

“A Lot Can Happen In 25 Years”

Mutual Funds and the Institutionalization of the Financial Markets

**Remarks by
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Some years ago, when I was trying to replace a side stay on my yacht, the *Blue Chip*, an aging 14½-foot O’Day Javelin sailboat, I struggled to find the manufacturer, a once fine firm that had, sadly, been bought and sold several times. O’Day was hardly in the pink, and when I finally found their number and spoke to one of their staff, I learned they couldn’t help me. When I expressed my disappointment, the nice older lady with whom I spoke asked me how long ago I had bought the boat. “25 years ago,” I answered. She responded simply: “Sir, a lot can happen in 25 years.” Yes, a lot *can* happen in 25 years. And on your 25th anniversary, I hardly need remind you of that eternal wisdom. Indeed it’s almost unimaginable how much the world of investing—especially the world of institutional investing—has changed during the past quarter century.

- America has prospered beyond our fondest dreams, with our GDP rising nearly six-fold, from \$1.8 trillion to \$10.2 trillion. Corporate earnings have grown almost as fast, from \$100 billion to \$500 billion.
- The stock market has soared, not merely proportionately to those profits, but actually four *times* as fast. The market value of U.S. stocks is up from \$850 billion to \$12.5 trillion, and the Standard & Poor’s 500 Index has risen from 100 (yes, 100!) to above 1100. The era began with pessimism—an earnings yield of 9% on the S&P 500 and a dividend yield of 4½%. But, measured by the same numbers today, there is still optimism in the air—a 4% earnings yield and a dividend yield of but 1½%.
- A once relatively unstructured institutional investing industry has become a giant force. Institutional ownership of U.S. stocks has grown from \$330 billion to \$8 *trillion*—from 39% of all stocks to a dominant 60% ownership of corporate America.
- Active managers have watched asset *non-managers* move to the fore. Passive market-indexing strategies now account for more than 30% of total institutional assets, compared with less than 0.1% at the end of 1976. Today, four of the eight largest money managers focus primarily on indexing.
- Despite the increase in passive indexing strategies, market activity has soared. Annual turnover in the U.S. stock market was 23% in 1976; in 2001 it was 134%. Institutional investors played a major role in this upsurge, with equity mutual fund turnover rising from 30%—long-term *investment*—to 110%—short-term *speculation*.
- The very nature of retirement plan investing has been turned on its head. We are at the culmination of a truly seismic shift, a massive transfer of investment risk from the *corporation* to the *employee*. Assets of defined benefit (DB) plans, more than 70% of retirement plan assets back in 1976, have declined to 45% of assets, and the end of that shrinkage is not yet in sight.
- Then, investing was sort of an obscure mystery to the public. There were said to be one million families owning equities, and a quarter-page in *The New York Times* listed about 300 mutual

funds. Today, some fifty million families own equities; there are dozens of investment magazines; CNN and CNBC and others broadcast financial news all day long; and it takes six pages of Sunday's *The New York Times* to list today's 8,346 mutual funds.

In his wonderful book, *The Money Flood*, Michael Clowes describes the rise of institutional investing as “a revolution that has reshaped the role of the federal government, the financial security of individuals, corporations, and financial institutions, and the capital markets (of the world) . . . yet a revolution that has occurred quietly, without bloodshed and with minimal disruption of lives, (one that has) gone largely unnoticed, a revolution of ideas that swept away old thinking and old ways of doing things.” And he's right.

What is more, much of what we accept as dogma today had barely come into existence by 1976. As Clowes points out, the start of this quarter-century era was virtually contemporaneous with a whole host of related developments: The end of fixed commissions on the New York Stock Exchange; the Employee Retirement Income and Security Act (ERISA); and the birth of *Pensions and Investments*; the Nobel Prize in Economics; and the emergence of Modern Portfolio Theory.

As it happens, also just moments before this quarter-century of change began, I had the good fortune to start a new mutual fund company. I named it *Vanguard*, after a British flagship that, at the battle of the Nile in 1798, led a fleet that crushed Napoleon's dreams of world conquest. Given our nautical heritage—“stay the course,” and so on—I use the term “sea change”—*radical* change—to describe what has since happened in the field of institutional investing. While few of you were as fortunate as I to be present at the creation of the new era of investing that began in the mid-1970s, everyone here in this room today has witnessed its culmination.

