STAY THE COURSE

The Story of Vanguard and the Index Revolution

JOHN C. BOGLE

WILEY

About the Author

"If a statue is ever erected to honor the person who has done the most for American investors, the hands down choice should be Jack Bogle."

—**Warren Buffett**, Chairman, Berkshire Hathaway

"Jack Bogle's remarkable career spans the spectrum from lonely iconoclast to celebrated rock star. His conception and development of index funds transformed the investment world for individuals and institutions alike. Countless millions of investors have purchased index funds because of Jack."

—**David F. Swensen**, Chief Investment Officer, Yale University

"What Gutenberg was to the printing press, Henry Ford to the automobile, and Shakespeare to the English language, Jack Bogle is to finance."

—**William J. Bernstein**, bestselling author of *The Investor's Manifesto: Preparing for Prosperity, Armageddon, and Everything in Between*

"One hundred years from today, historians will remember only two investors from this era–Warren Buffett and Jack Bogle. The two books they will note? Buffett's bible, Ben Graham's *The Intelligent Investor*, and . . . anything written by Jack Bogle. In a world of investment foxes, Jack remains a stalwart hedgehog."

—**Steve Galbraith**, Managing Member, Kindred Capital

"Jack Bogle has given investors throughout the world more wisdom and plain financial horse sense than any person in the history of markets."

—**Arthur Levitt**, Former Chairman, U.S. Securities and Exchange Commission

"Jack Bogle is one of the most lucid men in finance."

—**Nassim N. Taleb**, PhD, author of *The Black Swan*

Praise for *Stay the Course*

"Only one man could've created Vanguard and only one man could've written this book. I'm thankful Jack has done both. Investing for the many has been forever changed for the (much) better by him. Read the story of how it happened."

—**Clifford Asness**, Managing and Founding Principal,
AQR Capital Management, LLC

"Jack Bogle has done more for the individual investor than perhaps anyone on the planet. His seminal insights and relentless tenacity revolutionized the mutual fund industry, permanently and for the better. Yet for me, the signature of his greatness lies first and foremost in his passion to serve as an inspired teacher to us all. With nearly seventy years of disciplined thought on the topic of investing, Bogle's incisive mind and considered wisdom shines through always in his well-chosen words."

—**Jim Collins**, bestselling author of *Good to Great*,
co-author of *Built to Last*

"It's a rare privilege to be handed a backstage pass into the mind and motivation of the man who democratized finance, which is what this remarkable book has done. More than any other single individual, Jack Bogle has improved the lives of millions of investors, allowing us to save and invest for our future at lowest cost, so we really can stay the course. I can't think of a more important story to tell, and Jack tells it beautifully."

—**Andrew W. Lo**, Charles E. and Susan T. Harris Professor,
MIT, author of *Adaptive Markets*

"Jack Bogle—a man with a mission.

For a long while, it seemed to me, an almost 'mission impossible' to push the Wall Street establishment into providing individuals and investment institutions alike with practical and economical means for keeping up with the stock markets.

Book after book—twelve in all—drive home the point. It's rare, extremely rare, for even the most astute investors to beat the stock market averages year after year. And it was expensive to try; fees were high and active trading has costs.

Jack Bogle has won the point. 'Indexing' has swept much of the investing field. Now Jack has provided his valedictory: the saga of a determined boy whose family struggled financially but who thrived at boarding school and Princeton, and then in the investing world, fighting off both the investment establishment and a congenitally weak heart along the way.

Stay the Course puts it all in the broader perspective. Professional and personal battles, won or lost, give way to the larger responsibilities: to family, to communities large and small, to the nation itself."

—**Paul A. Volcker**, Chairman, Federal Reserve Board 1979-1987, author of *Keeping at It*

"I served on the Vanguard board for 28 years. I can attest that every policy that came before the board was resolved by applying a simple criterion: Was the policy good or bad for the individual shareholder? It is small wonder that Jack Bogle has been called 'the best friend the individual investor has ever had.'"

—**Burton G. Malkiel**, Chemical Bank Chairman's Professor of Economics, Emeritus, Princeton University, and bestselling author of *A Random Walk Down Wall Street*

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Dedication

Dedicated to the wonderful human beings who have helped to shape my life—the family of my heritage and the family of my procreation; my teachers and my mentors; the colleagues who have supported me during my long career; the Vanguard shareholders who have inspired me (and paid my salary!); and my friends from all walks of life.

