is simply the sum of what Jack calls the "fundamental return": the sum of dividend payout and dividend growth, and what he calls the "speculative return," which is the change in the dividend or earnings multiple. What that tells me is that the expected return of stocks is perhaps 7-8 percent, which assumes that stocks are fairly valued at the moment.

Whenever the market does poorly, people trumpet "the death of buy-and-hold." What they forget is that it's not "buy-and-hold," but rather "buy, hold and rebalance." That last operation mandated that investors purchase some equities after the declines of 1987, 1990, 2000-2002 and 2007-2009—and sell some equities when the sun shone in between. Add to that benefit the long-run surefire above-average performance and lower risk of deploying stock assets in broad market indexes. Why would you ever want to screw that up by chasing last year's best active manager or listening to this year's lucky talking-head?

JoI: What do you think John Bogle has gotten wrong?

Bernstein: I can't answer that for certain, since I only know what we disagree about, and I could be the one who is wrong. And given Jack's track record, the latter could easily be the case. Where we're a few degrees apart on is the existence of the value and small premiums, and on the variability of the equity premium itself with valuation. Actually, on that last point, he understood earlier than most that valuation matters. He just differs on what to do about it—I say adjust your equity allocation up or down a small amount opposite big changes in valuation; he says do nothing. I also think that U.S. investors should expose themselves to more foreign assets than he recommends.

JoI: What do you think John Bogle's lasting impact will be on investing and investors?

Bernstein: I had dinner the other night with a friend who, like many well-to-do individuals, has a stockbroker. In addition, he has a low-cost 401(k) plan that is heavily index oriented. When the broker heard that my friend had retired, he asked him to move his 401(k) plan to his brokerage firm. My friend wondered aloud to me, "Why would I want to do that? My employee plan's expenses are one-quarter of my broker's."

I'm not sure whether he'd heard of Jack, and I'm pretty sure he's never read him, but he sure as heck was channeling him. That will be Jack's legacy: For the first time, large numbers of ordinary investors are thinking about investment expenses; that's a very big thing.

Burton Malkiel, Chemical Bank Chairman's Professor of Economics, Emeritus and Senior Economist, Princeton University

JoI: What impact has John Bogle had on you as an investor and financial professional?
Malkiel: As a believer in indexing before such funds were available, I am delighted now to be able to recommend specific vehicles to the investing public. Jack has made that possible.

JoI: What is your current long-term market outlook? Do you think traditional buy-and-hold index-based investing has a place in that market scenario?
Malkiel: We are likely to be in an age of financial repression, such as the period following World War II. Interest rates are now artificially low, and high-quality bond portfolios are unlikely to produce positive real returns. But even though investment returns may be low for all asset classes, I believe a substantial equity risk premium does exist. Broadly diversified equity portfolios (including stocks from the rapidly growing emerging markets) will, I believe, serve investors well over the long term. I do not believe in market timing. No one can do it consistently, and when we try, individuals as well as professionals are more likely to get it wrong rather than right, as our emotions tend to get the best of us. Buy-and-hold index-based investing is still the best course. But techniques such as dollar-cost averaging and rebalancing can reduce risk.

JoI: What do you think John Bogle has gotten wrong?
Malkiel: Jack has been too negative on the ETF revolution. To be sure, his criticism that they are too often used for speculation rather than investment is absolutely correct. But because they can be even-lower-cost vehicles than mutual funds (and because they can have potential tax advantages), they can be very valuable instruments for longer-term investors. Buying an ETF at 11 a.m. and selling it at 2 p.m. is speculation rather than investing. But some people will want to do this, however foolish that may be, and trading in and out of mutual funds can create costs for long-term investors in the fund.

JoI: What do you think John Bogle's lasting impact will be on investing and investors?
Malkiel: Jack Bogle has made two major contributions with a lasting impact, in particular. First, Bogle created a unique mutual-fund company in Vanguard—owned by its fund investors and providing the lowest-cost investment vehicles publicly available. Vanguard is truly a

From the Foreword to "Common Sense on Mutual Funds: Fully Updated 10th Anniversary Edition" (2010)

Jack Bogle deserves the profound gratitude of the American public. First, he devotes enormous amounts of time and energy to showing investors how to navigate the treacherous marketplace for financial services. Second, he created Vanguard, a rare financial institution that places the interests of the investor front and center. Without Jack Bogle's efforts, Americans would face a financial landscape nearly barren of attractive alternatives.

Bogle offers disarmingly simple advice: employ low-cost index funds in a low-turnover, disciplined portfolio strategy. Unfortunately, few follow his sensible advice. The vast majority of investors play an active management game in which they lose two ways. First, they lose by choosing actively managed mutual funds that almost always fail to deliver on the promise of market-beating results. The shortfall comes from wildly excessive, ultimately counterproductive trading (with attendant market impact and commissions) and from unreasonable management fees (that far exceed the managers' value added, if any). And, as Bogle points out, nearly all mutual fund managers behave as if taxes do not matter, thereby imposing an unnecessary and expensive tax burden (that often blindsides the investing public when they deal with the IRS on April 15).

