December 17, 2012

To Principals and Veterans:

MORE "STUFF"

There have been so many press articles written about Vanguard, my new book, and my career that I don't feel comfortable sending all of the stories to you. Instead, I'm attaching to this note six of the most prominent articles, and then posting the others on my eblog—www.johncbogle.com/wordpress/in-the-press.

The following stories are attached:

1. ***Fortune,*** December 24, 2012, "A Visit with the Father of Indexing." (Good for at least a few laughs!)
2. ***Main Line Today***, October 2012, "You Don't Know Jack." (But you will know him—a bit—after you read it.)
3. ***Inc.,*** October, 2012, "The Finance Industry's Only Living Saint." (Over the top!)
4. ***Philadelphia Inquirer,*** December 9, 2012. "Antidote to Market Mania: 'Hold Tight.' " (Nice preview of Michael Smerconish's Book Club gathering at Villanova last week. Full house.)
5. ***Research Magazine,*** October 2012. "How John Bogle Really Sees ETFs." (More accurate than most characterizations of my views.)
6. ***Index Universe,*** September 28, 2012. "The Clash of the Cultures . . . is the latest and perhaps best book by the . . . founder of The Vanguard Group."

If that's not, well, *Enough* for you, I have also posted the following on my eblog: "The Scourge of Speculation" (**FIX Global**); "Dim View of the Asset-Management Industry" (**U S News and World Report**); a comprehensive book review (**Financial Analysts Journal**); "Best Books for an Investing Novice," (**The Wall Street Journal**,) selecting *The Little Book of Common Sense Investing;* "Forget Trading, Start Investing," (**Money-Life Show**, Chuck Jaffe); "Fund Directors (Secret) Holdings" and "Bold Commitment and Personal Magic," (**Directors and Boards**); "Bogle Walks the Talk," (**Corporate Board Member**); "Bogle's Lament for Investing's Culture Clash," (**Toronto Globe and Mail**); and—finally!—"Long Live Buy and Hold" (**Investment Advisor**).

You'll enjoy the surprising **Editor's Note** at the end of this final story, a nice way to end this huge compilation. The good news: there's almost nothing left to be said!

Please enjoy a wonderful holy day season!

Best always, Jack

P.S. *I must reiterate my strong personal reluctance to circulate all this material to you. But if I don't, you'll never see it. Now it's up to you.*

FORTUNE

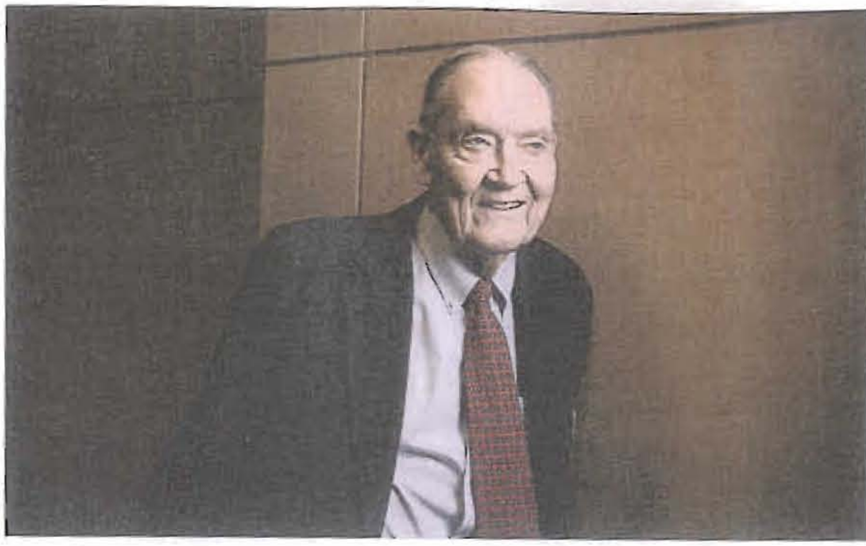
2013 INVESTOR'S GUIDE

There are many steps to managing your money wisely. A good way to start: a visit with the father of indexing, John Bogle.

BY ANDY SERWER

WHAT IF YOUR LIFE'S WORK could be measured by one simple number, and what if that number was 2.2 trillion? As in dollars. I walked into an upscale Midtown Manhattan restaurant looking for such a man. He was easy to spot. Not because he was oozing wealth from every pore and surrounded by an entourage—but because he wasn't. Over there in the corner, he's the older fellow in a plain suit and a boring tie who looks a tad uncomfortable in a place that serves up Spanish

Illustration by CARL DETORRES



Jack Bogle built Vanguard into a $2.2 trillion behemoth by selling low-cost mutual funds. Invite him to lunch at a fancy New York City restaurant, and he orders a hamburger

Octopus a la Plancha, with sofrito, cocoa beans, marble potatoes, and serrano ham. (He would have a hamburger—hold the pickled ramp dressing.)

John C. "Jack" Bogle, 83, didn't build Vanguard into one of the biggest companies in the world by sitting around eating fancy Spanish octopus. He's all about keeping things simple. And he's a fighter, a cantankerous iconoclast, and more than a bit of a zealot. He officially retired in '99 and hasn't been in the best of health for a while, but he still believes adamantly that conservative, low-cost index funds are the best way—nay, the only way—to invest. And now so, too, do millions of Vanguard customers around the world. They've invested $2.2 trillion in the house that Jack built from scratch 37 years ago.

This is the third time I've written about Vanguard in my career at *Fortune*. The first was in 1991, when the company had around $80 billion under management; then again in 2001, when it had $540 billion; and now, after it has quadrupled in size over the past 11 years. (I know, I'm a year behind schedule.) In that time Vanguard has quietly become one of the greatest business success stories of our time. And over the decades I've come to realize a thing or two about the company—namely, that it is truly unique and seemingly inexorable. Vanguard has grown in every kind of market as enlightened investors beat a path to its door.

In case you don't know, here's how Vanguard works: The company sells low-cost mutual funds (primarily index funds) and ETFs directly to investors, thereby bypassing brokers and their markups and marketing fees. The most important distinction, though, is that Vanguard is able to operate with the lowest margins in the business because, like a mutual insurance company, it is owned by its customers. (In Vanguard's case: investors in its funds.) Of course Vanguard pays its managers and executives. But instead of paying out profits to an owner or shareholders, the company's gains are instead realized by lowering costs. Got it? Meaning Bogle has built Vanguard into a global behemoth and yet not become fabulously wealthy. Which is a big reason no one else has seen fit to create another Vanguard. To do so, you'd have to be a true believer. And not many people are.

Bogle has met me to talk about his new book, *The Clash of the Cultures: Investment vs. Speculation*, in which he eviscerates most investing practices and much of what happens on Wall Street. "I don't pay attention to what others say. I say what I think," he tells me, while warily eyeing my Fall Roasted Root Vegetable Salad with petite lettuce, goat cheese, duck confit, figs, apple, and carrot vinaigrette. "I don't know how to do otherwise." (I think he wants to say something about my salad, but Jack does have some limits.)

The fundamental principles that Jack has always emphasized, and still does—getting diversified market exposure, not giving your profits away in fees—are the building blocks of success for the average investor. There is a lot of sophisticated advice in this year's Investor's Guide. And all of it—stock picks from elite managers, market insight from seasoned pros, tips on buying real estate in your IRA—can help give you a boost. But that doesn't mean we should ever lose sight of the basic, commonsense approach that works for Vanguard.

