

Honoring Our \$4 Trillion Trust: Mutual Funds in the 21st Century

**Keynote Speech by
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Somehow, someone first invited me to speak before this organization twenty years ago. I don't really know why. I was a man with a somewhat checkered record of accomplishment, having been fired as the head of Wellington Management Company scarcely three years earlier. I had immediately grabbed at the only straw I could find, determined to use that heart-breaking event as an opportunity-in-disguise to start a new company. I called it Vanguard, and when I spoke to you in 1977 we were a tiny mutual organization—then as now, owned by the funds we operate—with a charter that limited us to administration, accounting, and record-keeping for the six mutual funds whose management company had just dismissed me. (I was told by the Board to keep my hands off distribution and investment management. And I did. But only for a while.)

My First Visit: 1977

I'm confident, however, that your purpose in inviting me then had nothing to do with the founding of Vanguard, much less with the fact that in 1975 I had created the first index mutual fund in history ("First Index Investment Trust," as the name we proudly chose at the outset for the 500 Portfolio of our Vanguard Index Trust). Our index fund had begun with an initial public offering by a group of brokerage firms. (Vanguard wasn't permitted to "do" distribution.) They had labored and brought forth a mouse—a truly microscopic \$11 million fund. In those ancient days, the index fund was something of an industry joke ("Bogle's Folly"), a commercial failure that would take ten years to become an artistic success.

So, my claim to fame must have been that—only weeks before my speech—we had at last won the right to run the distribution effort and had cast our lot with the no-load segment of the mutual fund industry—an unprecedented complete conversion for a firm that had hitherto relied solely on stockbrokers for distribution. When I spoke to you in 1977, we were still nervously hoping that the "other shoe (a huge wave of share redemptions) would not drop." The first shoe had fallen in the market crash of 1973-1974, slashing by half our asset base, from \$2.6 billion to \$1.4 billion. We hadn't bothered to do any investor surveys or (in the modern mode) take any opinion polls. It was no more than intuition that told us, as I put it then, that an age of consumerism and public responsibility lay before this industry, and that "no-load is the wave of the future."

As I looked over that ancient speech two decades later—in preparation for these remarks—I must confess a bit of pride. I correctly forecast the coming of asset-based sales charges, the obscuring of the pure dichotomy between load and no-load funds, the development of sophisticated computerized systems

to offer modern services and more complete information to fund shareholders¹, the rise of index funds of many varieties, and, of course, the ascendance of the no-load segment, 15% of industry assets as 1977 began. (Vanguard's entry raised that number to 20%. It has now risen to 32%, the largest market share of any distribution channel.) Those were considered bold, even reckless, forecasts two decades ago, but they don't look so darn bad today.

A Second Visit: 1987

Alas, I didn't quit my forecasting while I was winning. And exactly a decade later—therefore a decade *ago*—when I was invited to talk at your meeting once again, I was forced to apologize for two forecasts that were, to say the least, appallingly wide of the mark. Then, my keynote speech was entitled “Mutual Funds: a \$700 Billion Trust.” (Sort of a swipe at the Investment Company Institute, whose theme at its previous General Membership Meeting was “Mutual Funds: a \$600 Billion *Industry*.”)

By 1987, my two then-misguided forecasts of a decade earlier could hardly have looked worse. One was that, “in the 1980s mutual funds will have lower operating expenses.” I graded that one an “F” when I talked to you, admitting that the huge 40% rise in equity fund expense ratios represented a perverse price-war—a war to *increase* the fees fund shareholders pay, not to reduce them. Investors should pay, the industry implicitly argued, “whatever traffic will bear.” I disagreed and predicted that future price wars would drive expense ratios *down*, and that relative cost would become a major determinant in success in the marketplace.

