

CONFIDENTIAL

MEMO TO: Messrs. R. W. Doran  
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SOME THOUGHTS ABOUT THE FUTURE OF WELLINGTON FUND

During the past several years, I have been accumulating a whole lot of seemingly unrelated ideas, as I have tranced around the question: What is the future of Wellington Fund? This is a question that has no easy answers, and involves the most complex kinds of conflicts and considerations, including how to improve performance, dividend policy, future marketing strategy, obligations to existing shareholders, fee structure, relationship to other funds in the Wellington group, and so on. While I am sure each of us could "write a book" in answer to any one of these questions, I have arrived at several preliminary conclusions that seem worthy of discussion.

Before turning to these questions, and certainly without trying to "turn you off" before you get interested, I have to say a word about (of all things) "Beta". I am using Beta in this memorandum as a simple index of volatility and, as you look at the attached figures, I think you will agree it is a fairly good one. Indeed, I believe it is probably the best single measure of analyzing

the character of Wellington Fund, both over a long historical period and relative to the other funds we manage. Forget, then, Beta's "buzz word" characteristics, and just think of it as a simple volatility index.

With this preamble, let me turn to my four principal points:

I. WELLINGTON FUND HAS BECOME A "DIFFERENT" FUND  
THAN IT WAS IN THE PAST

As Table A indicates, Wellington Fund's Beta, on a three-year moving average basis, is at the highest level in its 42-year history. From a figure of .62 during the 1930's and .65 in the 1960's, the Beta had risen to .81 and .82 in the last two 3-year periods. Expressed simply, this means if the S&P 500 Index were to decline by 20%, Wellington Fund would be expected to drop 16%, as compared to a traditional 12%. (Obviously, the reverse would be expected on the upside.)

The point of this analysis is simply this: the one characteristic that Wellington Fund has consistently offered to its shareholders has been relatively good "downside protection". The Fund's record, as we all know, has been less consistently achieved in terms of (a) reasonable current income (b) the securing of capital gains and (c) competitive total performance. From this evidence, I conclude that our failure to show reasonable stability in the next market decline--and there will be one--would be "the last straw".

II. WELLINGTON FUND, AT THE MOMENT, CAN BARELY BE  
CONSIDERED A "BALANCED FUND"

The Wellington Fund Prospectus (consistent with the SEC's policy guidelines with respect to "balanced funds") stated that

"...the present intention of management is that generally the Fund will have not more than 75% of its assets in common stocks."

At the present time, 79% of assets are in common stocks. An additional 2% of convertibles gives the Fund an "equity ratio" of 81%. The equity ratio has been in the 80% range for six to eight months. I have, therefore, grave doubts as to whether we are meeting the investment policy test specified in the Fund's Prospectus. At the same time, it is clear that Wellington Fund has departed from its traditional balanced posture of 55%-70% in common stocks--reinforcing the conclusion indicated by the Beta analysis above.

III. AT LEAST IN TERMS OF "BETA", IT IS INCREASINGLY DIFFICULT TO DIFFERENTIATE WELLINGTON FUND FROM SOME OF OUR OTHER FUNDS

Specifically, Wellington Fund has come to have a volatility very much like Windsor Fund. The Windsor Beta was .82 in 1971 and averaged .98 over the past three years; for Wellington, the Betas were .75 and .81, respectively. To the extent that volatility is an important (if implicit) part of the Fund selection process, an investor, in theory, would choose between Wellington and Windsor solely on the basis of management ability, and not on the basis of fund objectives. (This sentence is probably a little bit overstated, but I think it will do as a generalization.) You might be interested in seeing the 1971 Betas on all of our Funds:

Wellesley Income Fund.....	0.20
Wellington Fund.....	0.75
Windsor Fund.....	0.82
Trustees' Equity Fund.....	0.93
W. L. Morgan Growth Fund.....	0.99
Ivest Fund.....	1.11
Technivest Fund.....	1.14
Explorer Fund.....	1.57

This table, in my view, validates the concept of Beta as a differentiating factor. With a few exceptions, it makes it reasonably easy to differentiate our Funds relative to one another. If you accept this concept, it is clear that Wellington Fund is difficult to distinguish from Windsor--and to this extent is losing its identity in our fund "family".