As I help Jack hail a cab to take him to Penn Station (no Town Cars or limos for him) to catch his train back to Philadelphia, I realize that when you boil it down, his success is a result of the power of independent thinking. Jack has consistently gone his own way and made up his own mind. It's an important point to remember when considering how to invest. Very few of us have the same ability as Jack. We need help and advice. But you should always ask yourself, What do I really think about, say, Apple's stock or a particular bond fund? Does investing my money there make sense to me? You may not build quite what Jack has, but thinking a bit more like him is sure to help you succeed.

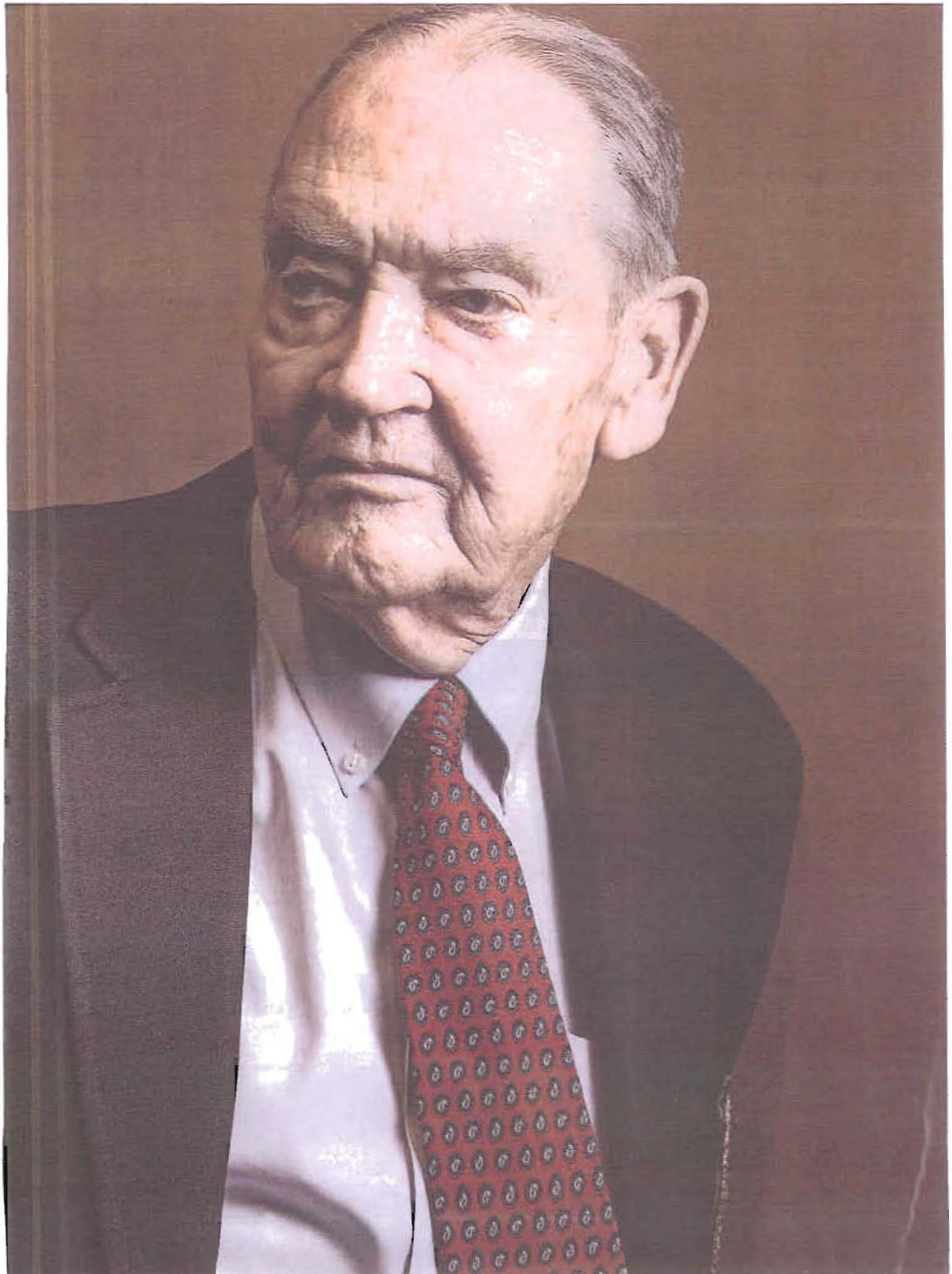
you don't know jack

For Vanguard's 83-year-old founder, it's always been about the greater good—just spare him the superlatives. BY J.F. PIRRO Photo by Jared Castaldi

"*I tell you that virtue is not given by money, but that from virtue comes money and every other good of man.*" – Socrates

Jack Bogle has shared many things in his life and career. Among them, the very financial giant he founded. He's shared stories, too—like the one about the student who approached him after a speech at the University of Pennsylvania's Wharton School.

"So what's the real story?" the student asked Vanguard's



Above: Jack Bogle (left) joined Wellington Management Company in 1951, after penning his senior thesis on mutual funds at Princeton University. **Right:** Bogle's successor, John Brennan (left), and chief investment officer Gus Sauter celebrate as Vanguard introduced its first exchange-traded funds in 2001. The company now manages more than $200 billion in ETF assets. **Far right:** Vanguard's oldest fund—now the $62 billion Wellington Fund—was founded in 1929.

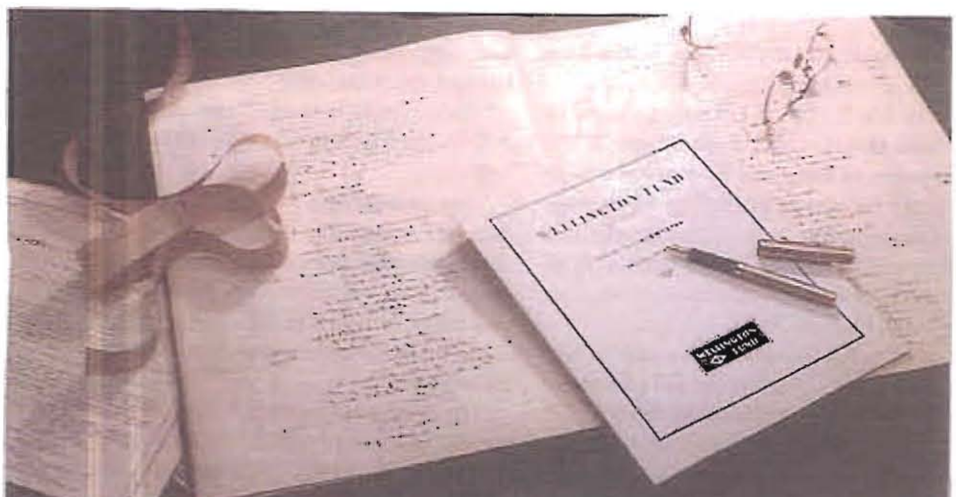
innovative founder with a wink. "Surely you retained some small ownership share to compensate you for your vision?"