The Mutual Fund Industry

During this era the once-midget mutual fund industry became a giant. Equity fund assets, \$40 billion a quarter century ago and 12% of the institutional total, have grown to \$4.1 trillion, holding 40% of all institutional holdings of U.S. stocks. But despite the industry's colossal growth, the success of the firms that lead the industry when the great boom began was hardly guaranteed. Consider what happened to the top 15 mutual fund managers in 1976 over the years that followed: (Ranked by equity fund assets only.)

Top 15 Equity Fund Managers, 1976 and 2001				
1976 Rank	Assets (bil)	2001 Rank	Assets (bil)	Increase
1. IDS	\$5.9	1. Fidelity	\$483	146x
2. Fidelity	3.3	2. Vanguard	364	182x
3. Capital Group	3.0	3. Capital Group	309	103x
4. Dreyfus	2.9	4. Putnam	151	79x
5. Mass. Financial	2.8	5. Janus	109	---
6. T Rowe Price	2.0	6. Franklin/Templeton	95	---
7. Vanguard	2.0	7. AIM	75	---
8. Lord Abbett	1.9	8. T Rowe Price	74	37x
9. Waddell & Reed	1.9	9. Mass. Financial	71	25x
10. Putnam	1.9	10. American Century	65	---
11. Seligman	1.8	11. Oppenheimer	57	---
12. Keystone*	1.5	12. AMEX (IDS)	54	9x
13. Anchor*	1.0	13. Merrill Lynch	45	---
14. Eberstadt*	1.0	14. Morgan Stanley	43	---
15. Kemper*	0.9	15. Alliance	43	---

*No longer exist

As you can see, there is a lot of creative destruction going on here. Among the 15 leaders in 1976 only seven remain in the top echelon. Four firms, swallowed up by larger rivals, no longer exist. Only three of the 15 (Vanguard, Fidelity and Capital Group) have actually increased their market share. On the other hand, of the eight new leaders, three did not even offer mutual funds in 1976, and the remaining five then had *aggregate* assets of less than \$1.5 billion. Note too the staggering increases in equity fund assets, even among the *slower-growing* firms. (I remind you that a 25-fold gain equals a 14% compound annual growth rate!) Note also the major increase in concentration: In 1976, the three largest firms controlled 35% of the total assets of this elite group. By 2001, the three largest firms controlled almost 60% of the total.

There were, of course, a whole variety of factors that shaped the relative success of these firms: The investment performance of their funds, their marketing strategies, whether they were load or no load; the extent to which they chose to embrace index funds, even their cost structures. But one difference stands out: *The extent to which they sought and attracted institutional assets.*

The fact is that the five largest equity fund managers just happen to be the five largest providers of mutual funds to defined contribution plans, and nine of the top ten firms appear on both lists. Those

Major 401(k) Mutual Fund Managers			
Equity Fund Assets		Defined Contribution Assets*	
1. Fidelity	\$483	1. Fidelity	\$289
2. Vanguard	364	2. Vanguard	127
3. Capital Group	309	3. Capital Group	78
4. Putnam	151	4. Putnam	47
5. Janus	109	5. Janus	39
6. Franklin/Templeton	95	6. T Rowe Price	33
7. AIM	75	7. Franklin/Templeton	18
8. T Rowe Price	74	8. Merrill Lynch	14
9. Mass. Financial	71	9. American Century	14
10. American Century	65	10. Mass Financial	13

*Includes bond assets estimated at 3% of total

managers alone account for \$580 billion of DC assets, fully 70% of the fund industry's \$820 billion total. Defined *benefit* plans also make up a significant portion of the asset bases of most of these firms. A focus on the *institutional ownership* of fund shares, then, has been one of the major forces that shaped the widely varying fortunes of mutual fund firms, and is responsible—for better or worse—for the increasing concentration of industry leadership.