The other was my hapless initial forecast that “institutional markets will become extremely important to our industry's growth.” For in 1987, pension and endowment plans still accounted for only about one-eighth of industry assets, unchanged since my first speech a decade earlier. I graded that prediction with a slightly higher “D,” because, I defensively suggested, “the jury is still out.” I assured you that I expected “to see that grade raised in the years to come,” and that “defined contribution pension and 401-k plans would open vast new markets for mutual funds.”

Well, here we are a decade-plus later. And your program chairman—clearly a man with a sense of history—must have been reviewing my previous speech and noting the challenge with which it concluded: “ask me back in 1997 to review my 1987 predictions and my theme of ‘trust’.” Alas, I couldn't be with you last year, but I've had a change of heart—a heart transplant that has given me a miraculous second chance at life—and if I am here a year late, at least I'm *here*. And I am filled with energy and enthusiasm as I present this, my third decennial message to you.

And Now A Third Visit: 1997 (Belatedly)

Today, I'm reaffirming my earlier theme of trust. I have chosen the title “Honoring our \$4 Trillion Trust: Mutual Funds in the 21st Century.” In 1987, our trust responsibility encompassed \$700 billion of assets of the hard-earned savings of 45 million human beings. We thought that was a lot of money—we'd increased 14-fold from \$50 billion in 1977—but today we're another six times as large: an awesome \$4.2 trillion, representing the savings of some 75 million human beings. But as I address your 16th Annual Meeting today (I guess the meeting at which I spoke 21 years ago was not “Annual”), I'm not at all sure we've adequately honored the standards of trust that I described in 1987, when I declared:

¹ It's fine that I accurately forecast these things. But it is you in this room, and your predecessors, who took the initiative to bring speculation into reality, to do the incredible hard work involved, with devotion and commitment, to make it all happen. For this service, the industry owes you a debt of enormous gratitude.

“We are much more than a mere industry; we must hold ourselves to higher standards, standards of trust and fiduciary duty. If we fail to do so—if we follow the lead of marketing companies in conventional consumer businesses, if we create investment expectations we cannot meet, often overlaid with high risks and laden down with exorbitant costs—the future of mutual funds is not bright. But if we return to the philosophy that a fully-informed investor paying a fully-disclosed cost for a sensible investment program, our finest hours lie yet ahead.”

Before I turn to our duty to honor those standards of trust—let me briefly review my two major forecasts of a decade ago. As it turns out, circumstances have left me with little doubt about the evaluation that I present today: one abysmal strike-out (without the bat ever leaving my aging shoulder), and one Brobdingnagian home run (perhaps an echo of the 1932 World Series, when Babe Ruth stepped to the plate, pointed to the center field fence, and promptly delivered the mighty blow).

The Strike-Out

The ignominious strike-out, of course, was my prediction that mutual fund shareholders would come to get a fair shake in pricing. But equity fund median expense ratios—up 40% from 1977 to 1987—have risen another 20%, and they continue to rise. Industry-wide expense ratios (including money market and bond funds) are also up—about 20%. This increase, despite the quantum rise in fund assets, has carried the costs borne by fund shareholders from some \$1 billion in 1977, to \$6 billion in 1987, to \$30 billion in 1997. Wow! And only a small portion of the \$30 billion—probably less than \$2 billion, less than 7% of the total—pays for investment research and portfolio costs. Rather, these revenues generate both truly awesome marketing expenditures and huge profits for fund managers. For management companies have arrogated to themselves virtually all of the staggering economies of scale entailed in fund operations at the expense of fund shareowners whose very assets created the fee bonanza in the first place. As a result, the investment capital created for the fund shareholder is but a pale reflection of the staggering fortune that has been created for the typical fund manager—despite the fact that the returns earned for fund shareholders by these managers have trailed far behind the returns of the stock market itself in this unprecedented bull rampage.