"Nope, Jack told him, no ownership stake hidden away in the bowels of the corporate charter," recalls Kevin Laughlin, Bogle's research assistant from 1999 to 2011. "Jack's often remarked that, while not every industry needs Vanguard, every industry needs a vanguard. I think it would be more accurate to say that every industry needs a Jack Bogle—someone who's willing to challenge the status quo, and suffer the slings and arrows of his peers, in order to build a vision."

Bogle is the first to say that he's no visionary. "History could totally ignore me or make me out to be bigger than that, but I'm really a very ordinary person who's had so many breaks. I'm so far removed from genius," says Vanguard's retired CEO, a longtime Bryn Mawr resident. "I used common sense to create and build a new kind of company."

He's modest, too—and quick to take more blame than credit for the ongoing Route 202 widening project. After all, his Malvern-based financial empire employs more people than any other company in Chester County.

If Vanguard were structured like other financial investment firms, Bogle's net worth would be in the multibillions. That's what he left on the table when he made it client-owned—a move that erased any Forbes 500-level riches for its creator.



Echoing our nation's seminal documents, Bogle created Vanguard as "a company that is of the shareholder, by the shareholder and for the shareholder." Funds, he proposed, should be operated at a cost to better serve shareholders with integrity, candor, fairness and honor. A guiding principle: "The honest steward who charges least, wins the most."

Today, the 83-year-old Bogle sees a trio of eye doctors. He's survived seven heart attacks and a 1996 transplant. Though riddled with arthritis, he remains spry and outspoken—a rare hybrid of sharp economist and wishy-washy idealist. In his eclectic 2008 book, *Enough. True Measures of Money, Business, and Life*, the staunch contrarian and self-described "battler" recounts a classic exchange between Kurt Vonnegut and Joseph Heller at a party for a billionaire:

Vonnegut asked Heller how it made him feel that their host, only yesterday, may have made more money than his novel, Catch-22, *earned it its history. Heller told Vonnegut that he had something the billionaire could never have—the knowledge that "I've got enough."*

Bogle Financial Markets Research Center was established in 2000 to support ongoing post-Vanguard work on behalf of investors. Four years later, its namesake would make *TIME* magazine's list of "The World's Most Influential People."

A month before his heart transplant in 1996, Bogle stepped down as Vanguard's chief executive. Three years after that, he stepped down from his position as chairman of the board—a move then cast as company policy and since disputed. He had differences with John Brennan, the successor he'd groomed, and was basically eased out of his own company. "No other director retired at 70," says Bogle now.

As for his independent venture, Bogle continues to be amazed. "When I left in 1999, I was afraid my phone would never ring," he says. "Well, that hasn't happened."

Headquartered in Malvern's Victory Building, the center has provided a conduit for Bogle's speaking engagements and other community and industry obligations. It's also a home base for launching new investigations—the next one focused on pension plans. Sitting in his office, dressed in a green sweater and khakis, his thinning hair combed straight back, Bogle reveals that he's 10 days away from finishing his 10th book, *The Clash of the Cultures*. Now available, it pits speculation against investment while lamenting how risk has supplanted solid decision making. Wall Street, he asserts, is one "gigantic gambling machine."

Casting out to sea in the mutual funds war in 1974, Bogle named his company after the *HMS Vanguard*, Lord Horatio Nelson's flagship in the British victory over Napoleon at the Battle of the Nile. In stark contrast to his industry peers, he's led a life that hasn't been about "greed or about being number one," as one veteran Vanguard employee puts it.

Bogle's causes have never been popular, nor has his perpetual search for the answer to the question: What value have you created for society? But he's remained consistent and persistent, with a dogged devotion to simple, humble investment convictions—balance, diversification and big-picture focus.

"Volatility means nothing to the long-term investor," he says.

In his books on investing, Bogle includes chapters on human beings. When it comes to Vanguard, he continues to advocate for cuts in marketing, an increase in management, a reduction in salesmanship and an uptick in stewardship. It all flies in the face of contemporary buy-now, get-rich philosophy.

Bogle has compared the dip in the American economy to the fall of Rome—a collapse that isn't due so much to greed and power as it is to arrogance, smugness, self-satisfaction, and a meltdown of traditional ethical standards. "Self-interest got out of hand," he says.

He's written that the financial industry has been "blown up by its own dynamite." And it's the only industry, he contends, where customers don't get what they pay for—that beating the market will always be a "loser's game," until it functions in the public's favor.

While Bogle predicted our economic slump, he also knows that he's painted himself into a corner as an "aging mutual-fund Luddite who is uninspired and unimpressed by the rise of complexity (and excess cost) at the expense of simplicity (and minimum cost)."

"It's a greedy industry," says Bogle. "I love it, but I've also had a lover's quarrel with it."

One thing Bogle will acknowledge is that he's responsible for three simple yet unprecedented innovations: the "mutual" mutual fund structure, the index fund, plus municipal bond funds and their three short-term, long-term and intermediate-term levels.

His creation, Vanguard is now one of the two largest mutual fund organizations in the world. He drew investors by the thousands at first, then by the millions. Today, the group comprises more than 130 mutual funds, with current assets totaling $1.82 trillion.

The largest is the Vanguard 500 Index Fund—which, together with its sister Institutional Index fund, has combined assets of more than $220 billion. It was founded and incorporated by Bogle in 1975, then launched the following year. The Vanguard 500 was the world's first index mutual fund.

Bogle calls indexing a "world-changing concept." Still, he's not sure it will change the world in his lifetime. "But it will," he promises.

Others have disputed that his index fund was the first. On its 35th anniversary year, a battle of words was waged in the op-ed section of the *Wall Street Journal*. Bogle's response: "Ideas are a dime a dozen, but implementation is everything."

The huge advantage to indexing is cost. Even if you're merely above average, there's no money left for the next crisis. Therefore, Bogle always wanted to be average—and that's not an easy concept to swallow where money is involved. But the long-term victory, he's always stressed, is based on huge cost advantages in wealth that's compounded over time. "Being average is the ticket," Bogle asserts. "You have to get cost out of the equation, have low-profile turnover and eliminate sales load—and over 10 years, you win. You can beat your peers, if you're average."

Others insist that you must make money for the conglomerates that own you. To do so, they slash workforces, raise fees, and offer new funds, with promises of great days coming.

"It's arrogant to even think you can deliver all that," says Bogle, who one biographer called the conscience of the industry. "It's a cash cow that only feeds management. It's like selling perfume—except they're selling hope."

In 1951, such ideas were those of an idealistic Princeton University student. You won't find the word "vanguard" anywhere in his senior thesis, but the objectives and values for the company he eventually launched are there. He sent his paper to Princeton alum Walter Morgan, the famed founder of the Wellington Management Company. Morgan hired Bogle immediately after graduation, quickly becoming a mentor.

"He was a lot of what I was not," Bogle admits. "But he entrusted me. He liked me. When he died (in 1998), others told me that he always said I was the son he never had."

Bogle became Morgan's heir apparent as executive vice president at Wellington in 1965. But he was fired as its company president in 1974 after a merger backfired. Retained as president of Wellington Funds, Bogle filed a report proposing three options for fund mutualization. The Wellington board authorized internalization of the fund's administrative duties. But since Bogle couldn't use the Wellington name for his new firm, he launched Vanguard.

All these years later, Wall Street hasn't totally turned its back on Bogle. Some 250 people attended its John C. Bogle Legacy Forum last January. After word got out about the honoree's favorite food, he was served a peanut-butter-and-jelly sandwich while being roasted. "It was nice what the people had to say about me," he says. "It was like being around for my own funeral."