In 1983, when Vanguard made the decision to plunge full-force into the brand new 401(k) arena—one of the first firms to do so—our reasoning was based on simple logic. Since we would be dealing with savvy corporate financial and human resource managers, we believed we had both the winning strategy and the winning structure: funds with high performance predictability relative to their peers (including the industry's only index fund), no sales commissions, and the exceptionally low expense ratios that our *mutual* form of structure (shareholder-owned, operated on an at-cost basis) facilitates. The decision to gear up for this new business was really a strategic “no-brainer,” although (as always!) I vastly underestimated the operating and systems challenges we were to face. But we made the plunge into the institutional arena, and it has obviously played a critical role in our growth.

What's Next For the Financial Markets?

As I peer out into the next twenty-five years, there's not much question that much will change in our field. Little of it is predictable, although it's hard to imagine that institutional ownership won't remain a major force in the fund industry. But in the coming era, far more than in the past, mutual fund managers will have to focus on two elements that have not yet appeared as consequential competitive factors. One will be increasing recognition of the profoundly negative impact of *financial intermediation costs* on retirement plan investors; the other will be increased attention to *asset allocation*. Both trends will be accelerated by the fact that, unless I miss my guess, the financial markets will *not* repeat their remarkable generosity of the past quarter-century.

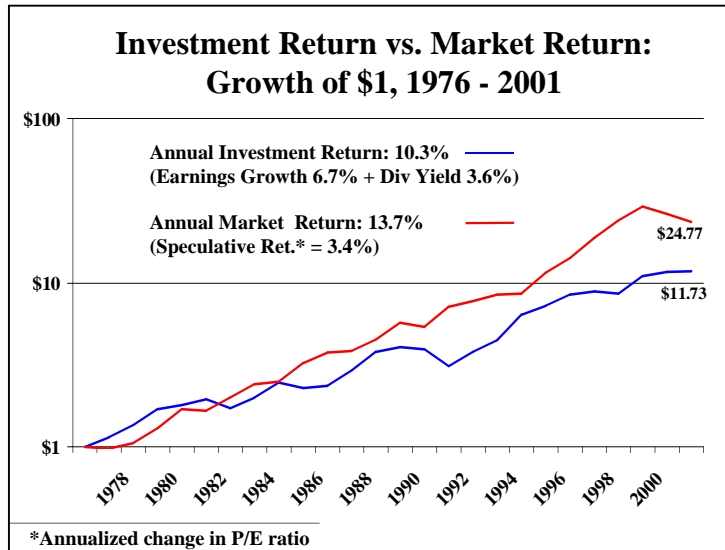
Let's think about that issue for a moment. First, in the stock market. We know that the annual return on U.S. common stocks during the past 25 years has averaged a remarkable 13.7%, more than five percentage points above the 8.4% rate over the prior 100 years. I won't try to forecast the next 25 years—at the end of which I'll be 97, but my new heart (a major acquisition of 1996) will be but 57!—but I will look ahead to the coming decade. Before I do, let me tell you how *not* to think about future returns: (1) Do *not* believe that the stock market is an actuarial table; (2) do *not* accept that the past is prologue; and (3) do *not* succumb to Monte Carlo-itis, assuming that if you throw all of those annual returns into something like a computerized Waring blender, you'll establish the precise odds that a particular return might be earned in the future.

I say that because I believe, with all due respect, that too many quantifiers of the American stock market have failed to understand the difference between *risk* and *uncertainty*. Risk is *not* volatility; risk is *not* standard deviation; risk is *not* beta. Risk represents the odds that particular outcome will occur in a *known* number of events, i.e., the chance that you will flip heads in one toss of a coin is one out of two; the chance that you will flip heads ten times in a row is one out of 1024. Uncertainty, on the other hand, is simply not knowing what lies ahead. Uncertainty is the possibility that you will lose a lot of money just when you need it the most. *Uncertainty is the central maxim of investing.*

Lord Keynes warned us: “It is dangerous . . . to apply to the future inductive arguments based on past experience, *unless one can distinguish the broad reasons why past experience was what it was.*” That warning suggests that if we can distinguish the reasons *why* the past is what it was, we can apply that very line of reasoning to the development of reasonable expectations about what may lie ahead for stock prices. The *reasons* that stock returns averaged 13.7% during the past 25 years are clear: The average dividend yield on the S&P 500 Index was 3.6%, the subsequent earnings growth was about 6.7%; the

combined *investment* return, then, was 10.3%. An additional 3.4% percentage points was added from *speculative* return, a result of the tripling of the price-earnings ratio from nine to 24. Result: a total return of 13.7%. The math is not complicated!