Second, investors lose by trading mutual funds with eyes fixed unwaveringly on the rearview mirror. By dumping yesterday's faded idol and chasing today's hot prospect, mutual fund investors systematically sell low and buy high (which is a poor approach to making money). Moreover, the frenzied switching of funds often triggers a further tax burden. If investors followed Bogle's advice to use index funds, by dint of low costs they would beat the vast majority of fund managers. If investors followed Bogle's advice to take a steady approach to allocating assets, by avoiding perverse timing moves they would benefit from realizing nearly all that the markets have to offer.

Of course, as a financial professional I have my own views and offer two small amendments to Bogle's recipe for investment success. I would place a greater emphasis on the value of international diversification, particularly with respect to exposure to emerging markets. Second, I would limit holdings of bonds to full-faith-and-credit issues of the United States government. The experience of investors in the recent financial crisis (as well as the experience of investors in the market dislocations in 1998 and 1987) illustrates in high relief why exposure to credit risk (and optionality) undermines the very reason for holding bonds in the first place. That said, Jack Bogle gets the essential elements right. Follow his advice.

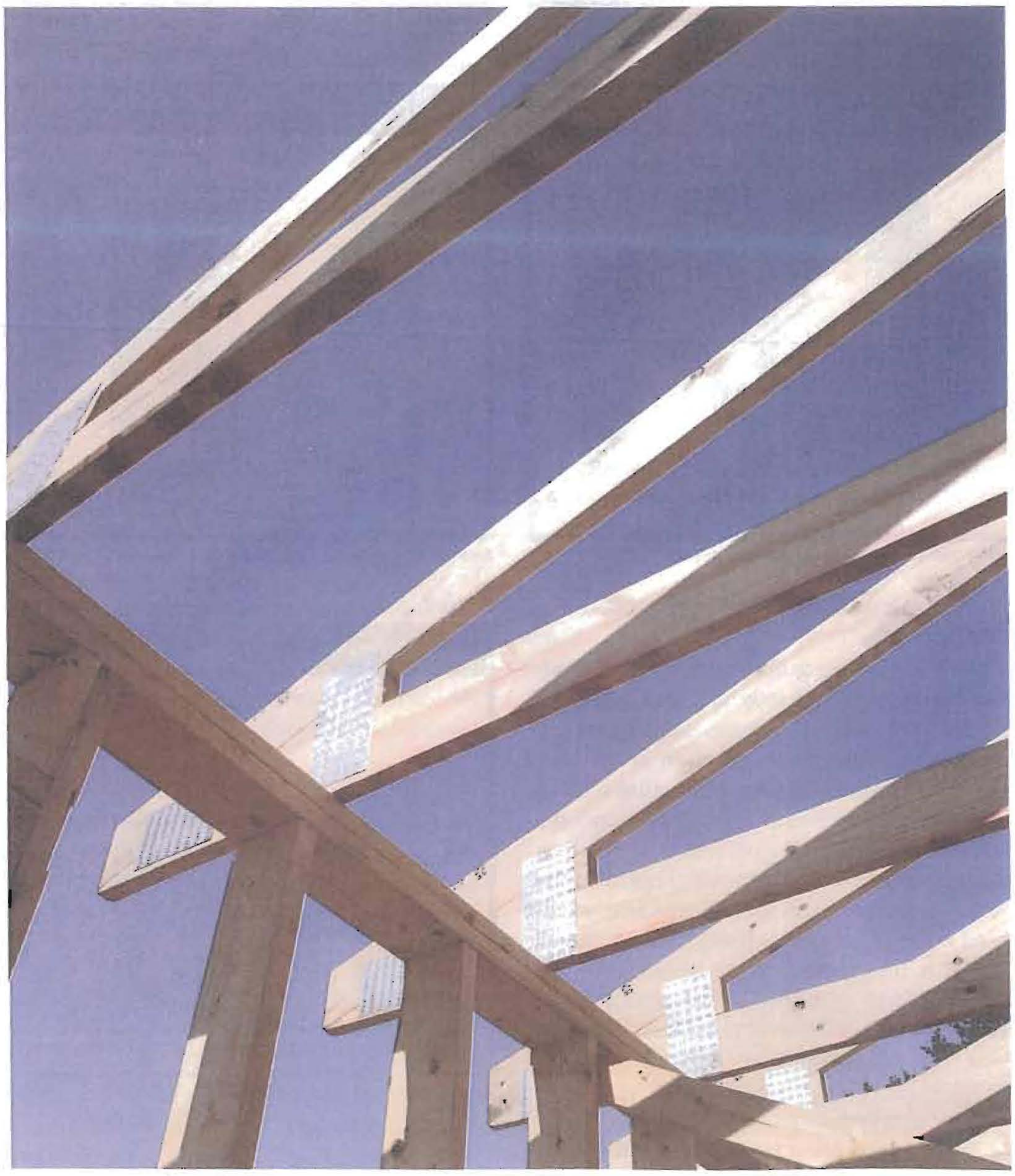
David F. Swensen
Chief Investment Officer, Yale University