Jack Bogle's start in life was about as uncertain as the stock market. He was born in Montclair, N.J., on May 8, 1929, the year of the crash, one of a second set of twins. The first two died at birth.

Initially, the Bogles were well-off. But after the crash, they were soon without. His father had trouble finding and holding jobs, so Jack began working at age 9. And though the family had to move in with Jack's grandparents, his mother's ambition was always to educate her three sons.

On scholarship at Blair Academy in New Jersey, Jack was salutatorian and named both "Best Student" and "Most Likely to Succeed." At Princeton, where he also attended on scholarship, he was captain of the cafeteria's waiters and ran the athletics office's ticket booth.

His older brother, William, settled in Ardmore, and over two Christmas vacations, Jack worked the graveyard shift at the post office. He took a summer job as a police reporter at the *Evening Bulletin* and was also a pinsetter in a bowling alley.

Today, Bogle and his wife, Eve, have six children and 12 grandchildren. For the past 25 years, he's given half his annual income to philanthropic causes—among them, the National Constitution Center, where he once replaced Ed Rendell as its chairman. He also backs scholarships at both Blair and Princeton.

These days, what keeps him coming into the office is "lunacy, ego and fear." "Deep down, I think that, if I stop, I will die," he confesses. "By all accounts, I should've already died seven or eight times, so I don't go around bitching."

And Bogle is still passionate about Vanguard. He loves eating in its cafeteria and chatting with veteran employees—2,000 of them with at least 15 years at the company. "He's tremendously grounded," says Laughlin, who's now a project manager in planning and development. "He never fell into the trappings of wealth and success that ensnare other captains of finance and industry. No collection of homes, boats or luxury cars. No lavish vacations or art collections. He's remained a very simple guy, a child of the Depression who would no sooner make a purchase to let others know just how wealthy he is than fly to the moon."

Bogle remains careful in evaluating himself, weary of the "great inclination to give oneself the benefit of the doubt." Religious and patriotic, he's skeptical of the Information Age and laments the lack of common purpose that pervades society.

"As a teacher of 18th-century English literature and history, I'm struck by how much Jack seemed to fit into that era," says Chan Hardwick, headmaster of Blair Academy. "It was a time when some leading figures believed that moral authority, reason and self-discipline were the elements of armor against self-doubt, irrationality and human weakness."

Meanwhile, Vanguard has changed. What was once a "cottage industry" has grown to an empire of 13,000 employees. That size has led to a betrayal of some principles. "I don't know that it bothers me, but it does disappoint me," says Bogle.

He's diametrically opposed to the commercial branding of the Vanguard name. "If that's what we did, then there's a knot in my stomach," he says.

Laughlin, for one, doesn't shy away from addressing Bogle's sizable contrarian streak. "He relishes challenging conventional wisdom and championing unpopular ideas," he says. "But the fact is that many in the industry view him as a thorn in their side."

By way of proof, Laughlin relates a story about the Investment Company Institute's general membership meeting, where George H.W. Bush spoke. After the speech, all the former ICI chairmen were ushered into a room for a private reception with Bush—all, that is, except for Bogle.

"He rightly viewed this snub as petty. But, in relating it to me, there was a trace of, well, disappointment," Laughlin says. "It made me realize just how lonely his crusade was. The best contrarians—the ones who end up making a difference—need an enormous dose of character and fortitude to weather the push-back and inevitable self-doubt. Fortunately, Jack is well-equipped on all counts." MLT

Inc.

The finance industry's only living saint
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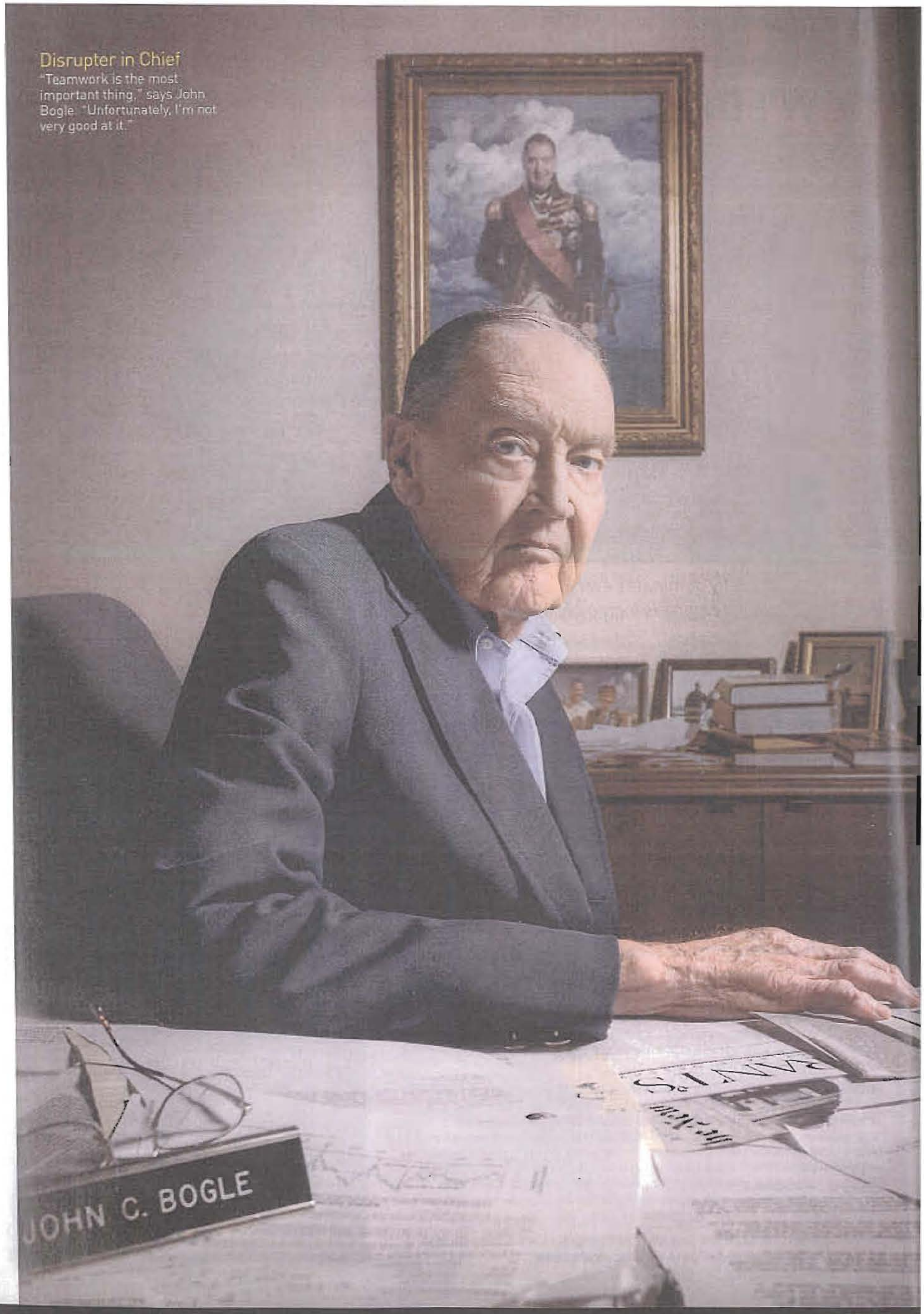

Disrupter in Chief
"Teamwork is the most important thing," says John Bogle. "Unfortunately, I'm not very good at it."