But make no mistake about it: That speculative return loomed large in the golden era in which institutional investing flourished. The fact is that, based solely on investment return, \$1 invested in stocks at the outset would have grown to \$11.73—a handsome near-twelve-fold enhancement. But the leap in the p/e multiple more than *doubled* that investment return to \$24.77—nearly *twenty-five* times over. Yes, we had literally *never* had it so good.



So, let's look at these factors in the decade ahead. Today, the S&P 500 Index yields not 3½% but 1½%, reducing this key contributor to stock returns by two full percentage points. Even if we assume a continued 6½% earnings growth, the annual *investment* return on stocks would be just 8%. Will *speculative* return add to or detract from this figure? It would be, I suggest, *absurd* to expect today's P/E ratio of 24 (based on "normalized" earnings at that), having risen at a 3%-plus annual rate during the long bull market, to continue to rise at the same rate, which would take it to 34 a decade from now. Indeed I'd expect it to decline to perhaps 18 to 20 times.

No one—*no one*—can be confident about how much investors will pay for a dollar of earnings ten years hence. But *if* my expectation is reasonable, the resultant drop in the P/E would create a *negative* speculative return of something like 2% per year, reducing the annual return on stocks to about 6%. I'm not much for such precision, however, so let's assume a wide range of, say, 3% to 8%. In any event, we'd best all count on a coming era of lower returns in the stock market, and then hope we're wrong. But I hardly need remind you: *Relying on hope is an unsound investment strategy.*

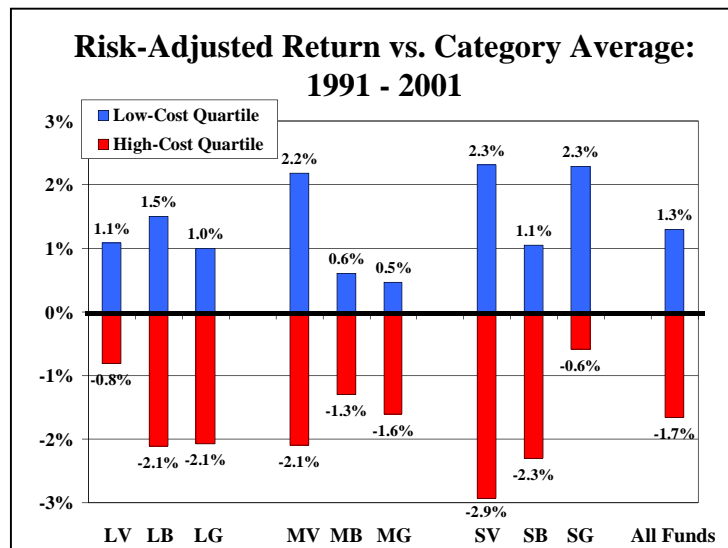
Costs Matter!

In such an environment (and, I might add, even if the environment proves more felicitous), mutual fund costs will be more important than ever. During the past quarter-century, all-in equity fund costs—management fees, operating expenses, portfolio transaction costs, sales charges and cash drag—*averaged* slightly over 2% per year, consuming something like 15% of the stock market's 14% return and leaving fund investors with a return of less than 12%. Fund expense ratios are now much higher, however, and the staggering increase in fund portfolio turnover, despite much lower brokerage

commissions, probably *increased* transaction costs. If we assume 2½% in annual costs—and that may well be conservative—they would consume more than 40% of a 6% stock market return. There are only two ways to minimize such a confiscation: (1) Reduce fund *transaction costs* by slashing portfolio turnover; that is, by *investing* on the basis of long-term *corporate value* rather than *speculating* on the basis of short-term *stock price*. (2) Reduce fund *expense ratios* by operating more efficiently, and by cutting the level of management fees.