Becoming 90

Even as I approach my 90th year on this Earth, I strive to follow the impassioned advice expressed by the Scotsman Sir Harry Lauder (1870–1950):

Keep Right on to the End of the Road

Every road through life is a long, long road,
Filled with joys and sorrows too,
As you journey on how your heart will yearn
For things most dear to you.
With wealth and love 'tis so,
But onward we must go.

With a big stout heart to a long steep hill,
We may get there with a smile,
With a good kind thought and an end in view,
We may cut short many a mile.
So let courage every day
Be your guiding star always.

Keep right on to the end of the road,
Keep right on to the end,
Though the way be long, let your heart be strong,
Keep right on round the bend.
Though you're tired and weary still journey on,
Till you come to your happy abode,
Where all the love you've been dreaming of
Will be there at the end of the road.

Contents

About *Stay the Course*

This book tells the story of how my career began, how it was abruptly cut short, and what followed once I resumed that career. It is a story of creativity and innovation; of victory and defeat; of laughter and tears; of pure coincidence and sheer luck; of commitment to high values; of determination, stubbornness, and cussedness. All in the name of serving investors, small as well as large, simply by giving thrifty human beings—directly or through their employers' savings plans—their fair share of whatever returns the financial markets bestow on our investments.

It is also the story of a revolution. No, there are no Molotov-cocktail-throwing radicals involved. Just one man with a truly financial-world-changing idea called the index mutual fund. That idea has spread like a meme, maybe even a religious sect. It is *The Index Revolution*, and Vanguard has been its clear leader.

For as long as I can remember, I've used the phrase "stay the course" to urge investors to invest for the long term and not be diverted by the daily sound and fury of the stock market. In this book, as you'll see, "Stay the Course" also has been my motto in building Vanguard, holding fast to a long-term business strategy and overcoming both adversities and adversaries, none of which were able to halt our rise.

What This Book Contains

Part I is the heart of the book. "The Story of Vanguard" proceeds more or less chronologically, from my time at Blair Academy and Princeton University through my early years at Wellington Management Company;

my rise to leadership and my descent into failure; my career saved by my creation of the upstart Vanguard in 1974, then, quickly, the index fund in 1975. Vanguard's mutual structure and index strategy defied convention; together they drove Vanguard to its place as the largest mutual fund complex in the world.

Along the way, you'll pass a series of "Landmarks." These Landmarks are highlights of the key events that were required to transform Vanguard's initially skeletal structure into today's complete fund complex—engaged in fund administration, marketing and distribution, and investment management—able to compete with our peers on a level playing field. Without this transformation, Vanguard would have been unable to join in the price competition that pervades today's powerful index fund industry.

Part II recounts the history of major Vanguard funds, including Wellington Fund, our index funds, Windsor funds, PRIMECAP funds, and bond funds. In Part III, "The Future of Investment Management," I discuss the future of investment management and reflect on some of the major changes that I see for the years ahead.

In Part IV, "Personal Reflections," I move from those financial subjects and offer a memoir of sorts (with a weird format!) of personal reflections on life, on the institutions that I've done my best to serve, and some unforgettable quotations that hold special memories for me.

Stay the Course: The Story of Vanguard and the Index Revolution should be of interest to investors, financial historians, entrepreneurs of all stripes, business people, academics, students, and, yes, any reader who simply enjoys a good story with a happy ending.

Striving for Accuracy

I've written the story of Vanguard and the index revolution in part because I've lived it and led it, in part because no one else who was involved in all of Vanguard's long saga still lives. I've done my best to be totally objective (you have a right to challenge that!) and to stick to the facts, revealed partly in my files and partly in my memory, reinforced by the notes I've taken along the long journey.

That said, I've had to write without access to primary sources of information. My request to review the corporate minutes of the Vanguard mutual funds during the long period in which I served as chairman was denied by Vanguard, a decision finally ratified by Vanguard's board of directors. Of course I could have let that inexplicable denial stop me from writing my book. But I decided to, well, stay the course, and persevere on my own.

I've had assistance from the many people who have worked with me to produce this book (Michael Nolan, Emily Snyder, Kathy Younker) or provided editorial comments (Cliff Asness, Andrew Cassel, Andrew Clarke, Rafe Sagalyn, Bill Falloon, and especially Monie Hardwick and Susan Cerra). I take this opportunity to thank each one.