HOW I DID IT

John Bogle

The Vanguard Group

How "Saint Jack" took on an industry—and won

As a student at Princeton, John Bogle wrote his thesis about the mutual-fund business, at the time a Wall Street backwater. Upon graduation, he joined one of the oldest firms in the field—and proceeded to become the most creative disrupter the industry has ever known. In 1974, he founded the Vanguard Group, whose unique approach to fund management has saved shareholders hundreds of billions in fees; that and his righteous denunciations of his industry's sharper practices earned Bogle, 83, the grudging nickname "Saint Jack." Vanguard is now the largest fund group in the U.S., with 13,000 employees and $1.9 trillion under management.

AS TOLD TO ERIC SCHURENBERG / Photograph by Chris Crisman

I'm not sure I really am an entrepreneur. I'm not much of a businessman. I know I'm not a marketing guy. I do have an entrepreneurial lineage, though. My grandfather was a wealthy and respected merchant in Montclair, New Jersey, where I was born. But his estate was wiped out in the Great Depression, and as a result, I had what I consider the ideal upbringing: We were a proud family, good citizens, and we didn't have a sou.

Vanguard never would have happened if I hadn't been fired as CEO of Wellington Management Company, the firm that did the investing for the Wellington fund and eight sister funds. In 1966, I had merged the company with a high-flying group of whiz-kid traders from Boston. I cringe to say it today, but I thought their hot performance would be permanent. I was naive, overconfident, full of every kind of bad attitude. The whiz kids' streak whizzed out, as it inevitably had to, in the recession of 1973–74, and the fund fell by 50 percent. In January of '74, I was fired from the company I considered my own.

I looked into finding another job, but I concluded my best move was to fight back. I went to the fund's board and proposed that it and its eight sister funds split from WMC and start a new company to oversee the funds. The new company would be owned by the funds—it wouldn't have to make a profit and for that reason

could serve the funds much more economically than a profit-seeking management company. Oh, and I would be chairman and CEO.

It took seven months of arguing to reach agreement. The deal left me unhappy and Wellington Management unhappy, but that's what happens in tough negotiations. The new company, which would become Vanguard, could administer the funds, but it couldn't invest the funds' money. So, basically, I was left with only one of the functions of a mutual fund and the least interesting one at that. I could see more fighting was ahead. Thank God I love to fight.

It quickly became obvious that if I wanted to build the company, I had to get into investment management. So I snuck in. I created a fund that arguably didn't require any investment management. All it would try to do is match the return of the S&P 500 index. It sounds like a recipe for mediocrity, but the index fund is actually the killer app of investing, a strategy that cannot empirically be improved on.

It is based on a simple fact. In the stock market, some investors do better and some worse, but their aggregate returns equal the market's returns, minus the costs of investing. After all, they are the market. So if a fund matches the market's gross return and does so at a cost much lower than the average fund, it will always beat the average fund over time. It has to. Borrowing a phrase from Justice Louis Brandeis, I call it the Relentless Rules of Humble Arithmetic. And of all the things I've said and done that people disagree with—and there's no shortage of those—no one has successfully taken that one on.

Academic research supported the wisdom of indexing, but at the time, everyone in the industry thought it was the stupidest idea. I hired four Wall Street brokerages to manage the underwriting. They hoped to raise $150 million;

"Never ask anyone if your idea's any good. If I had, I never would have started the index fund."

they delivered $11.4. I thought, Oh, my God, that's not enough even to buy the stocks in the index. The underwriters suggested we cancel the fund and give the money back. I said, "Wait a minute. This is the world's first index mutual fund." So we managed to approximate the index with the money we had and kept it going. The fund is now the largest in the world.

When I started Vanguard, we had 28 employees, counting me. At that stage of a company's existence, when values were so important and when you had to lay down the law, people considered me something of a dictator. I would say that's a fair criticism. When people ask me about teamwork, I say, "Teamwork is the most important thing. Unfortunately, I'm not very good at it."

You don't have to like Steve Jobs as a person much, bless his soul, but he and I are similar in a lot of ways. He said: Never do surveys; never ask anyone if your idea's any good. I never did If I had, I never would have started the index fund.

The one thing I wouldn't tolerate on the Vanguard crew is arrogance. That's one of the reasons I decided that everyone who was remotely qualified had to be trained to answer phone calls from investors. We had a lot of executive types who thought they were too important to do that kind of thing They had no idea what it's like to be a shareholder.

When we had the panic on Black Monday, in 1987, virtually everyone had to work the phones. I took 106 calls myself. I'd answer the phone: "This is Vanguard; John Bogle speaking. How may I help you?" And they'd say, "Is it really you?" I spent a lot of time on one call explaining bond funds to a woman who didn't know who I was, and at the end she said, "Can I have the name of your supervisor? I'd like to commend you."

The structure of Vanguard has meant that I couldn't get the financial rewards that might have accrued to any other CEO of a trillion-dollar financial services company. I made a decent amount of money before I stepped down in 1999, but every once in a while, because I'm human, I think maybe I should have done it a little differently. Maybe Vanguard should have gone to a profit model, and I should've kept a 1 percent interest. Vanguard would be worth, I don't know, $30 billion, and 1 percent of that is $300 million, which wouldn't be bad. When the hospital that did my heart transplant says they'd like me to give $25 million, I wouldn't have to say no.

But you reach a point in life where you say what is, is. The rewards of my life have been great. I built a company; I left things better than I found them. I have a good reputation. I put the Vanguard shareholders and crew first. That's a huge thing.

And I lived to see index investing, and low-cost fund management and fiduciary duty to fund shareholders, all vindicated. I never thought I'd live to see it. I had my first heart attack when I was 31. My heart stopped beating on seven different occasions before I got the transplant 16 years ago. But you see: I'm still in the fight. I'm like Antaeus, that guy from Greek mythology who took strength from the earth. They knock me to the ground, and I get back up stronger.

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The Pulse: Bogle's antidote to market mania: 'Hold tight'

MICHAEL BRYANT / Staff Photographer

Jack Bogle in 2008.

Michael Smerconish, *Inquirer Columnist*

POSTED: SUNDAY, DECEMBER 9, 2012, 3:01 AM

Don't peek."

Parents with children prone to snooping for presents aren't the only ones urging that. It's also the recommendation of Jack Bogle, founder of the Vanguard Group, who has just published his 10th book, *The Clash of the Cultures: Investment vs. Speculation*, in which he offers 10 simple investment tips, including "Remember reversion to the mean" and "Buy right and hold tight."

Most important, Bogle told me last week, investors should resist impulsiveness. "One of the worst mistakes investors make is paying too much attention to the daily ups and downs on Wall Street," Bogle said.

"All too often, we get caught up in the cacophony of the market and make impulsive, emotional, and simply bad investment decisions - we feel the urge to buy after the market has risen up to the heavens, and to sell after it comes tumbling back to Earth.

"My simple advice is this: Turn off the TV, and don't pay much attention to the regular quarterly statements for your retirement plan. Maybe glance at them once a year, or every five years. And if you toss them all away until you retire, when you open that final statement after all those long years of saving and investing, you'll exclaim: 'Where did all that money come from?' You will be completely astonished by the size of your nest egg.