The role that fund costs play in fund performance is substantial. Indeed, an equity fund’s expense ratio is the greatest single factor in predicting its future relative performance. The *Journal of Portfolio Management* has just published my study of the relationship between fund performance and fund expense ratios over the decade ended June 30, 2001. It is an eye-opening study, showing that while the *average* equity fund provided an annual risk-adjusted return of 12.5%, the average *high-cost* fund returned 10.8%—1.7% *lower*—and the average *low-cost* fund provided a return of 13.8%—1.3% *higher*, a spread of three percentage points a year, representing a near-30% enhancement in return. Even more impressively, compounded over the full ten-year period, each dollar in the high-cost fund increased by \$1.79, while each dollar in the low cost fund increased by \$2.64—an enhancement to return of nearly 50%, largely achieved merely by selecting low-cost funds rather than high-cost funds and holding risk constant.

Importantly, the pattern for equity funds *as a group* held constant for all nine distinctive styles of equity fund investing. Morningstar data for each of the nine “style boxes” (large-cap growth, mid-cap blend, small-cap value, etc.) confirmed the low-cost advantage, not only in each case, but in remarkably consistent dimension. While the high-cost/low-cost differential averaged 3.0% for all funds, the spread was tight—a high of 5.2% among small cap value funds, and a low of 1.9% for both large-cap value funds and mid-cap blend funds. What is more, in each case, the high-cost funds provided significantly *below-average* returns, and the low-cost funds provided significantly *above-average* returns—18 independent demonstrations of a simple hypothesis: *Costs matter*. And you can easily add a 19th: Low cost is what gives the *index fund* its remarkable performance edge.



It is easy to understand why the average man-on-the-street is unaware of the importance that cost plays in shaping fund returns: Cost information, while available, is not exactly highlighted; the fractional percentage point differences seem almost trivial; there are always some high-cost funds that have

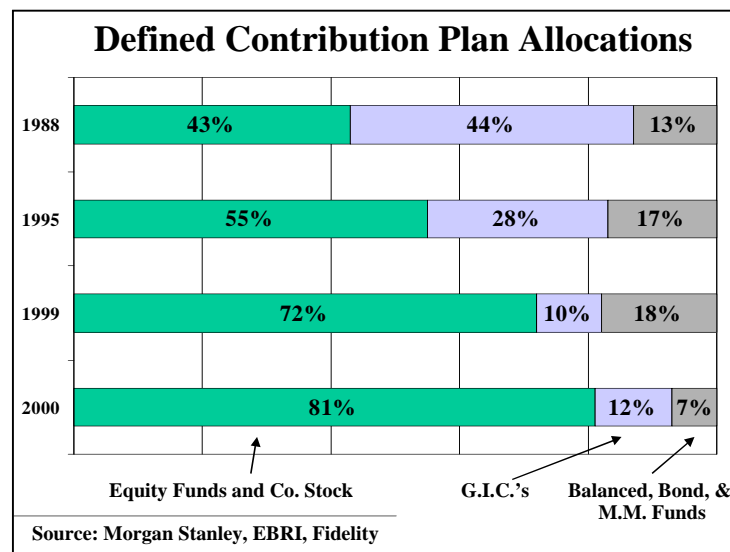
provided good past returns, and some low-cost funds that have failed to do so; and the impact of cost, while compelling on a long-term basis, makes little impression on a typical fund investor with a short-term focus.

But it is impossible for me to understand why plan trustees and human resource and financial managers seem similarly oblivious to the importance of cost. Individually, executives that supervise, say, a \$25 million pension plan or a \$1 billion 401(k) plan have a lot of clout, and they could surely exercise it collectively—and in the interest of their plan participants—if they wished to do so. Indeed, knowingly or not, they did just that when they determined that funds with sales charges would have to waive them. Today, every major load fund firm has done exactly that, making their funds competitively-priced with no-load funds for their large institutional clients. But I predict that a decline in fund expense ratios for giant institutional accounts—perhaps by a separate series of funds, or perhaps by clone funds—is one of the major changes that lies ahead.

The Coming Rise of Asset Allocation

I also predict that asset allocation will be given far more attention in DC plans, and that bond funds will explode upward from their present 3% share of the assets of retirement plan participants. In the aftermath of the burst stock market bubble, investors are coming to realize that all that glitters about the stock market is not gold. And if I'm right that we are in for a time of lower stock market returns, that will add to the already increasing focus on the importance of asset allocation in intelligent retirement plan investing.