The irony that managers earn huge returns on *their* capital while fund shareholders earn below-average returns on *their* capital is worse than paradoxical. I believe that it is incompatible with our trust responsibilities. So, I press on with my consistent—and consistently wrong—prediction that shareholders will ultimately get a fair shake. Despite 20 years of unfilled expectations, I’m confident that the excessive costs paid by fund investors will at last begin to decline, as the unremitting evidence sinks in that lagging performance is engendered largely by those very costs. That lag won’t go away, for it is largely the result of the mathematical tautology that investors as a group inevitably earn the returns of the total market, *reduced by the costs of playing the game*. And that cost—about 2% per year—would reduce a “normal” market return of 10% to 8%, fully 20% lower. *Costs matter*.

The Home Run

My second prediction, to say the least, fared considerably better. “The jury is in.” And its verdict has affirmed not only that defined contribution retirement plans have opened “vast new markets” for funds, but that they have altered the very fabric of this industry. Fund assets of 401-k plans, a mere \$15 billion in 1987, total approximately \$400 billion today—fully one-eighth of the assets of all stock and bond mutual funds. Indeed, tax-deferred retirement plans in the aggregate accounted for 40% of industry cash flow last year.

I see little likelihood that the importance of institutional ownership of funds will decline in the years ahead. As long as today's financial markets remain strong, our industry's cash flows will continue unabated, and the institutional uptrend should persist. And when the stock market falters—as it will someday (I think!)—I would expect institutional flows to level off even as individual flows drop or even vanish, perhaps to the point where retirement plans account for all of our net cash flows. (A sustained bear market, however, would surely shift the preponderance of flows from stock funds to bond funds and stable-value investment contracts.)

But I continue to believe that, “mutual funds offer extraordinary opportunity to institutions, from the largest to the smallest, in terms of simplicity, efficiency, liquidity, and flexibility,” just as I did in 1977, when I spoke those very words to this Association. To be sure, I pointed out then that to attract institutional clients, funds would have to “offer shares on a no-load basis *and* with a low expense ratio” (emphasis in my original remarks). As we now know, fund shares sold without sales loads account for something very close to 100% of institutional purchases. They include both “pure no-load” funds as well as “institutional shares,” offered side-by-side with shares of the same funds sold to the great masses carrying full commissions (an interesting paradox itself).

But even more striking is the anomaly that most funds of both types typically carry the industry's conventional high operating expense structure. This “neither fish nor fowl” approach—cutting clients a break on sales commissions but not on expense ratios—cannot be sustained in the face of rational, well-informed corporate intermediaries with a fiduciary duty for accounts that often run from \$10 million to \$100 million, and, yes, to \$1 billion and more. I know next to nothing about the *science* of marketing. But even 20 years ago it took only common sense to recognize the obvious about the *art* of marketing. “An internally-consistent pricing policy,” as I said to you then, “must be implemented in such a way that it reinforces the marketing approach.” In short, I believe that my two predictions of a decade ago—lower costs, where I was so abjectly wrong, and thriving institutional markets, where I was so clearly right—must finally be reconciled. Some firms will maintain prices and abandon the institutional markets; others will reduce prices sharply for institutional clients and embrace these markets. These are the alternatives. No other options exist.

Well, I apologize for my ruminations about the past. I would not do so if I didn't believe that the lessons of history were so valuable. (“Those who fail to learn from the past are condemned to repeat it.”) Surely the past can help to guide those willing to learn constructive solutions to profound issues, and I'm confident we can learn. But, for mutual fund managers and for mutual fund shareholders alike, both perspective and patience are the order of the day.

Looking to the 21st Century

Now let me turn to the future. The 21st century lies but three years away. (Yes, in spite of what you might assume, it doesn't begin until January 1, 2001.) What practices must we change to preserve the trust of investors? I'll begin with three red flags that I set forth a decade ago as the antithesis of trust: over-emphasis on marketing, creating excessive expectations on the part of investors, and offering funds bearing unnecessarily high risks and excessive costs. Let's look at each warning signal.