More importantly, you will have saved yourself from all those potentially disastrous investment decisions along the way. Think about 'Don't Peek' as an important rule of long-term investing."

That's not the sort of advice you'd hear from a Gordon Gekko, the character from the movie *Wall Street* who said, "Greed is good." Bogle is more apt to say, "Stay the course." He didn't earn his reputation by beating the market. He developed an investment model that sought to keep pace with the market. (Critics actually said that was un-American!) And while his life's work has been about money, the man is not driven by wealth accumulation. At the height of his earnings, this proud Princetonian delighted in giving away half of his income to educational and charitable institutions.

So after 61 years in business, nine books, at least six heart attacks, and a heart transplant, what was left for him to say?

"There's a message there that I don't think anybody else or hardly anybody else is talking about," he told me. "Everybody knows our financial system is a mess, but nobody looks through to see what the data actually show. There is an overwhelming presence of speculation in the market that is crowding out long-term investment. The damage it's doing to our society is great."

Bogle's book offers many suggestions for changing our culture, one of which is to require shareholder approval for corporate political contributions. He also singles out a number of "gatekeepers" who have failed to protect investors, including Congress, the judiciary, the Securities and Exchange Commission, the Federal Reserve, rating agencies, accountants, the financial press, security analysts, directors, and stock owners.

Bogle saves his harshest condemnation for money managers, whose timidity he attributes to a fixation with salesmanship rather than stewardship and long-term governance. Bogle sees a corrosive conflict of interest in which the managers overseeing corporate pension funds, thrift plans, and 401(k)s also own stock in these entities. So "you don't want to offend the management," Bogle says, because "you might lose the account."

"There are only two kinds of clients we institutional managers don't want to offend: actual clients and potential clients," he explained. "And that's a lot of clients."

There is something very humble about Bogle. Time magazine may have said he was one of the 100 most powerful and influential in the world, but he never loses sight of the fact that he had a D-plus in economics and was close to dropping out of Princeton in 1948.

He pulled himself out of that early collegiate hole, but there was, he admits, a bit of luck involved in the path he followed from there - the senior thesis he wrote "quite by accident" after reading about the emerging mutual fund industry.

"I never heard of it. I never had any money to invest," he says. "What we were doing was getting dunning notices from lending companies in my family. So I wrote my thesis about this little industry, tiny industry, tiny, but contentious as the magazine described it. And I got a job here in Philadelphia with Mr. Walter Morgan and the Wellington Fund. With a lot of bumps along the way, the rest is history."

Yes, the history of a rare breed in today's financial sector: a humble millionaire selling simple steps in a time dominated by complex counsel.

Contact Michael Smerconish via www.smerconish.com.

Michael Smerconish *Inquirer Columnist*

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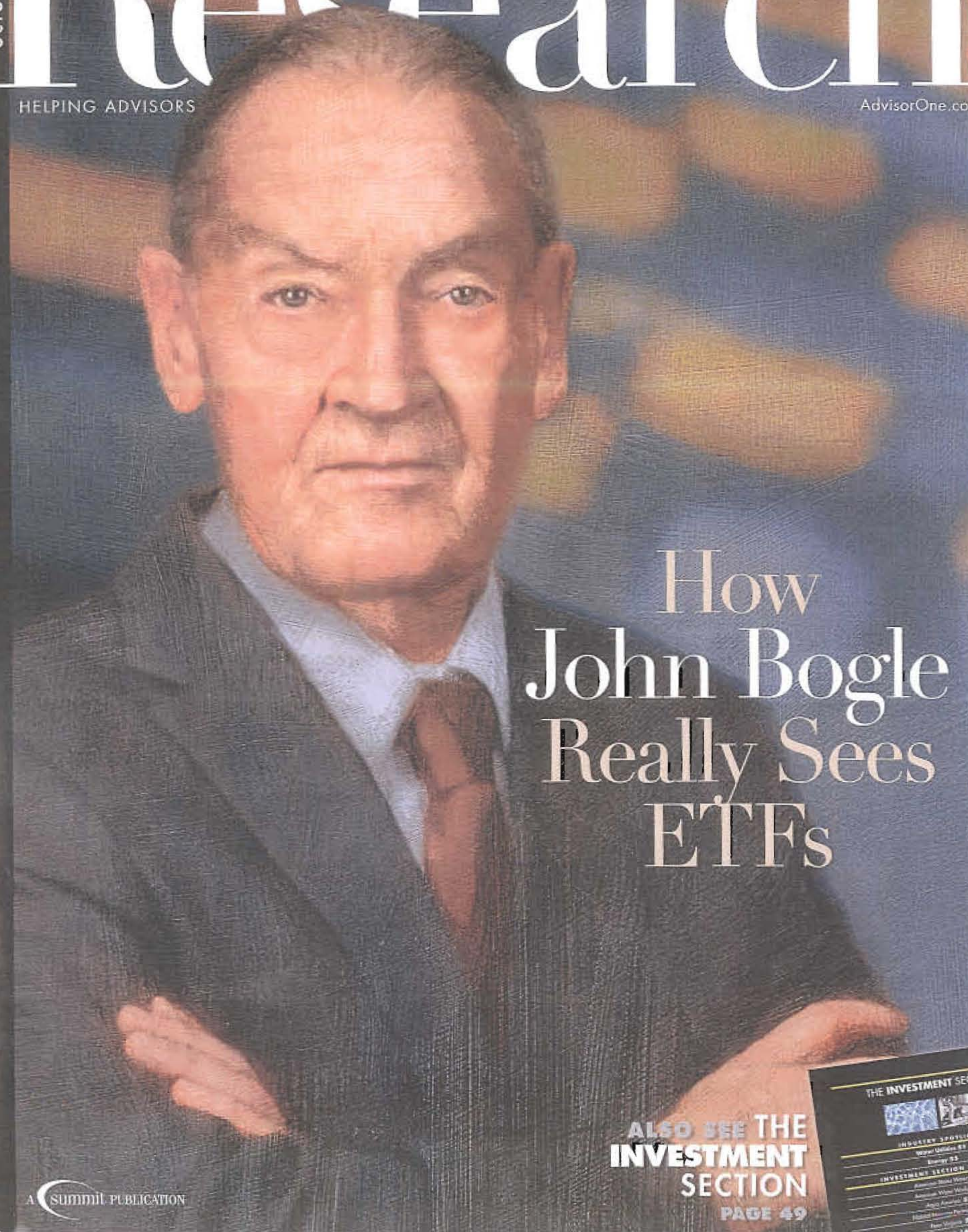

How John Bogle Really Sees ETFs

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A Summit PUBLICATION

How JOHN BOGLE Really Sees ETFs

The investment visionary, long a skeptic of exchange-traded funds, gives his candid assessment of the fast-growing field.

BY JANE WOLLMAN RUSOFF

When John C. Bogle, the founding father of index funds, takes time to interrupt summering in Lake Placid to talk with *Research* about exchange-traded funds, it isn't because he has nothing to say.

"ETFs have become a marketing and promotional game. Those kinds of things are great for marketers but bad for investors," says Bogle, in an August telephone interview, on vacation in the Adirondack Mountains.