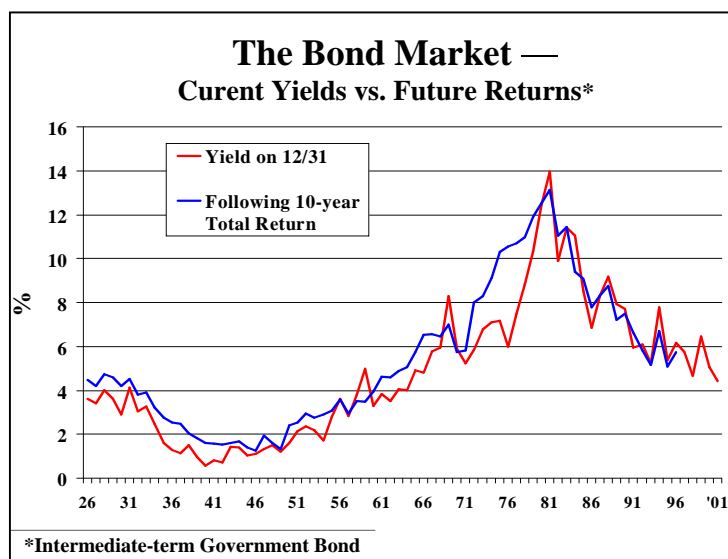
So far, the pattern of asset allocation has been remarkably *counterproductive*. In 1988, with stocks (as it turned out) at bargain-basement levels, defined contribution plan participants had 43% of their investments in equity funds and company stock, and 57% in fixed income investments such as guaranteed insurance contracts (GICs) and bond funds. With each ratcheting up of stock prices, up went the stock portion of their plans—55% in 1995, 72% in 1999, and by the end of 2000, 81%, including 62% equity funds and 19% company stock. That perverse pattern meant that, just before the fall, the risk assumed by participants was at an all-time high. Doubtless some of these investors are now reconsidering their asset allocation strategy.

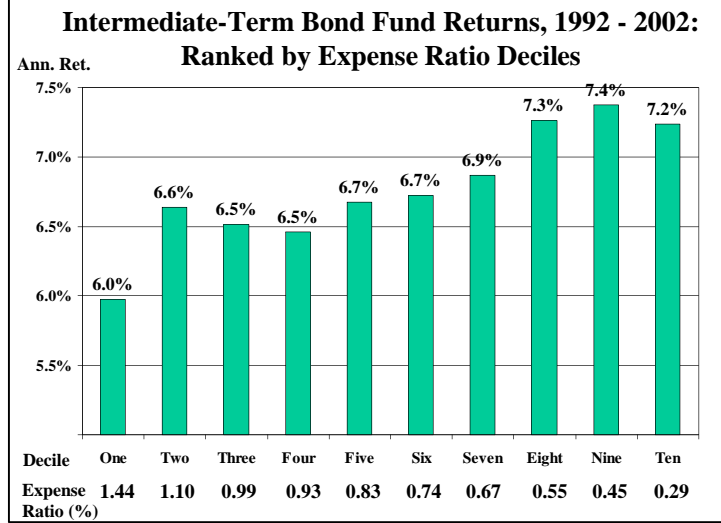


And it's at least possible that they're wise to do exactly that. For I believe that future returns on bonds may well be competitive with the returns on stocks. Indeed that 3% risk premium that existed during the *twentieth* century—and that we all accept as holy writ—may be far smaller in the coming decade, perhaps even non-existent. If, following Keynes' advice, we have only the wisdom to look to the reasons why past bond returns were what they were, we see that the principal reason that bond returns averaged 9% over the past quarter-century is largely that at the outset the yield on bonds was almost 8%.

The fact is that the best forecaster of long-term bond returns is the *known* yield at the start of the period. Decade after decade, the initial yield explains some 90% of the subsequent total return of bonds. Currently, the Lehman Aggregate Bond Index yields about 6%, almost *guaranteeing* substantially lower future bond returns, perhaps in the range of 5% to 7%. At the *low* end, of both and stock return ranges, then, bonds would provide *higher* returns than equities, something that has happened in one decade out of every five in U.S. history. At the high end of both, the equity risk premium would be just 1%—exactly what it was during the *nineteenth* century!