First, our emphasis on marketing has become even more extreme. We spend more time and effort—to say nothing of our shareholders' dollars—on marketing than on management, an anomaly that takes my breath away. (For obvious reasons, I dare not say that it breaks my heart!) Turning a theme of long ago on its head, “the message has become the medium.” Frustrated, I suppose, by our failure to

outpace unmanaged market indexes, we have leaned on massive advertising to promote sales of our relative handful of funds that have had outstanding records of past performance, even though we know that few if any of those records will be repeated.

We promote hope—romantic idylls of gray-haired couples aboard cruise ships; children cavorting on beaches with their labradors; college graduates with their caps and gowns—which is fine for typical marketing organizations. But we have a higher duty, including the responsibility to “market” essential information about risk and cost. But we don’t do it. And we create untested “new products” that are apt to be attractive only for a moment in time. That is not a very creditable strategy for an industry that must *know* that sound investing is a lifetime task.

Let me describe three examples of misguided fund marketing that have already ridden in the saddle and driven this industry in the past decade:

First, the Government-Plus Fund, “investing in the safety of U.S. Government Securities and providing a high return.” This genre reached its crest in 1987, when aggregate assets of the dozen funds that had emerged during the previous two years totaled some \$30 billion. One of them advertised a 12% return when U.S. Treasury bonds were yielding less than 8%. (The extra yield—net of 1% expenses—was created by premiums earned on covered call options, plus short-term gains, annualized for the quarter!) Really, it took no more than common sense to say, as I did then, that the “yield is untrue,” and that “net asset value must decline as it is converted miraculously into income,” and that an income decline would soon follow. And so it did. By 1994, the initial \$15 offering price of that fund had fallen to \$8, and its income dividend had plummeted from \$1.20 (counting the capital gain distribution, \$1.60) to \$0.52 (no capital gain). The assets of these funds plummeted to \$6 billion and their decent, unknowing, generally older shareholders never recovered their lost capital. Finally, these funds abandoned their fruitless strategy, often changing their names. They have not been heard from since.

Next, there was the Short-Term Global Income Fund. This concept popped up in 1989, a time of 10%-plus yields on short-maturity international bonds, and provided returns of up to 15% in 1990, largely because of a weak dollar. Their high yields quickly attracted investor assets, and nearly 40 funds joined the fray. The concept promptly fell on its face, with these funds providing average annual returns of but 2% in 1992-1996, as net asset values tumbled 25%. Total assets of the group, which had reached nearly \$25 billion in 1991, were then truly decimated, falling to \$2.5 billion in 1996, at which point *Morningstar* said “goodbye” and discontinued the category.

Finally, there was the Adjustable Rate Mortgage Fund, the best of this sorry lot, but a failure nonetheless. Billed as a kind of money market fund, offering considerable price stability but higher yields, it became, God forbid, popular. By 1992, it had quickly attracted 37 entrants and \$20 billion. Alas, during the next three years, its annual return averaged but 1.5% (net of a 1% expense ratio, which had consumed fully 40% of the total return!). Assets had then fallen below \$5 billion, many funds have changed their objectives and their names, and *Morningstar* also bade this category goodbye in 1996.

These three examples illustrate that my concern about letting “new products” call the tune was not misplaced. But it was the fund shareholder who paid the piper in each case. Sure, the industry proved its marketing savvy, but its management prowess failed to measure up to what reasonable investors had a right to expect. We watched our shareholders lose their capital in a way that they should not have, without, as far as I can determine, an apology. It may have been a great ten years for creative marketing, but it was hardly great for investment integrity.

Second, we failed to meet reasonable investor expectations of returns. Of course, I acknowledge that in the wonderful bull market that favored us during the decade, even our least capable managers provided outstanding returns. Fully 97% of our equity funds in fact recorded double-digit *absolute* annual returns. But with an 18% return for the total stock market, their average return of 15.5% wasn't very good, failing to meet the expectations of any investor who assumed, at least implicitly, that professional management worthy of its hire would outpace the market.

