“For Distinguished Service to Humanity”

Remarks by

John C. Bogle, Founder of The Vanguard Group

At the

101st Gold Medal Dinner

Of

The National Institute of Social Sciences

New York City, New York

November 19, 2015

I must confess to being astonished by my selection as one of the three 2015 recipients of the Institute’s Annual Gold Medal for Distinguished Service to Humanity. At a time when “Service to Self” seems more the mode of the moment for many denizens of Wall Street, rare indeed is it for a leader in the investment community to be noted for “Service to Humanity.” But, truth told, during my 64-year career, I’ve always “marched to a different drummer,” using Thoreau’s formulation. I’ve done my utmost to serve that slice of humanity represented by our nation’s investors—more than 100 million strong—who are working to build a sound financial future for themselves and their loved ones.

Previous Medalists

I accept your award with great humility. It is truly amazing for me to realize that tonight I join a long list of great Americans whose qualifications for being honored with your gold medal during the past century so obviously exceed my own—William Howard Taft, Andrew Carnegie, Calvin Coolidge, Marie Curie, George C. Marshall, and Charles A. Lindbergh, to name a few of your most eminent medalists.

I’m also humbled to be joining a group of more recent recipients that includes some of the finest colleagues of my long career: the Honorable Paul Volcker and Peter G. Peterson, and Nobel Laureate Paul A. Samuelson—each of whom contributed a foreword to one of my ten books—as well as William E. Simon and John C. Whitehead.

What brings me before you tonight, as your award states, is my invention of the world's first index mutual fund. Just 40-plus years ago, in September 1975, First Index Investment Trust (now Vanguard 500 Index Fund) was approved by the directors of the newly-formed Vanguard Group of Investment Companies. That original index fund and its 74-index-fund brothers and sisters now constitute $2 trillion of Vanguard's $3 trillion asset base.

"The Relentless Rules of Humble Arithmetic"

"What's so hot about the index fund," you ask? It's so simple that almost any one over the age of twelve could understand it. Think about the rationale: If the stock market delivers an annual return of, say, 8%, investors *as a group* earn that same 8%. Beating the market is a "zero-sum" game for the group. The same is true in the casino, where the profits and loses of gamblers *as a group*, playing against one another, net out to zero.

But only until the croupier's rake descends, and "the house" takes its share. So it is in our investment system. Wall Street always wins. Our stock brokers and dealers take a seemingly small cut from each trade, and our money managers deduct a seemingly small but regular cut of the assets they supervise. But our investment system is not cheap. It will cost investors an estimated $500 billion in this year alone.

After all is said and done, whether in the gambling casino or the financial casino on Wall Street, the cost of playing turns a zero-sum game into a loser's game, for gamblers and investors alike. *Gross stock market return minus investment costs equals the net return delivered to investors*.

In the long run—say, over a 50-year investment lifetime—those intermediation costs—roughly 2% per year—take an enormous toll. After compounding both *returns* and *costs* over the long term, only about one-third of the cumulative return on stocks reaches the last-line investor, for the croupiers of Wall Street arrogate to themselves some two-thirds of the returns.

Think about it. You put up 100% of the capital. You take 100% of the risk. Yet you earn only 37% of the stock market's long-term return.[1]

There must be a better way.

And there is . . . it is called the index mutual fund.

[1] Example: Over fifty years, $1 compounded annually at 8% grows to $46. After deducting 2% for intermediation costs, $1 compounded at 6% grows to $17.

Enter the Classic Index Fund

First Index Investment Trust was—and is—the classic index fund. It owns all of the stocks in the Standard and Poor's 500 Stock Index, weighted by their market capitalizations. It is diversified to the nth degree, engages in almost no trading, and is highly tax-efficient—designed to be held by the investor *forever*.

Importantly, our innovative mutual fund pays no advisory fees (after all, it needs no advice), operates on an "at cost" basis, and is offered without sales commissions ("loads"). Thus, it delivers that assumed 8% return on stocks, less all-in annual costs as low as five one-hundredths of 1%, leaving 7.95% for the investor. I assume that's why the National Institute of Social Sciences, in its wisdom, has determined that the index mutual fund is a service to humanity.

That original classic index fund revolutionized the way that America's Main Street families invest. (And now our corporate and government retirement plans too.) Even the trust created by Warren Buffet for his wife will be invested almost entirely in a low-cost S&P 500 index fund. Through index funds, our investing population can now earn its fair share of whatever returns our stock market delivers. (I remind you that, alas, those returns fluctuate and are not always positive.) These investors are now getting a fair shake.