Bogle created the first stock index mutual fund in 1975, a year after he founded the Vanguard Group, where he served as chair-CEO for 22 years and senior chair until 2000. Today, at 83, Bogle—who has appeared on *Time* magazine's list of the world's "100 most influential people"—is president of the Bogle Financial Markets Research Center, on the Vanguard grounds in Malvern, Pa.

He has long been a critic of exchange-traded funds but seems to be warming to them, provided they are used in accord with his specs. Still, Bogle is far from ETFs' No. 1 fan.

Indeed, the funds do not suffer from a lack of fans. They are in the thick of a spectacular

ILLUSTRATION BY ALLAN BURCH

> “The ETF has become a heavily traded vehicle used for speculation, often on indexes without much claim to fame.”

growth phase, boasting 2011 estimated net asset flow totaling over $120 billion, according to Morningstar. As of August 2012, there were 1,471 ETFs on the market versus 1,369 at the end of 2011. Traditional mutual funds have been losing market share to ETFs; consequently, mutual fund families are offering them too. Some funds even use ETFs to equitize cash in their own portfolios.

ETFs have become a phenomenon because of their low expenses, tax efficiency, excellence as a prudent diversification tool and last—but certainly not least—because, like stocks and bonds, they can be traded throughout the day.

The ETF is "the most successful marketing idea of the modern age in the securities business. Whether it proves to be the most successful investment idea of the age, however, remains to be seen. I have my doubts," Bogle writes in his new book *The Clash of the Cultures: Investment vs. Speculation* (Wiley).

Twenty years ago, before the first exchange-traded fund was introduced, Bogle was pitched the ETF concept. But the staunch buy-and-hold, stay-the-course advocate refused to be sold. He worried that the product's extra liquidity would invite excessive trading and therefore speculation. Now, he is all but saying: I told you so.

"The ETF has become a heavily traded vehicle used for speculation, often on indexes without much claim to fame except that they have new ideas some marketers waut to test on unsuspecting investors," Bogle says. The proliferation of "fringe element ETFs" has resulted in "a quagmire of choices—everybody's trying to be more creative than the next guy. So there are ETFs of dubious credit quality, leveraged ETFs, people creating their own investment ideas, their own indexes. All that has led to speculatiou."

Many ETFs are indeed exotic funds tracking extremely narrow market niches. A substantial number have proven to be of questionable, if not poor, quality.

Notes Edward Jones principal Matt Embleton, who heads mutual fund and ETF research, and is based in St. Louis: "Every day I get a notice that a new ETF has come out. I'm not sure how many are going to survive and be around for the long term."

Russell Investments in fact announced in August that it was closing all its U.S. passively managed ETFs. The niche funds had failed to generate much interest, possibly because investors needed to drill down deeply to understand them.

Even financial advisors who pioneered ETF investing and remain enamored are quick to point out that the sheer number of ETFs has become troubling.

"There are a lot of ETFs in the smorgasbord of options that are not good. You have to beware of the traps," says Shelley Bergman, a managing director and senior portfolio manager at Morgan Stanley Smith Barney in New York City, an ETF investor since 2006. The Bergman Group manages assets of $3 billion, about $250 million of which are in ETFs. "As the ETF world grows larger and larger," says the FA, "there's mass confusion as to what the underlying securities are."

Bogle's advice to advisors: "Be very wary of narrow segments because the narrower you get, the more risk you expose your clients to. Stay out of lunacy."

He gives ETFs his blessing only when the right funds are used—and used for investing, not speculation. Advisors "should be very selective about ETFs and rely primarily on broad-based-market ETFs. Buy and hold the right ones. Don't buy and hold a fund that's giving you triple leverage. That's a foolish thing to do. It's rank speculation."

While many FAs like ETFs because they consider the low-cost funds to run on "autopilot," others insist they should be watched carefully.

"The average advisor thinks this is a 'set it-forget it' strategy. But they are sorely mistaken, especially in the macro environment we're in," Bergman says. "There are dangers. We constantly monitor the portfolio. We're meeting with a lot of wholesalers. It's a full-time job."

Bogle, of course, still favors traditional index funds over ETFs. "I don't think there's auy great magic to ETFs except for low cost and diversification, though you can get that, and do every bit as well, through a garden variety S&P 500 index fund or total stock market index fund, emerging market index fund or international market index fund."

But he adds: "Anybody who wants to buy a Vanguard S&P 500 ETF and not trade it and hold it forever, more power to them!"

To the extent that ETFs are index funds, Bogle is positive. It is the trading aspect that he claims had led to speculation with which he mainly takes issue.

The ETF marketplace has turned into a chaotic arena dominated by institutional trading, says Bogle, who estimates that 75% of all ETFs are held by institutional investors and that roughly less than 10% of ETF assets are with long-term investors.

According to the Investment Company Institute, "over the past five years ... institutional investors have found ETFs a convenient vehicle for participating in, or hedging against, broad movements in the stock market."

Notes Bogle: "ETFs probably have a turnover rate of 700% per year. That is staggeringly high by any measure," he says. "The mutual fund industry, in general, has a turnover rate among shareholders of 30% to 35%, a three-year average holding—which I myself think is amazingly short."

Bogle is not alone in charging that ETFs played a major role in the stock market "flash crash" on May 6, 2010.

"Sixty percent to 70% of securities that were suspended were ETFs," he says. "Of course it can happen again! With high frequency trading, we have a system that seems out of control. We've created a kind of Frankenstein's monster."

Many investors are drawn to ETFs, Bogle suggests, because "they are worried there'll be a big crisis and that [with ETFs] they'll be able to get out of the market before the end of the day. But when that bad event happens and you want to get out, you're probably right at the bottom. So you're apt to decide at exactly the wrong time."

FAs enjoying significant success with ETFs choose funds with high trading volumes "so there won't be a shortage of buyers when we sell," notes Lawrence Grabenstein, a Raymond James Financial Services branch manager and president of Potomac Financial Group in Calverton, Md.

"The biggest pitfall," Grabenstein says, is choosing the hot sector—getting into an area that has performed well only to see it disappoint. And many ETFs have special risks, such as commodity ETFs or leveraged ones."

Edward Jones won't even permit its clients to purchase leveraged ETFs. Other industry participants are leery of these as well.

"With leveraged ETFs, the ups and downs are magnified," says Michael Iachini, managing director, ETF research at Charles Schwab Investment Advisory, in Englewood, Colo. "There is basic market risk and also risk

Vanguard's ETF Path

TWO DECADES AGO, the American Stock Exchange's head of product development pitched John C. Bogle, then CEO of the Vanguard Group, his brand-new idea of an exchange-traded mutual fund. Bogle, concerned that the extra liquidity would become a magnet for speculation, gave the would-be product a pass.

Nine years later, when Bogle no longer helmed the firm he founded, Vanguard introduced its first exchange-traded fund. Had Bogle still been head, would he have launched an ETF?

"Maybe yes, maybe no. I don't know which way I would have decided," he says. "I've been profoundly skeptical about ETFs. And I've also found in my long, long, long career that when I did something for marketing reasons, it usually turned out to be a mistake."

Since Vanguard debuted its first exchange-traded fund in 2001, ETFs have driven about 25% of the Group's total growth, according to Bogle.

"What Vanguard is trying to do is get into the business in a sounder way than somebody else, and we have done that. There is no reason," he says, "that a Vanguard S&P 500 ETF, for instance, can't go on for a long, long time—and it will."