Published in 2010 by John Wiley & Sons

The Case For Indexing

Revisiting the foundations of passive investment

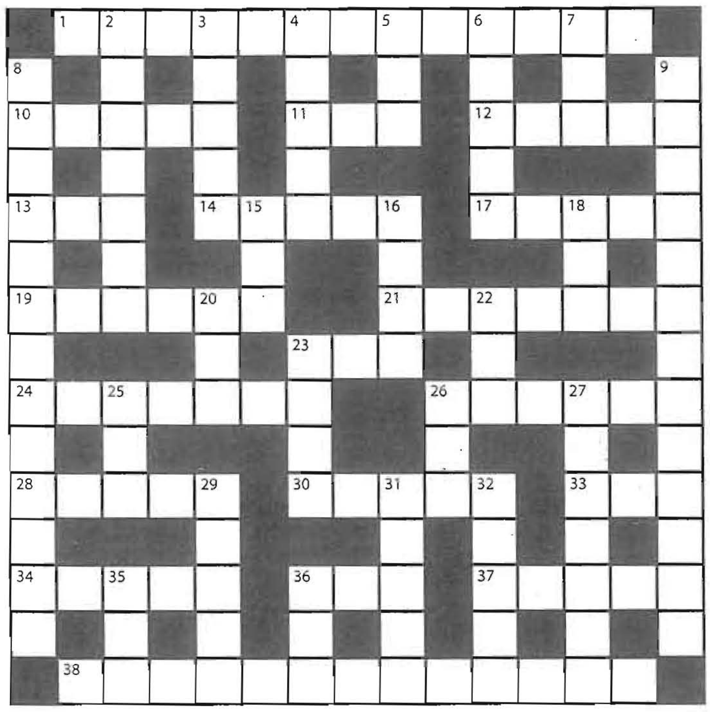
By Christopher Philips



A True Industry Vanguard

How much do you know about the origins of index-based investing?

By Bruce Greig



ACROSS

1. Proponent of the efficient market hypothesis, and major influence on 37 across
10. ___ drop of a hat
11. Investment fund viewed skeptically by 37 across
12. One of the "Greeks" in options trading
13. Pioneer cell phone co.
14. Not a liability
17. Accord maker
19. Grove, ex-CEO of Intel
21. Type of "equity"
23. Chart often used to show asset percentages
24. It was spent in Athens
26. Money-back deal
28. Sharpe, P/E or dividend yield
30. Shell alternative
33. Unit of market-traded shares
34. Bring together
36. Oft-traded beans
37. Puzzle's theme, John ___
38. First American to win Economics Nobel Prize, and major influence of 37 across

DOWN

2. Bull market chart pattern
3. See 12 across
4. Necessities
5. Justice Dept. division
6. Retirement plan for the self-employed
7. Chicago-to-Pittsburgh direction (abbr.)
8. Investment company founded by 37 across
9. 37 across prefers it to be low
15. Spotted
16. Old-time Wall Street machine
18. Magic and Wizards org.
20. Biblical verb ending
22. NY Exchange for trading Russell index futures
23. One source of oil
25. One-time competitor of 13 across
26. Financial ratio, similar to rate of return
27. Fast, in music
29. *Investor's Business Daily* founder, William ___
31. Louisiana waterway
32. Motown, Atlantic or Columbia
35. Retirement vehicle championed by 37 across
36. Loan-granting Fed. agency

Solution

Across: *1. Burton Malkiel; 10. At the; 11. ETF; 12. Omega; 13. GTE; 14. Asset; 17. Honda; 19. Andrew; 21. Private; 23. Pie; 24. Drachma; 26. Rebate; 28. Ratio; 30. Mobil; 33. Lot; 34. Unite; 36. Soy; 37. Bogle; 38. Paul Samuelson*

Down: *2. Uptrend; 3. Theta; 4. Needs; 5. ATF; 6. Keogh; 7. ESE; 8. Vanguard Group; 9. Management fee; 15. Saw; 16. Tape; 18. NBA; 20. Eth; 22. ICE; 23. Palm; 25. AT&T; 26. ROI; 27. Allegro; 29. O'Neil; 31. Bayou; 32. Label; 35. IRA; 36. SBA*