A Word about the Inventor

Now, how did it happen that the simple human being who stands before you tonight came to invent the first index fund? It's a story of good fortune (literally!), implacable determination, learning from hard-won investment experience, a strong contrarian nature, a respect for data, stern moral values, and a willingness, even an eagerness, to shout the index message from his Bully Pulpit.

Implausible as it may seem, the road to the index fund began 70 years ago when I entered Blair Academy, a boarding school in northern New Jersey. My wonderful mother wanted her three boys to get the best possible education, and while our family lived sort of pillar to post, Blair took us in, our tuitions funded by scholarships and school jobs. After a slow start at Blair, I did well, graduating second in my class of 1947, and voted "most likely to succeed."

My years at Blair paved the way to Princeton University, again with scholarship and jobs, and a slow academic start followed by a fine finish. Searching for a topic for my senior thesis, I stumbled across

an article entitled "Big Money in Boston" in the December 1949 issue of FORTUNE magazine. It described mutual funds—a topic that had been unknown to me—as "tiny but contentious." (Yes, that's good *fortune*!)

I leaped at the opportunity to explore such an industry, and entitled my 1951 thesis, "The Economic Role of the Investment Company." In it, I called for mutual funds to operate in the most economical, efficient, and honest way possible, and observed that mutual funds "could make no claim to superiority over the market averages (indexes)." (Sixty-four years later, that statement seems prescient.) To my amazement, my thesis helped me earn an A.B. degree in Economics, *magna cum laude*.

Hired, then Fired

Fund pioneer and Wellington Fund founder Walter L. Morgan was impressed by my thesis and, when I graduated, he hired me. He became my great mentor. I learned firsthand the seemingly insurmountable difficulty of earning consistent performance superiority over Wellington's peers and comparable market indexes. This is a hard business!

When the "Go-Go" bubble began in mid-1960, the conservative and balanced (bond/stock) Wellington went out of style. Mr. Morgan asked me to run the firm, directing me to "do whatever it takes" to fix our problems. At age 35, callow and over-confident, I arranged a merger with an aggressive firm, one of the "New Breed" of fund managers. It was a triumph . . .

But only until it wasn't. The managers added substantial risk to the Wellington Fund portfolio at just the wrong time, and the Fund was crushed by the 1972-74 bear market. And the other funds run by these once-hot managers did even worse. Yet *they* fired *me*. (How about that!) My career at Wellington was over. I had to find a new path. And I did.

Enter Vanguard

As it is said, "when a door slams, a window opens." In this case, it opened to the creation of Vanguard. Although fired by Wellington *Management Company* in January 1974, I remained chairman of the Wellington *Funds* (largely independent of the management company) and offered the Board a plan to retain me as their CEO and administer the funds' affairs. After a tense and politicized battle lasting seven months, the Board endorsed my plan to "mutualize" the funds. Our mutual funds would now be independent of Wellington Management Company, free to operate solely in the interests of their own shareholders.

For the first time in history, mutual funds would be truly *mutual. The funds* would own the new company, which would operate them on an "at cost" basis. *No longer would the manager control the funds; the funds would now control the manager*. The industry structure was turned upside down. But first we needed a *name*. More luck. Studying British naval history, I learned about Lord Horatio Nelson's victory over the French at the Battle of the Nile in 1798. His flagship bore the name *HMS Vanguard*. Inspired, I chose the name "Vanguard" for the new firm. The Vanguard Group was incorporated on September 24, 1974, with existing fund assets under management of $1.4 billion.

Given Vanguard's low-cost structure, we focused our strategy on funds in which costs made, not only a difference, but a material difference and an *obvious* difference in relative returns. Forming the world's first stock market index fund would be our first strategic move.

Think about this incredible string of events, each of which was necessary for the creation of that first index fund.

No Blair, no Princeton.

No Princeton, no FORTUNE.

No FORTUNE, no thesis.

No thesis, no Morgan.

No Morgan, no Wellington.

No Wellington, no merger.

No merger, no firing.

No firing, no Vanguard.

No Vanguard, no index fund.

Perhaps all innovations depend on such a chain of remarkable coincidences.

A Long and Winding Road

When the idea of the index fund became reality, its reception by the financial community was, well, bereft of enthusiasm. One Wall Street firm produced a large poster headlined: "INDEX FUNDS ARE UNAMERICAN! HELP STAMP OUT INDEX FUNDS."