That "mere" 2.5% lag in relative return cost real money. Any investor who invested \$10,000 ten years ago and merely earned the market return would today have \$52,000 of capital. But in the average equity fund, he has an inadequate (if wonderful) \$42,000—a \$10,000 shortfall from what he might have been led to expect. And some of the funds in the handful that did succeed in outpacing the S&P 500 Index during the decade now stoop to advertise their successful conquest of that Mt. Everest of the mutual fund industry, the market index—a curious competitor that happens to employ no research analysts, no economists, no market momentum technicians, and not even, as such, a portfolio manager. Is that really an accomplishment worth bragging about in a Super Bowl television commercial?

Third, to complete the litany, we've surely offered funds bearing both high risks and excessive costs. We've provided the waiting world with some 5,000 equity funds, more than ever before and even more than the number of stocks listed on the New York Stock Exchange. Only 3000 of them have been around more than three years, and 1600 of *them*—more than half—carry more risk—a remarkable 36% more risk on average—than the stock market itself. (I'm using the *Morningstar* risk measure.) That *may be* all right as far as it goes, but I don't think it goes very far. Because we pretty much ignore these specifics. Real numbers showing past risk are conspicuous by their absence in mutual fund promotional literature, and an investor must go to *Morningstar* and the other reputable publishers of industry performance data to find them.

Turning now to excessive cost, I'm at a loss for words. A huge majority of funds—99% or more—never even discuss the role of costs. We explicitly present only figures that are legally required, and even those *only* where they are required. We offer no quantification of the actual and expected costs of portfolio turnover and taxes, and provide expense ratios only in prospectuses and in the Annual Reports, where they are buried in a dense table right before the ever-exciting "Notes to Financial Statements."

We present charts showing imposing long-term *market* returns without mentioning this fact of life: when these costs are deducted from market *gross* returns, investors as a group receive *net* returns that fall materially short. Nor do we show that even two percentage points of shortfall in annual return can shrink optimal capital value by nearly 40% over 25 years. Everyone in this business *knows* that costs matter, and matter a great deal. But apparently we want to keep our shareowners in the dark—ignoring unpleasant realities just as did the legendary monkeys, who would see no evil, hear no evil, and, above all, speak no evil.

In all, as must be rather obvious by now, I'm disappointed in what appears to be, not only the lack of progress, but retrogression in the past decade. So, I'm hoping we will start to get ready now, in 1998, for the new millennium which begins in 2001. To that end, let me now attempt to define an industry agenda for the 21st century, focusing on how we can make this a far better industry, not for those of us who govern it or serve it, *but for those who are served by it*—by then perhaps 100 million human beings, shareowners and their families alike. There are four distinct areas in which we should reconsider our approach to mutual fund investors.

On Investment Strategy

First, investment strategy. Appropriate strategy is the first step that investors should consider for investors. At the outset, of course, investing is an act of faith, a willingness to postpone present consumption and save for the future. We must address the historical returns, *and risks*, that have characterized U.S. financial markets—in stocks, bonds, and cash reserves—and not just recent history. And we must make certain that investors understand the fundamentals that have determined those returns, as well as the role of speculation in determining returns. The lessons of history are central to the investment understanding of investors. In turn, they must understand the important, indeed critical, role of asset allocation, but also the various factors that influence the risk-reward equation. Above all, investors must come to recognize the paradox that, more than ever in this day of complexity, simplicity underlies the best strategies. We must turn away from today’s emphasis on witchcraft and mystery in investing, and go “back to basics”—to the investment principles on which our industry was founded nearly 75 years ago. Investors must understand these fundamentals, and it is our duty to impart them to our clients.