As in the equity fund arena, of course, bond *funds* don't earn the bond *market* return. While different maturities and categories (government, corporate, municipal) don't lend themselves to easy collective analysis, the patterns look the same no matter which group we look at: Almost with each step up the cost ladder, down goes the return—not only by the amount of the extra costs, but by a slightly larger amount. Consider intermediate-term bond funds. With an expense ratio of 1.4%(!), the highest cost decile provided a return of 6.0% over the past decade; the middle two deciles, with a cost of 0.8%, returned 6.7%; and the lowest-cost decile, with a cost of 0.3%, returned 7.2%. Note that each decile earned a gross return of about 7½%; the differences in net return were engendered largely by cost differences, *not* by maturity differences nor by quality differences nor by management skills. The reality is that investment costs have a much greater *short-term* relationship to bond fund returns than to equity fund returns, and that clarity will not long be ignored by investors selecting bond funds as a haven from volatile stock markets. I should add that the net return on a bond *index* fund—which carried the lowest expense ratio in the group—was 7.3%. *Bond Indexing is an idea whose time has come.*





As retirement plan investors age and begin to gain some asset allocation wisdom—sadly, often through hard experience—they will come to understand both the need for bond funds and the critical role of cost in their bond fund selections. Pressure will grow on mutual fund managers to do exactly what the marketplace is apt to require them to do in their equity offerings: One way or another, to reduce expense ratios and turnover costs and give a fairer shake to retirement plan participants.

Private Retirement Plans

In this final section of my remarks, I'd like to consider private retirement plans in the perspective of the remarkable changes we've witnessed. During the past 25 years, corporations have radically shifted the investment risk of retirement savings from the firm to the employee. Twenty-five years ago, there were nearly 30 million participants in DB plans, today there are 22 million—eight million fewer. Then, there were 10 million participants in DC plans; today there are 58 million—48 million *more*. This shift has given corporations greater control of their pension costs, and given participants greater control over their portfolios. Who could argue against providing employees with the flexibility to establish bond-stock allocations consistent with their own time-horizon and risk tolerance? Further, the concept of a voluntary and remarkably attractive means of saving on a tax-deferred basis with the plan assets “traveling” with the employee, is a good one. *But the great experiment is not working as well as it should.* There are at least three problems: First, as the asset allocation choices of DC participants show, overall risk exposure rose sharply, just at the wrong time. Second, not *enough* employees are saving. Fully 25% of eligible employees have not yet even begun to participate in available DC plans, a heavy penalty when the magic of compounding means that *time is money*.

Third, those who are saving are not saving *enough*. Some 18% of all employees are borrowing from their plans to meet current living expenses, college tuition, and the like, mortgaging part of their future to enjoy the present. While those who *do* save are putting away about 10% of their salaries (including company contributions), many will fail to reach their retirement savings goals. A recent study reported that the typical employee in a DC plan would earn retirement income, *including social security*, equal to only 48% of previous income, compared with 60% for the typical employee in a DB plan.

This under-saving would be less of a problem if future returns on bonds and stocks are sustained at the generous levels of the past. But, as I have argued, it is unlikely that will be the case. Further, measured by equity exposure, not only has risk risen sharply, but even more risky options are being introduced. In the name of “choice,” I fear many investment sins are being committed. Funds with hot past performance are demanded by many plan sponsors; separate accounts are gaining popularity; and a self-directed brokerage account option is the newest gimmick. (Just imagine the likelihood of success for an employee who engages in day-trading to build a comfortable retirement nest egg!)

Thanks importantly to Enron, another flaw in the DC system has come to light: A woeful lack of diversification. Almost a decade ago, in *Bogle on Mutual Funds*, one of the twelve pillars of wisdom I presented was, “Diversify, Diversify, Diversify.” And I know of *no* academic, or investment practitioner, or financial adviser who wouldn’t agree. Yet the shares of a *single company* represent 20% of the assets of *all* DC plans, and 48% of the assets of those plans that mandate the use of company stock. When all goes well, of course, the employee prospers, both in his career and in his retirement assets. But when things go wrong, the employee can lose both. As the employees of Enron, Lucent, Rite-Aid, and Global Crossing—and doubtless many more—would agree, company stock is not a panacea. Staggering portions of the value of their retirement plans have gone up in smoke.