Finally, *Stay the Course* represents my own candid and deeply held opinions. They are not necessarily those of Vanguard's present management.

Enjoy!

JCB
September 1, 2018

Postscript: All of the underlying information that supports the data in the book is available electronically at www.johncbogle.com.

Foreword

Burton G. Malkiel

It is an honor for me to write the foreword to this important history of the unique and extraordinary financial institution that is Vanguard. Many institutions that call themselves "mutual" are mutual in name only. The Vanguard that Jack Bogle created is truly mutual in practice. Owned by those who have entrusted their money to it, Vanguard is run with only its shareowners in mind. Any "profits" are returned to its owners in the form of reduced fees. New investment instruments are created only if they promise to provide real benefits for investors.

I served on the Vanguard board for 28 years. I can attest that every policy that came before the board was resolved by applying a simple criterion: Was the policy good or bad for the individual shareholder? It is small wonder that Jack Bogle has been called "the best friend the individual investor has ever had." Perhaps my favorite testimonial to Jack was written by a group of acolytes, the Bogleheads, devoted to propagating Bogle's investment ideas: "While some mutual fund founders chose to make billions, [Jack created Vanguard] to make a difference."

And what a difference it was. In an industry known for imposing high fees, Vanguard's were invariably the lowest. Moreover, the complex was run with the objective of distributing any economies of scale back to the shareowners and inexorably lowering the fees over time. Jack's own research made clear that fees were the most important determinant of investment performance. If you want to own a mutual fund with top quartile performance, you are most likely to do so if you buy a fund with bottom quartile fees. As Jack so presciently remarked, "This is a business where you get what you don't pay for."

But lowering fees was only part of the reason for Vanguard's commercial success in now having over $5 trillion under management. Vanguard was also enormously innovative in bringing countless new financial instruments to market to better serve investors with different objectives and in different circumstances.

Vanguard was the first to offer tax-exempt bond funds with three distinct maturities: short, intermediate, and long. It then extended the idea to taxable bonds. It created the first total bond market index fund and then the first balanced index fund, holding both total bonds and total equities. In its drive to continuously lower costs, it created the "Admiral" series of funds. It even initiated the now-popular method of factor investing by bringing to market the first "value" fund in 1992.

But eclipsing any of these innovations, by far the most important was the creation by Vanguard of the first index fund available to the investing public. In my judgment, the index fund is the most important financial innovation that has been created for the individual investor.

Financial innovation is frequently disparaged. It is often associated with financial engineering and complex derivative instruments that were not well understood by their creators and certainly misconstrued by rating agencies and investors. The fallout from this misadventure was not confined to the hapless investors and global financial institutions that suffered punishing losses. The existence of complex mortgage-backed securities helped fuel an enormous housing bubble. When the bubble deflated, a sharp recession followed, and the repercussions practically brought down the entire world financial system. One can understand the animus toward this sort of financial technology, and it is not surprising that many observers have suggested that the only worthwhile financial innovation over the past century has been the ATM machine.

We can readily accept that not all financial innovations have benefited society and that some have actually been toxic. But it would be a serious mistake to brand all new financial instruments as having little or no benefit. For me, the index fund is unquestionably the most important financial innovation of our time, and it has unambiguously been of enormous benefit to the individual investor saving and investing to achieve a secure retirement.

Index funds that simply buy and hold all of the stocks in a broad-based stock market index guarantee that their investors will earn the rate of return generated by the market. Because they involve little turnover, they minimize trading costs and are extremely tax efficient. Index mutual funds and exchange-traded funds can be purchased at expense ratios close to zero, and thus for the first time enable the individual investor to earn the full return generated by the market.

According to Standard & Poor's research, over 90% of actively managed funds underperformed their benchmark indexes over the 15-year period ending in 2017. The average active fund underperformed its equivalent index by a full one percentage point per year. Index funds don't provide average performance: they give the investor top decile returns. The index fund has provided the ideal instrument to invest savings and receive the highest returns available.

When Jack Bogle created "The First Index Investment Trust" (the original name of today's Vanguard 500 Index Fund), it was greeted with derision by the professional investment community. It was variously called "Bogle's folly" or "doomed to failure" and even "un-American." Not even Jack would have predicted that it and its sister Total Stock Market Fund would become the two largest mutual funds in the world. But he did know that his innovation would give the ordinary investor a fair shake, and that managing the Vanguard organization exclusively for the benefit of those who entrusted their money to it would fundamentally change the ability of millions of people to achieve financial security.