IV. WELLINGTON FUND'S INCOME DIVIDEND, PARTLY AS  
A RESULT OF AN INCREASING COMMON STOCK RATIO,  
IS IN SERIOUS JEOPARDY

If a bad downside performance would be the "last straw" for Wellington Fund, a reduction in the \$.11 quarterly dividend would be the "very last straw", in my view. That is to say, a dividend cut in the face of the performance problems of the past and the demise of the capital distribution, would be a disaster. Yet, at present, Wellington Fund is earning income at the annual rate of \$.42. It appears increasingly doubtful that, absent a policy change, we will have sufficient "adjustments" to meet our \$.44 for the year. If the fourth quarter dividend were to drop say, to \$.09, absent (we assume) a capital distribution of any form, I think we could look to an even higher amount of liquidations than in the first quarter of this year (\$47 million). At present, Wellington Fund is running annualized

redemptions of \$170 million a year, plus some \$40 million of "exchanges"-- a total cash outflow of \$210 million annually. If that grotesque number is to increase in 1973, I would assume it would make the Fund Portfolio Manager's job incredibly difficult, to say the least.

#### V. CONCLUSION

Putting together these four, perhaps seemingly disjointed, conclusions, I conclude that "surgery" is needed with respect to restructuring Wellington Fund. Specifically, I ask each of you to consider the wisdom of having the Wellington Fund return to its traditional policy of greater conservatism. If we moved, for example, to a "60% commons, 40% seniors" investment position, we would accomplish the following:

(a) A return of Wellington Fund to its traditional investment posture, with a consequent ~~enhancement~~ of its downside protection characteristics.

(b) Preservation of Wellington Fund's identity as a balanced fund. If this is hardly a marketable concept at the moment, at least it is consistent with ~~what~~ 250,000 shareholders ~~has~~ purchased in the first place.

(c) Reestablishing Wellington as a fund "in its own right" in the Wellington group, with volatility characteristics that are significantly different and ~~distinct~~ from those of our other funds.

(d) Not only insuring the \$.44 dividend, but increasing the dividend to a \$.52 annual rate (assuming a 60/40 ratio and our present common stock yield of 3.1%). Indeed, if we were to increase the income yield on the Wellington Fund commons to 4.1%--the yield on Gemini Fund commons--the dividend would rise to \$.58. To put this latter change even more dramatically, Wellington Fund's net income would rise from \$47 million to \$63 million--an increase of \$16 million.

\* \* \*

I recognize that there are lots of risks in making a change like this--the worst of which, I suppose, would be a rampant bull market. But I believe the greater risk is doing nothing--ignoring the significant change that has developed in the Fund's investment characteristics, and disregarding a very serious income problem. In this change, in my judgment, are sown the seeds of a new future for Wellington Fund, even if in its old vestments.

What we appear to have done, perhaps unknowingly, is to turn Wellington Fund very nearly into an equity fund. Perhaps, what we should have been doing is turning--or "returning"--Wellington Fund into an "income development fund"--that is to say, a fund with a realistic current yield, along with a growing dividend. Making such a change is risky, I repeat, but it seems a lot less risky with the Dow at 940 and bond yields at 7 1/4%--this is hindsight of course--

than it might have been with the Dow at 400 and bond yields at 4 1/2%. In other words, my view is that this change would be good long-term strategy, and may even be good short-term tactics.

Let me close by asking all of you to give this matter your most thoughtful and deliberate consideration. Wellington Fund assets are \$1,330,000,000. Wellington Fund pays us annualized revenues of \$3,452,000. Wellington Fund has more than 43 years of history. Wellington Fund is the foundation upon which our Company is built. In Wellington Fund, to a major extent, lies the value and goodwill of the very name that we at Wellington Management Company apply to almost everything we do.

John C. Bogle

JCB:jc

NOTE: This memo is deliberately not directed to the question of Wellington Fund investment performance. It is also worthy of our full attention, but in my judgment, is a separate and distinct problem from the issues raised in this memo.

JCB

WELLINGTON FUND  
VS. S&P 500

<u>YEAR</u>	<u>BETA</u>	
	<u>ANNUAL</u>	<u>THREE YEAR</u>
1930	.45	--
1931	.73	--
1932	.61	.60
1933	.49	.61
1934	.68	.59
1935	.37	.52
1936	.74	.60
1937	.75	.62
1938	.62	.70
1939	.75	.71
1940	.88	.75
1941	.38	.67
1942	.71	.66
1943	.79	.63
1944	.65	.72
1945	.57	.67
1946	.58	.60
1947	.37	.51
1948	.48	.48
1949	.46	.44
1950	.60	.51
1951	.54	.53
1952	.58	.58
1953	.52	.55
1954	.52	.54
1955	.40	.48
1956	.63	.52
1957	.58	.54
1958	.57	.59
1959	.68	.61
1960	.64	.63
1961	.70	.67
1962	.64	.66
1963	.56	.64
1964	.68	.63
1965	.54	.60
1966	.80	.68
1967	.66	.67
1968	.78	.75
1969	.86	.77
1970	.83	.82
1971	.75	.81