On Investment Choices

Second, investors must give much more thought to the investment choices mutual funds offer. In one of the most interesting of the infinite number of paradoxes we have created for investors, we have defined investment options much more explicitly than ever before, relying on a clever but useful system of defining styles of equity management. It consists of a grid of nine “boxes” arraying mutual fund styles in terms of their investment orientation toward value, growth, or a blend of the two, combined with their emphasis on large, medium, or small stocks. But we have yet to own up to the curious—and accurate—implication of the fact that the nine-box matrix resembles the field for a game of tic-tac-toe, the consummate loser’s game. And, discouraging as it may be, that “game” appears to be played, not only for funds as a group, but for the funds in each of the nine boxes. We have yet to acknowledge that, if investing—clearly a winner’s game on an *absolute* basis—is a loser’s game on a *relative* basis, the one who decides *not* to play the game gains the Olympic gold medal—for relative returns to be sure, but for absolute returns as well. I hardly need point out that the index fund simply represents investing *without* playing the game. The implications for investors are obvious.

A similar nine-box grid exists for bond funds—long, intermediate, and short-term maturities on one axis, high, medium, and low quality on the other. But if the news about the stock matrix is sobering, the news about the bond matrix is devastating. The record shows that even the best fund managers can add only a small margin of return—*before costs*—in such a highly-efficient market. (A long-term U.S. Treasury bond fund or a GNMA fund, for example, is essentially a commodity.) So, when bond funds carry exorbitantly high costs—as nearly all do—they are, plainly put, unsuitable investments. In other words, when costs consume a large portion of returns in a generic medium, investors are on a treadmill to oblivion. The bond fund segment of this industry—in the early 1990s, its largest segment—will be headed for oblivion too, unless we act to give today’s increasingly-aware investors a fair shake.

On Performance

Third, performance. If this industry’s implicit promise of superior returns has been unfulfilled in the greatest bull market in stocks in U.S. history, what will happen if—as seems all too likely—we experience a decade of moderating, perhaps even negative, returns. Yes, “it *can* happen here.” We haven’t been up front with investors that top fund performance has always been followed by mediocre

(truly meaning “average” or less) performance—i.e., that reversion to the mean remains a fact of life in the world of investing.

We blithely ignore the fact that reversion is normally all the more promptly (and permanently) manifested when our manager “stars” achieved their seemingly-Herculean feats when their funds had small amounts of assets. Today, victims of their past success, they find themselves as managers of funds with tens of billions of assets—to say nothing of being units of fund complexes with hundreds of billions, a whole second order of magnitude that further hardens the arteries of the over-weight investment body. In the fund world, “small was beautiful,” and “nothing fails like success.” We ought to have the courage to fully disclose to investors this pervasive fact of investment life, and the still greater courage to stop the marketing merry-go-round and take *meaningful* steps to limit funds to appropriate asset size.

We also need the courage to finally acknowledge that we have virtually ignored the needs of our taxable investors. The 1997 capital gains realized and reported in the IRS Form 1099s that have recently annoyed so many of our shareholders—and the surprisingly large tax bills that they’ll be paying less than two months hence—will take an enormous toll from the investment returns of our traditional client base. Because we never adequately disclosed our almost universal policy of managing our funds without regard to tax considerations, it will come back to haunt us. Yes, we ought to be ashamed, but we also ought to fix it. Much better disclosure is essential. But equally essential is reshaping funds—and designing new funds—that serve the needs of the taxable investors who have been so ill-served by us.

On Funds

Fourth, funds. We must reexamine the whole nature and philosophy of today’s mutual fund industry. We have moved this industry away from our guiding principle—that prudent, disciplined management is our core function, around which all others are satellite—to a principle that aggressive marketing is the core function, dictating both the way we manage funds and the kind of funds we offer. To reiterate: the message has indeed become the medium. Further, the incredible blessing of technology in our operations and services has also become our bane, facilitating the metamorphosis of mutual funds away from their role as the providers of sensible long term investment programs and toward becoming the proxies for individual common stocks—to be bought when they’re hot, sold when their cold, and traded in mutual fund marketplaces that too often act as thinly disguised casinos to accommodate short-term traders in fund shares.