Think of a person of modest means who made an initial $500 investment in the Vanguard 500 Index Fund at the start of the fund's life at the end of 1977 and then added $100 of savings each month thereafter. The following table presents the results through the end of 2017. With the most modest of investments, the individual would end up with a $0.75 million nest egg. With $150 per month of savings, the individual would be a millionaire. Small wonder that the index fund has been called the "best friend an investor could have," and that Jack has been called "the greatest investor advocate ever to grace the fund industry."

ILLUSTRATION OF DOLLAR-COST AVERAGING WITH VANGUARD 500 INDEX FUND

Year Ended December 31	Total Cost of Cumulative Investments	Total Value of Shares Acquired
1978	$1,600	$1,669
1979	2,800	3,274
1980	4,000	5,755
1981	5,200	6,630
1982	6,400	9,487
1983	7,600	12,783
1984	8,800	14,864
1985	10,000	20,905
1986	11,200	25,935
1987	12,400	28,221
1988	13,600	34,079
1989	14,800	46,126
1990	16,000	45,803
1991	17,200	61,010
1992	18,400	66,817
1993	19,600	74,687
1994	20,800	76,779
1995	22,000	106,944
1996	23,200	132,768
1997	24,400	178,217
1998	25,600	230,619
1999	26,800	280,565
2000	28,000	256,271
2001	29,200	226,622
2002	30,400	177,503
2003	31,600	229,524
2004	32,800	255,479
2005	34,000	268,933
2006	35,200	312,318
2007	36,400	330,350
2008	37,600	208,941

Year Ended December 31	Total Cost of Cumulative Investments	Total Value of Shares Acquired
2009	38,800	265,756
2010	40,000	306,756
2011	41,200	313,981
2012	42,400	364,932
2013	43,600	483,743
2014	44,800	550,388
2015	46,000	558,467
2016	47,200	625,764
2017	48,400	762,690

Source: Vanguard

In 2016 investors pulled $340 billion out of actively managed mutual funds while investing over $500 billion in index funds. The same trends continued in 2017 and 2018. Today over 45% of investment funds are indexed. A sea change was occurring in the fund industry. Active managers could no longer claim superior investment results, so they fought back by inventing new criticisms of indexing. Indexing is now alleged to pose a grave danger both to the stock market and to the general economy.

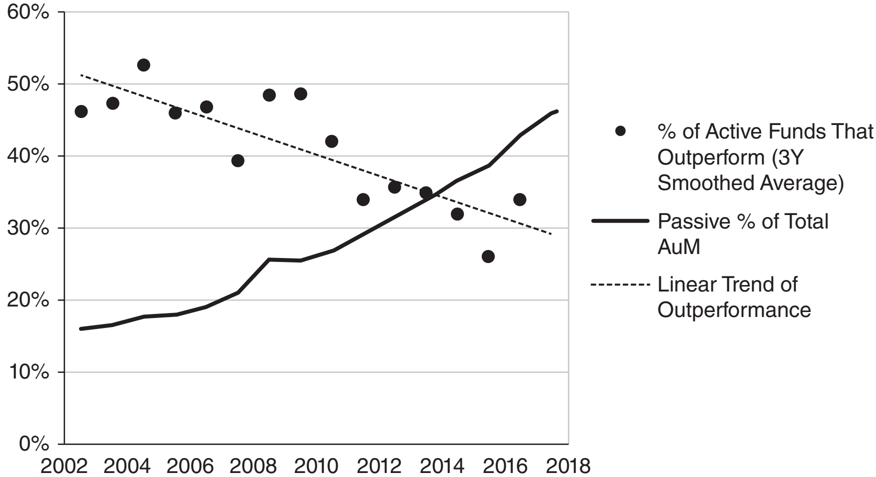
One of the most respected research houses on Wall Street, Sanford C. Bernstein, published a 47-page report in 2016 with the provocative title "The Silent Road to Serfdom: Why Passive Investment Is Worse Than Marxism." The report suggested that a capitalist market system in which investors invest passively in index funds is even worse than a centrally planned economy, where government directs all capital investment. Indexing is alleged to cause money to pour into a set of investments independent of considerations such as profitability and growth opportunities. It is active managers who ensure that new information is properly reflected in stock prices.