Alas, there proved to be little worth "stamping out." Following an IPO that produced but a pathetic $11 million, growth was painfully slow. During its first decade, the fund drew only 0.1% of the industry's net cash inflow from fund investors, and First Index was described as "Bogle's Folly." No

competitor appeared until 1984. Even by 1993, assets of First Index (and all of the other Vanguard index funds) totaled $18 billion, just 0.8% of mutual fund assets—a drop in the bucket.

But in 1993, the far-sighted Paul Samuelson saw something that the Wall Street community had missed. In the words of his lovely foreword to my first book *Bogle on Mutual Funds: New Perspectives for the Intelligent Investor*: "John Bogle has changed a basic industry in the optimal direction. Of very few can this be said."

Dr. Samuelson's prediction that the fund industry would change in the optimal direction was right on the mark. (What else is new?) As he wrote those words, the acceptance of the Vanguard index funds was about to explode. Today, assets of that pioneering Vanguard 500 Index Fund total more than $400 *billion*. With $1.6 *trillion* in a variety of other Vanguard index funds, our indexed assets now total some $2 *trillion*.

Looking Ahead

Vanguard's creative innovation is reshaping American finance. We have demonstrated that it is more profitable to own the U.S. stock market for the long run at minuscule cost, than to focus on the short term and trade stocks with one another. Yes, everyone had the opportunity to form the first index mutual fund. But only Vanguard had both the *opportunity* and—given its low-cost structure—the *motive*.

By putting investors first, Vanguard's low-cost mutual structure has paved the way for our investment industry leadership. Our mission is an echo of the conclusion of that 1951 Princeton thesis:

> "*The principal role of the mutual fund should be to serve its shareholders.*"

That conclusion is in turn an echo of what Adam Smith wrote in *The Wealth of Nations* in 1776:

> "The interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer."

In the profession of investing, *fiduciary duty* is the only way. It's time has come.

The triumph of the index fund is now beyond doubt. Today, assets of index mutual funds total $4.2 trillion, and fully 35% of the total assets of all U.S. equity funds are invested in index funds. Since 2007, net cash *inflow* of equity index funds has totaled $1.4 trillion, while actively managed funds have experienced some $400 billion of *outflow*, an astonishing $1.8 trillion shift in the preferences of equity investors. Index funds are here to stay.

Service to Humanity

I conclude with this business of "Service to Humanity." We can easily measure the extra investment returns earned by the structure and strategy developed at Vanguard 41 years ago. It's the product of our simple investment principles and the cost savings we have delivered relative to our major peers, and it comes to more than $250 billion of savings to Vanguard investors. What's more, that figure doesn't take into account of the impact of our innovation on the fees charged by our peers, nor on pushing our U.S. financial sector toward greater economy and efficiency.

But that $250 billion is only a number. The more important reality is that we have helped millions of families to live more comfortably, to send their children to college, to buy a home, and to enjoy a more comfortable retirement—even to do well enough to exercise their philanthropic instincts.

I know these things, because I hear about them from many hundreds of our shareholders who write to me, who visit me, when I cross paths with them on the street, on trains and on airplanes, and in restaurants, wherever I go. These investors know that indexing has worked for them. They care about Vanguard, and they know that we care about them. This letter, which I received earlier this year, makes the point:

> . . . *thank you for creating an investment that has served me very well. I am indebted to you and grateful that you had the courage to persevere in creating Vanguard and its funds, particularly the S&P 500 Index fund. I am a very fortunate man.*
>
> *Congratulations to you on a lifetime of accomplishment and for being a strong advocate for the fundamentals that made this country so great. I think you for those efforts and encourage you to speak loudly and often.*

Despite the challenges to the traditional index fund that are raised by later innovations such as exchange traded index funds (ETFs); despite the challenges of giant size in business and in investing; despite the fact that any firm like ours depends on disciplined and forward-looking leadership; I believe that, together, our mutual structure and our index strategy will enable us to continue to lead our industry. I take heart from the words of Stephen Vincent Benet. "*If the idea is good it will survive defeat. It may even survive its victory.*" Yes, the simple, traditional index fund has won. It has served investors. It works. Let us hope that it will survive its victory.

Thank you again for the high honor that you at The National Institute of Social Sciences have bestowed upon me. And congratulations to my fellow medal recipients Paul Krugman and Michelle Kwan. Happy investing, and good night.