The resolution of these tensions is not clear. To many in this industry, my ideas simply reflect a Luddite yearning for the more peaceful days of those of nearly (an appalling) 50 years ago, when I entered this industry. Idealism and principles may well not serve the needs of the business side of this industry. But I have absolutely no doubt that they will serve the investment side, and therefore serve the long-term mutual fund investor—a human being who, despite the obstacles we place in front of him, is taking a serious approach to meeting the serious goal of accumulating and preserving a capital investment to ensure personal and financial security.

A Radical Idea

To get from here to there—to return this industry to its founding principles—is conceptually simple. Are you ready for an idea that will seem radical on first impression? All we need to do is change the structure of this business. We need a structure in which our mutual funds—organized as corporations or trusts—are managed like virtually every other corporation or trust on the face of the earth: in the interests of our shareholders. Fund directors rarely seem aware that the *status quo* of having funds

managed by an outside organization is the exception, not the rule, and that the relationship is ridden with potential conflicts of interests. One day—sooner rather than later—the traditional corporate governance structure must be brought to this industry.

I can't tell you when or how this new structure will develop. Perhaps it will come through investor awareness of the burden of high costs—an awareness that a few percentage points of lost return carry a huge penalty on capital accumulation over an investment lifetime. Perhaps through a brilliant insight by lagging managers that a significant reduction in a fund's cost can give them a fighting chance to outpace an unmanaged market index. Perhaps through an SEC initiative to press the industry not only to reconcile its high costs with its low relative returns, but to eliminate serious conflicts of interest. Perhaps even through the Congress—at the moment far too busy with campaign contributions and presidential peccadilloes—when and if it turns its gaze to the Investment Company Act of 1940, which, after all, charges fund directors—-independent and affiliated alike—to place the interests of fund shareholders ahead of the interests of fund managers. Perhaps precipitated by a reversal of the unfortunate perception that—after a 15-year bull market—“if we get high returns, high cost is fine, and no holds are barred.” In a bear market, the perception is all too likely to be, “if we get poor returns, even low cost is excessive, and we need to set new investment standards.”

Echoing the theme of this conference in a different way, the “Agent of Change” that will foster a better mutual fund industry is not easy to identify. Perhaps there will be a confluence of “all of the above.” But, as always, such a great change must await the day that opportunity knocks, and will require patience. But change is imperative if we are to honor the trust that investors have placed in mutual funds. However it happens, major change is on the way.

Yesterday, your conference opened with a panel that discussed “Competitive Intelligence: Winners and Losers 10 Years from Now.” I haven't heard what was said, but I imagine that the winners were identified either as firms providing a full range of financial services; or firms that have consolidated into giant “franchises;” or banking conglomerates; or firms that hold distribution and unlimited investor choice as paramount. Let me present a contarian view. I hope and believe that with the onset of the 21st century, the winners will be . . . the *shareholders* of mutual funds. They must win in terms of the funds we provide, the principles under which we manage them, the way we offer them, the services we provide, and the costs at which we make our funds available. Our owners, to whom we owe the highest order of duty and responsibility, deserve to be in the winners' circle. They deserve a fair shake.

The idealistic French author Victor Hugo, he of “Les Miserables” fame, espoused, according to a recent article in *The New Yorker*, “a single insistent doctrine: the grand old idea that man begins in darkness, and history is grim, yet man, led by the words of prophets, ever drags himself forward toward freedom and enlightenment.” That comment immediately reminded me of his wonderfully inspiring epigram: “No army can resist the power of an idea whose time has come.” I cannot tell you how much of the 21st century will elapse before the time will come for the compelling idea that mutual funds must be structured to serve, with an interest single, their own shareholders—and manage their portfolios and their business affairs under that sole standard—but the time *will* come.

Ever the optimist, I hope it will come by 2008, when I look forward enthusiastically to joining you once again!

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