Could it be possible that if everyone invested only in index funds, indexing could grow so large that stocks could become massively mispriced? If everybody indexed, who would ensure that stock prices reflect all the information available about the prospects for different companies? Who would trade from stock to stock to ensure that the market is reasonably efficient? The paradox of index investing is that the stock market needs some active traders who analyze and act on new information so that stocks are efficiently priced and sufficiently liquid for investors to be able to buy and sell. Active traders play a critical role in determining security prices and how capital is allocated.

Active managers are incentivized to perform this function by charging substantial management fees. They will continue to market their services with the claim that they have above-average insights that enable them to beat the market even though, unlike in Garrison Keillor's mythical Lake Wobegon, they cannot all achieve above-average market returns. And even if the proportion of active managers shrinks to as little as 10 or 5% of the total, there would still be more than enough of them to make prices reflect information. We have far too much active management today, not too little.

But as a thought experiment, suppose everybody did index and individual stocks did not reflect new information? Suppose a drug company develops a new cancer drug that promises to double the company's sales and earnings, but the price of their shares does not increase to reflect the news. In our capitalist system it is inconceivable that some trader or hedge fund would not emerge to bid up the price of the stock and profit from the mispricing. In a free-market system we can expect that advantageous arbitrage opportunities are exploited by profit-seeking market participants no matter how many investors index.

The evidence indicates that the percentage of active managers outperformed by the index has actually increased over time. If anything, the stock market is becoming more efficient – not less so – despite the growth of indexing. The following figure presents the data. The solid line shows the growth of indexing over time and measures the percentage of equity investment funds that are indexed. The dots on the exhibit show the percentage of actively managed equity funds that are outperformed by the Standard & Poor's 1500 benchmark index. The data shown are three-year averages taken from the 2018 S&P report comparing active manager performance versus index returns through year-end 2017. What is clear is that the proportion of funds that have outperformed the broad S&P 1500 index has declined over time even as the proportion of funds that are passively managed has increased.



Source: Strategic Insight and S&P SPIVA Report – March 2018.

To be sure, index investors are free riders. They do receive the benefits that result from active trading without bearing the costs. But free riding on price signals provided by others is hardly a flaw of the capitalist system; it is an essential feature of that system. In a free-market economy we all benefit from relying on a set of market prices that are determined by others.

A second criticism of indexing is that it has produced an unhealthy concentration of ownership that has not been seen since the days of the Rockefeller Trust. Two academic papers, a law review article, and a widely circulated op-ed have hypothesized that common ownership of companies in the same industry may produce unwanted anti-competitive effects and invites remedies to prevent losses for the economy as a whole.[1]

[1] See T. F. Bresnahan and S. C. Salop, "Quantifying the Competitive Effects of Production Joint Ventures," *International Journal of Industrial Organizations* 4, no. 2 (1986): 155–175; J. Azar, M. C. Schmalz, and I. Tecu, "Anti-Competitive Effects of Common Ownership," *Competition Policy International* 1, no. 3 (2016); E. Elhauge, "Horizontal Shareholding," *Harvard Law Review* 129 (March 10, 2016): 1267–1317; and E. Posner, F. S. Morton, and G. Weyl, "A Monopoly Trump Can Pop," *New York Times*, December 7, 2016.

The argument by Azar, Schmalz, and Tecu is that common ownership can reduce the incentive to compete. If the same asset manager is the largest shareholder of all the airline companies, that manager will be loath to see vigorous fare competition that would reduce the profit margins of all the companies in the industry. The authors find that changes in ownership concentration over time in the airline industry have been associated with anti-competitive incentives and have led to ticket prices being 3 to 5% higher than they would be under separate ownership. Elhauge has proposed that the regulatory authorities as well as the private plaintiffs' bar bring antitrust claims against institutional investors who engage in horizontal shareholdings. Posner et al. propose that institutional investors limit their shareholdings to no more than 1% of the total equity stake in the industry when holding shares in multiple companies. Any of these remedies would deal a fatal blow to the ability of companies such as Vanguard to offer index funds to their shareholders.

The argument that common ownership could produce anti-competitive effects is certainly a plausible one. But it is important to note that there is absolutely no direct evidence of the mechanism that implements the behavior to cause higher prices. The empirical support for a finding of competitive harm is far from definitive so as to support a blanket remedy. And there is no consideration to the harm that would be caused if low-cost index funds become unavailable.

