



Bogle Keeps it Simple *Tips from the index fund founder*

This summer, we approach the 33rd anniversary of index investing. It all began on August 20th, 1976, with the initial public offering of Vanguard's 500 Index Fund Investor Shares (VFINX). The fund's annual return since inception has been a healthy 9.6%, with dividend income accounting for almost half of that return. What's the future hold for indexing? Here's what John Bogle, founder of Vanguard and inventor of the index fund, has to say.

The Brilliant Inventor

John Bogle is the Thomas Edison of investing. He invented a tool so useful and popular – the index fund – that it's difficult to imagine where we'd be without it. Bogle, well known for his relentless commitment to indexing as a fundamental investment strategy, seems to have converted many believers over the last three decades. VFINX now has \$77 billion in assets – a 12% market share of all index funds, mutual and ETF – and Vanguard has total assets of more than \$1 trillion, primarily in broadly diversified index funds.

Bogle believes that the keys to successful equity investing are to invest for the long term in a broadly diversified index of equities, and to keep return-eroding expenses as low as possible. He calls index funds the “gold standard” of investing, and blames the investment industry for creating so many other complicated and needlessly expensive products, which he calls “lead ingots.” At a recent Morningstar conference he stated, “I am an apostle of simplicity and low cost.”

Buy and hold

Many investors point to the last decade, with annual returns for US equities at approximately zero – the worst ten year stretch in modern times – as the rightful end of buy and hold. Bogle disagrees. He expects buy and hold index returns to return to historical norms over time. At the same Morningstar conference he stated that the “odds are highly probable that stocks will outperform bonds” in future years and that he expects equity returns to average 8% annually, with 3.5% of that coming from dividends.

Long term trends support his view. History shows that a decade of extreme returns, like the bountiful ones of the '90s, are often followed by the opposite in the next decade. Hence, the miserable 'Naughts. Simple odds favor a better or more “normal” annual return in the upcoming 'Teens. While it is impossible to reliably predict the returns of a single year, much less a decade, we concur with what Bogle has been saying for his entire career: a properly diversified portfolio positions the investor to reap market returns in both stocks and bonds.



As Bogle puts it, “If buy and hold is dead, we are all dead in terms of our financial futures.”

In our view, the alternative to buy and hold – market timing – is just a fancy term for gambling. To systematically beat the market by knowing when to jump in and out presumes consistently higher intelligence, better information, or clearer insight, which are all easy to claim but difficult to deliver. Bogle, in his 2009 book, *Enough*, demonstrates the challenge facing investors:

The average equity fund reported an annual rate of return of 10 percent for the period (1980 to 2005) – trailing the 12.3 percent return on an S&P 500 index fund. But the return actually earned by the investors in these funds was 7.3 percent, a lag of 2.7 percentage points per year. (*Enough*, p. 81)

Simply buying and holding all the funds would have returned 10 percent. Buying and holding the S&P returned 12.3 percent. But investors seeking to do better than average actually did worse by picking worse than average funds and moving in and out of them at inopportune times.

It’s no easier for professionals. The 10 percent average return produced by highly educated and compensated equity fund managers lagged the passively managed S&P 500 by 2.3 percent per year. Much of that underperformance can be attributed to expenses – transaction costs, management fees, and other costs that directly decrease shareholder return.

Even with the help of a trusted advisor, investors face an uphill climb in the quest for outperformance. In his 2007 book, Bogle quotes a study by Harvard Business School professors that showed the average return of funds recommended by advisors to be 2.9 percent per year, versus 6.6 percent for funds purchased directly by investors during the period 1996 to 2002. (*The Little Book of Common Sense Investing*, p. 104)

In this era of complex investment models, buying and holding an index portfolio is an easy target for critics as it seems relatively unsophisticated (or as Bogle proudly describes it, “simple”). In truth, blaming buy and hold for poor returns misses the point. The most important determinant of portfolio return is asset allocation (the mix), not managers (the players), or individual securities (the pieces), or timing (the clock). Yes, certain asset classes can and do perform meagerly for long periods of time, as bonds did in the ‘70’s as inflation set in, and as US stocks have done since this millennium began. They can also surge forward for years at a time. As it’s

The OCM Advantage

Osbon Capital Management is an index boutique. As firm believers in market efficiency, we make no attempt to beat the market through stock picking, market timing or fundamental or technical analysis. We focus on asset allocation, risk management, the selection of cost-effective ETFs and exceptional client service.



impossible to know which will happen next, buying and holding is Bogle's recommendation, and ours.

Bogle on allocation

John Bogle likes simple investments like low cost indexes. And he promotes an elegantly simple asset allocation plan as well: "Keep your age invested in top quality bonds, with the balance in equities." For example, a 25 year old would hold 25% in bonds and 75% in stocks. A 75 year old would have the reverse mix, 75% in bonds and 25% in stocks.

Bogle's allocation is simple and functional: it works from the day you invest until the day you die. It's optimistic too: it assumes you will live to be 100 and ultimately keep all your money in bonds! And it is long term: it is designed to keep you fully invested at all times in both stocks and bonds, and to ignore short term market fluctuations that can breed doubt, panic, or regret. Thus, you are more likely to reap long term investment averages over time.

Lastly, his advice is dynamic and changes with time, just as your risk tolerance changes with time. According to actuaries, the longer you live, the longer you are likely to live, so any allocation strategy must address life span, which this one does. A boy's age expectancy age at birth is 76 years, but if he makes it to 76 the actuarial table predicts another 8 years of life. And upon reaching 84 he will most likely hit 89. And so on. Bogle's allocation model adjusts accordingly.

Good reading

Mr. Bogle's clear, honest thinking shines through in all he says and writes. His ideas are powerful, actionable, and yes, simple. We recommend the books mentioned above, and his five other works as well.

For further reading see [The Bogle Financial Markets Research Center](http://www.vanguard.com/bogle_site/bogle_home.html)

http://www.vanguard.com/bogle_site/bogle_home.html



O S B O N
CAPITAL MANAGEMENT

Osbon Capital Management, LLC
225 Franklin Street, 26th Floor
Boston, MA 02110
617-217-2772
www.osboncapital.com

This newsletter contains general information that is not suitable for everyone and should not be construed as personalized investment advice. Information regarding Vanguard is for informational purposes only and does not represent actual Osbon holdings. Past performance is no guarantee of future results. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Investing in the stock market involves gains and losses and may not be suitable for all investors. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security.

Osbon Capital Management, LLC ("Osbon") is an SEC registered investment adviser with its principal place of business in the Commonwealth of Massachusetts. Osbon and its representatives are in compliance with the current notice filing requirements imposed upon registered investment advisers by those states in which Osbon maintains clients. Osbon may only transact business in those states in which it is notice filed, or qualifies for an exemption or exclusion from notice filing requirements. This newsletter is limited to the dissemination of general information pertaining to its investment advisory services. Any subsequent, direct communication by Osbon with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of Osbon, please contact Osbon or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov).

For additional information about Osbon, including fees and services, send for our disclosure statement as set forth on Form ADV using the contact information herein. Please read the disclosure statement carefully before you invest or send money.