A Vanguard research study, published in July 2012, examined the trading behavior of the company's mutual fund and ETF individual investors from 2007 through 2011. Looking at 3.2 million transactions, it concluded that though ETF investors were more active than those in traditional mutual funds, this was because "investors who are inclined to trade, choose ETFs—not that investors who choose ETFs, are induced to trade."

The study, Bogle says, showed that "Vanguard individual investors traded ETFs significantly more than holders of our regular funds, but that it wasn't outrageous." —*J.W.R.*

> "Actively managed ETFs are basically casino-type things, leveraging three to one. I call that a lunatic strategy."

because they reset their leverage daily to deliver twice or three times the daily return of whatever index they track. Over six months to a year, the compound effect of that tends to erode returns.... So you set yourself up for failure every time the market reverses direction."

One of the most controversial issues on the ETF landscape is the introduction of actively managed funds, now available from about 10 providers. Fifty-four such funds have been launched as of August 2012, Morningstar says. For example, last March Pimco unveiled an ETF version of its huge Total Return mutual fund; and Fidelity Investments, among others, have filed with the SEC to also introduce actively managed ETFs.

However, financial advisors aren't jumping up and down about actively managed ETFs because the funds, they say, are largely unproven. And, as Bergman points out, "they violate the two main advantages of ETFs: low cost and tax efficiency."

Adds Grabenstein: "If we're looking for actively managed, we'll use either a mutual fund or a separately managed account. We're going to let somebody else be a beta test."

For his part, Bogle fiercely opposes actively managed ETFs.

"It's a bad joke," he says. "People are trying to capitalize on the ETF fad by bringing in these funds at very high cost. I don't see any merit to them except marketing or promotional merit."

He continues: "Actively managed ETFs are basically casino-type things, leveraging three to one. I call that a lunatic strategy. You're not only gambling about whether the market is going up in [the next half hour], you're gambling that in that tiny half hour, your manager is going to do better or worse than the market. How does that comport even remotely with any kind of common sense? It's flagrant stupidity. Do I make myself clear? Active management is a loser's game."

The 401(k) plan that is comprised of ETFs is another new wrinkle—which could become a trend. Schwab, among others, is set to offer, in the second half of next year, an all-ETF version of its Schwab Index Advantage retirement solution, which it debuted last January.

"We're doing this to create better outcomes for employees. We're looking at the next generation of 401(k) plans," says Steve Anderson, senior vice president, national head of Schwab Retirement Plan Services, based in Cleveland. "We're not going into esoteric categories. The real magic is the third-party advice we'll be providing. We see minimal risk in terms of trading."

Thumbs-down, unequivocally, to ETFs in 401(k) plans, Bogle stresses.

"It's very, very foolish. Telling employees that they need investments 'you can trade all day long in real time' is nuts. It's totally counterproductive investment behavior. My impression from working with individual investors over 61 years," he says, "is that they don't need any encouragement to trade—they need encouragement to stay the course."

But ETFs aren't the only encouragement to what Bogle sees as today's rampant speculation. "What's the point of all this trading? Instead of being a vehicle for owning shares in a corporation, the stock market has turned out to be this casino in which people buy shares because they think they can sell them to somebody at a higher price. That's speculation."

In his book, the financial services innovator opines that ETFs, "in general, have not served their investors well" because "picking an ETF"—which are tracking more than a thousand indexes—"is just like picking a stock, with all the attendant risks."

In the interview, though, he notes that ETFs "are less speculative than owning an individual stock. ETFs are a safer approach. I'd rather own a technology ETF than a combination of Microsoft and Apple, say. I don't know which one will do the best, but the ETF will give me the technology sector's return."

Right now, ETFs are in robust growth mode. Once this phase ends, the space will have reached maturity.

"Ultimately," Bogle forecasts, "the market will clean itself out of the ETFs that don't work and that run at high cost. They'll just go away."

But that doesn't mean the visionary envisions ETFs becoming "the Holy Grail of Investing," Bogle writes.

"Once the dust settles," he tells *Research*, "I don't see ETFs ever taking over the industry."

Hot ETF Topics

[Hot ETF Topics]

Invest Your Time In Latest Bogle Book

By Olivier Ludwig | September 28, 2012

John Bogle's latest book, as much a piece of history as is it a playbook for how to repair financial markets scarred by two bear markets in 10 years and a loss of confidence, is one of those books on finance that ought not be left unread.

"The Clash of the Cultures: Investment vs. Speculation" is the latest and perhaps best book by the now-83-year-old founder of Vanguard Group. You may not agree with everything he has to say, and you may be familiar enough with the Vanguard tale to want to be spared a new riff on it. But it's hard to argue with the decades of experience in the fund industry that course through the entire narrative.

Because at the end of the day, the book seems to be the latest iteration of what Bogle first articulated in his 1951 thesis at Princeton; namely, that the mutual fund industry needs to be more mindful that its principal duty is to serve the interests of fund holders.

But the intervening 61 years have added a lot of punch to the argument, not least because of changes in financial markets, which he argues are increasingly dominated by a "short termism" that has come at the expense of true investing with a long-term focus.

"At a certain point in life, you start to get a little wisdom, so I think it's maybe a little more impassioned now, and maybe a hair more sophisticated," Bogle said in a recent interview with IndexUniverse. "But the basic value is and basic strategy has been really quite consistent throughout my long career. "

Plus, for those not familiar with Bogle's prose, the man *can* turn a phrase. which makes the book all the more enjoyable. Moreover, he's well aware that preaching the "cost-matters hypothesis" via the Vanguard story can get to be a bit much, and he wears his lack of impartiality regarding the Valley Forge, Pa.-based company he created on his sleeve. That, for me, adds credibility to what he has to say.

Additionally, it's hard to poke holes in the Vanguard story, and if you're going to do it, you have to do so with a fine-toothed comb. For example, you might ask whether the cap-market weighting that Vanguard favors is really the best way to organize an index fund. Might the fundamental indexing pioneered by Rob Arnott be the future of passive investing?

That possibility—remote as some may say it is—hardly makes Bogle a historical artifact. At 83 years old and with a 1996 heart transplant behind him, his mind is crisp, and what the New York Times called his stentorian voice suggests vigor and vitality. This is a man who will go out sprinting and relevant.

I particularly enjoyed the section of the book where Bogle takes measure of how markets, the economy and U.S. society got to this point, with the simple verities of investing seemingly cast aside and crass profiteering now on center stage.

"Our 'Gatekeepers'—the courts. the Congress, the regulatory agencies, the public accountants, the rating agencies, the security analysts, the money managers, the corporate directors, even the shareholders—largely failed in honoring their responsibilities to call out what was going on right before their eyes," Bogle writes in the first section of the book.

For Bogle, good behavior and incentives to do the right thing are a function of corporate structure, and in this regard he returns again and again to the virtues of Vanguard, a mutually structured company that is owned by its fund holders and that runs its funds at cost. Again, he seems aware that his championing of Vanguard can be a bit annoying, and his caveats about that are effective and even a bit endearing.

But the deeper flavor of the narrative is one of optimism, which makes Bogle an unmistakably American figure. For me, the son of European immigrants who came to America full of hopes and dreams, that optimism goes to the heart of why I like the book so much and why investors really ought to read it.

America isn't over, it's just regrouping. And Bogle is one of the figures helping that process along.