In my own experience as a longtime director of Vanguard, there was never an instance where a vote was made that would encourage anti-competitive behavior. There is simply no evidence that anti-competitive practices have actually been encouraged by other indexing giants such as BlackRock and State Street because of their common ownership of all the major companies in an industry. Nor would it be in their interest to do so. The same investment companies control a sizeable portion of the common stock of every major company in the market. Perhaps banding together to encourage the airline companies to raise their prices would benefit their holdings of airline stocks. But this would mean higher costs for all the other companies in their portfolio that depend on the airlines to facilitate business travel. Index funds have no incentive to favor one industry over another. Indeed, since index funds have encouraged managements to adopt compensation systems based on relative rather than absolute performance, they have explicitly promoted vigorous competition among the firms in every industry.

Index funds have been of enormous benefit for individual investors. Competition and economies of scale have driven the cost of broad-based index funds very close to zero. Individuals can now save for retirement far more efficiently than ever before. Indexing, pioneered by Vanguard, has transformed the investing experience of millions of investors. It has helped them save for retirement and meet their other investment goals by providing efficient instruments that can be used to build diversified portfolios. They represent an unambiguous benefit for society.

Good public policy requires that the interests of all stakeholders be considered when contemplating blanket measures that have the potential to interfere with the ability of households to accomplish their long-run financial goals. When considering a hypothetical cost against the benefits from the most consumer-friendly innovation in history, it seems clear where the net benefit comes out. Even if it could be proved that institutions' cross-holdings are related to less competition, disruptive requirements on organizations such as Vanguard would be the last remedy that should be pursued.

Part I

The Story of Vanguard

Chapter 1

1974

The Prophecy

In July 1974, I was in Los Angeles at the headquarters of the American Funds, meeting with friends that I had made as a governor and two-term chairman of the Investment Company Institute. Jon Lovelace, then the head of American Funds and son of the firm's founder, Jonathan Bell Lovelace, came into the meeting and said that there was an urgent matter that he needed to discuss with me. Jon had a reputation for integrity, independence, and wisdom, so I was eager to speak with him.

Following my visit to his firm, however, I had a scheduled dinner meeting before flying back to Philadelphia on the 7:30 flight the next morning. "That's fine," Jon said, "I'll meet you at the LAX breakfast room counter at 6 a.m."

Jon was already seated at the counter when I arrived. After a few pleasantries, he got right to his point: "I understand that you're planning to create a new mutual fund complex that will actually be *mutual*, owned by the fund shareholders." Yes, I responded, I hoped to build such a firm. To put it mildly, Jon was not amused. I still remember his exact words, "If you create a mutual structure," he said sternly, "you will destroy this industry."

More than four decades later, it is clear that Jon Lovelace was on to something. If he had amended his dire prediction to say, "you will destroy this industry *as we now know it*," today we could credit him with almost perfect foresight.

Structure and Strategy

Then again, nobody in 1974 really could have predicted that an upstart firm, founded at the bottom of a vicious bear market, would overcome all odds and not merely survive, but ultimately dominate the mutual fund industry. The firm's mutual structure – owned by its fund shareholders and operated on an "at-cost" basis – had never been tried before.

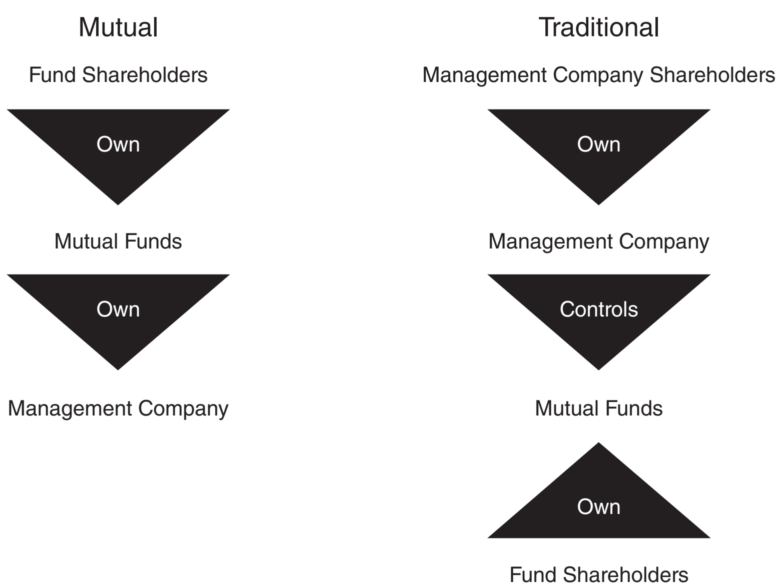
We were compelled by our own directors to retain an external investment adviser with a previous record of failure. Our role was initially limited to fund administration, for we were barred from portfolio management or share distribution. And we would soon stake our future on an unprecedented strategy: a stock portfolio that would not rely on an investment adviser.