Given these problems of inadequate savings, excessive risk exposure, and a bewildering array of investment choices—to say nothing of the negative impact of the higher investment costs incurred by DC plans relative to DB plans—one commentator, writing in *Barron’s*, has described the extraordinary shift from DB to DC plans as “a social and economic time bomb.”¹ And yet it seems to me that shifting of retirement plan risk from employer to employee is unlikely to abate. Not only do DC plans have the momentum, but the impact of DB plan costs on corporate earnings is almost certain to rise dramatically in the years ahead. Why? Because today companies are adding illusory billions of dollars to their reported earnings by making highly aggressive assumptions about future returns on their pension assets. The average future pension fund return, as reported for 2001, is running about 9½%, far higher than the stock and bond market returns that lie in prospect. When the painful reality of tomorrow overrides the bright perception of today, pension costs will rise and earnings will be penalized (appropriately!) by those billions and more.

It’s not too late to prevent the retirement plan time bomb from exploding. While we can’t change the pension funding situation—today, at least—we can change other things. Institutional managers and consultants can help by beginning to seriously consider the issue of the proper balance between DC/DB plans, and discuss this issue with their clients. At the same time, we all must work with our clients to help educate their employees in the inherently simple principles of investing, in understanding risk, and in the critical role played by investment costs. (It’s remarkably easy, for example, to earn virtually 100% of the return of the stock market and the bond market through index funds.) And we must work together to encourage them to increase their savings in order to assure a comfortable retirement. To keep our corporate retirement plan system from “riding for a fall” (the headline on the *Barron’s* article), it’s high time to focus on these issues.

Will History Repeat?

Well, we’ve all been part of a 25-year golden era for institutional investing, and a lot *has* happened. What will happen next? Although history does not *repeat* itself, as Mark Twain said, sometimes it *rhymes*. Old weaknesses and vulnerabilities appear, but in new garments. As Henry Kaufman² has written, “(We) are unaware of or have forgotten about the damaging effects of irresponsible behavior in the rush to ‘innovate’ and profit.” We’re now paying the price for those excesses. But some verities remain, and Dr. Kaufman did us all great service when he reminded us of one of the simple basics: “*People in finance are entrusted with an extraordinary responsibility: other people’s money.* This basic fiduciary duty too often has been forgotten in the high-voltage, high-velocity financial environment that has emerged in recent decades,” indeed those very decades in which the financial markets have become institutionalized. We must learn from those mistakes in the *next* 25 years.

¹ *Barron’s*, November 28, 2001, “Riding for a Fall,” by William Bernstein.

² Henry Kaufman, *On Money and Markets*, McGraw-Hill, 2000.

In such an era of growth, Dr. Kaufman added, “The notion of financial trusteeship is frequently lost in the shuffle . . . Financial institutions and markets must rest on a foundation of trust. The large majority of ethical and responsible market participants must not tolerate the transgressions of the few abusers . . . and leaders of financial institutions must be the most diligent of all. Why should current management of financial institutions be concerned about distant events? After all, they will have retired long before then. It will be someone else’s problem.” *But we can’t let that happen.* We must be concerned about distant events. Whether we’re talking about America’s financial system, or the environment, or for that matter, the very character of our society, we have a moral obligation to leave our world better than we found it—and that includes the world of investment management.

The final sentence in Henry Kaufman’s fine book states our responsibilities to our clients, to ourselves, and to our successors with crystal clarity: “Financial intermediaries will need to be ever-more diligent, to balance their entrepreneurial impulses with their fiduciary responsibilities.” I close these remarks by putting it more bluntly: *We need more stewardship and less salesmanship.* We who offer financial services must never forget that we are not merely in a business. We are in a profession. In the next 25 years, of course, a lot can—and will!—happen. But if we want the *right* things to happen, we must never compromise our professional responsibilities in favor of the tough demands of our highly competitive business. Only if we measure up to that standard will our successors, 25 years from now, give us credit for making the field of institutional investment management live up to its high promise.

Note: The opinions expressed in this speech do not necessarily represent the views of Vanguard’s present management.
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