If those liabilities were not burdensome enough, the firm had a brand-new name: **Vanguard**.

The new organization would be the first – and to this day, the only – *mutual* mutual fund organization, run on an "at-cost" basis, not by an external management company seeking to earn high profits for its own shareholders, but by the funds themselves, and ultimately by the funds' shareholders. We called it "The Vanguard Experiment" in mutual fund governance.

It may be useful to see how the Vanguard mutual structure differs from the conventional industry structure followed by (literally) all of our peers. (See Exhibit 1.1.)

Exhibit 1.1 Mutual Ownership Structure versus Traditional Corporate Structure



2018: The Prophecy Fulfilled

Yet during the decades that followed, the name Vanguard – along with its unique structure and an unprecedented strategy built around the creation of the world's first index mutual fund – would unquestionably change the nature of the mutual fund industry as we then knew it.

Call it creative destruction. Call it disruptive innovation. Call it luck. Call it, as some have, my attempt to salvage my career. (There's some truth in that.) But more than anything else, call it good karma, along with a healthy dollop of good timing. For surely the passage of time would have eventually awakened the investment world to this fundamental truth: before costs are deducted, the returns earned by investors as a group precisely equal the returns of the market itself.

After those costs, therefore, investors earn lower-than-market returns. The irrefutable fact: the only way for the 100 million families whom the mutual fund industry serves to maximize their share of the financial-market returns they earn as a group is by minimizing their costs. Paraphrasing the words of our nation's Declaration of Independence in 1776, "We hold this truth to be self-evident." Vanguard took the leadership role in bringing down the costs of investing, ultimately becoming the world's lowest-cost provider of mutual funds.

Vanguard: Lowering Costs for Investors

Since our founding in 1974, Vanguard has been focused on lowering the costs of investing. As a result, the Vanguard that we know today is a colossus. Worldwide, we manage more than $5 trillion on behalf of some 20 million clients – more than our two largest competitors *combined*. Our near-25% share of long-term mutual fund assets is almost double the previous high of 15%, reached earlier by three different firms, and our 65% share of the industry's entire net cash flow during the past five years is also without historical precedent.

In recent years, investors have entrusted an average of some $1 billion each business day to Vanguard's care, an amazing endorsement by the investing public, also without precedent in our industry.

Index Strategy Follows Mutual Structure

What accounts for Vanguard's acceptance in the marketplace? Surely our growth is rooted in that mutual structure that so concerned Jon Lovelace, and the strategy that it entailed. Thanks largely to the rock-bottom costs generated by our mutual structure, the long-term returns earned by the Vanguard funds for their investor/owners frequently rank among the highest in the industry. Such acceptance would not have been imaginable during the stormy and uncertain years following our founding. Indeed, at the outset we experienced 83 consecutive months of net cash *outflows* from our funds.

Nor would it have been imaginable that such a structure would almost compel the design of a strategy focused on index funds, which were not even a blip on the horizon when Vanguard began. But it took no genius to realize that "strategy follows structure," and within a year of Vanguard's founding, we created the world's first index mutual fund.

"The Emperor's Clothes"

Almost a century has passed since the first U.S. mutual fund was incorporated in 1924, yet only during the past two decades have investors come to fully embrace the truth that Vanguard holds self-evident. Rather than wearing the clothes of market-beating "professional management," the mutual fund emperor was wearing no clothes at all. In fact, it wasn't only the mutual fund emperor who was naked, it was the entire mutual fund empire, an industry unable to deliver on its prime, if tacit, promise: that professional money managers as a group would enhance the returns earned by fund investors.

The concept that fund managers could not add value to their clients' wealth, once considered nearly heretical, is now broadly accepted. It has led to a disruptive revolution in the mutual fund industry, largely driven by the rise of index funds. The index revolution, in turn, has been led by Vanguard.

The odds against Vanguard's ever coming into existence, let alone surviving that first decade, were staggering. To paraphrase a line from the hit musical *Miss Saigon*, Vanguard was "conceived in Hell and