Portfolios & Planning | Sue Stevens

A Heart-to-Heart Talk with Jack Bogle

Bogle shares his portfolio, ruminates on the market.

Sue Stevens, CFP, CFA, CPA
Director of Financial Planning

Sue Stevens, Morningstar Associates' director of financial planning, was recently named one of the top financial planners in the U.S. by *Worth* magazine for the second year in a row. Prior to joining Morningstar, Sue headed up the research and development team for institutional participant education at The Vanguard Group.

Watching the Dow drop 2,500 points in the space of two months isn't easy. To paraphrase Thomas Paine, these are the times that try investors' souls. It's clearly the most difficult market environment I've ever been through.

To help put the current tumultuous environment in perspective, I recently welcomed the opportunity to chat with Vanguard founder and investing legend Jack Bogle. He talked candidly about his own portfolio, the current market environment, and where we go from here.

An Inside Look At Jack's Portfolio

As you'll see below, Jack's portfolio has gotten notably more conservative since we last talked to him back in September 2000. At that time, his allocation to equity funds was 58% of his portfolio, with the rest in bonds.

By the end of 2000, his stock weighting had dropped to 44% of assets, while his bond position had risen to 56%. Although Jack is clearly not a market-timer, he wanted his asset allocation to better reflect his age, his risk tolerance, and the fact that he would not be earning as much in the future as he had during his "working" years. (Jack has retired from his corporate day-to-day responsibilities at Vanguard.) All three factors prompted him to take a more conservative view of his portfolio.

Jack only re-evaluates his portfolio once a year, at year-end. At that time he reviews his overall asset-allocation policy as well as each of his funds. At the end of 2001, he decided to reduce his stock position to 36% and did so early in the second quarter of 2002. Depreciation in his equity funds leaves him with roughly 68% in bonds and 32% in stocks these days.

You can see Jack's largest positions at left. I'm guessing he has the Admiral shares wherever available. (Admiral shares, available to longtime Vanguard investors with generally higher balances, have lower expenses.) On the bond side, he's generally focusing on short- to intermediate-term bond funds, and he uses the **Vanguard Limited-Term Tax-Exempt** VMLTX as a liquidity reserve fund (it offers a slightly better return than a tax-exempt money market). On the equity side, you'll notice a slight value tilt in his style allocation.

As investors, we can take away several important lessons from Jack's approach. First of all, investing is a long-term proposition. If you've matched your overall mix of stocks and bonds to your goals, you won't need to rebalance more than once a year. That discipline will help you save money by keeping your trading costs down and will also save wear and tear on your emotions (especially if you're someone who agonizes while watching the daily news). As your needs and goals change, you need to take a look at what your priorities are and how they affect your portfolio design.

Then and Now: A Taste of Jack Bogle's Portfolio

Asset Allocation in 2000

Asset Class	%
Bond Funds	42
Stock Funds	58

Core Holdings

Fund Name	%
Vanguard Tax-Managed Balanced VTMFX	10
Vanguard Total Stock Market Index VTSMX	10
Vanguard Tax-Managed Capital Appreciation VMCAX	9
Vanguard Limited-Term Tax-Exempt VMLTX	9
Vanguard Intermediate-Term Tax-Exempt VWITX	8
Vanguard Growth & Income VQNPX	6
Vanguard 500 Index VFINX	5

Asset Allocation in 2002

Asset Class	%
Bond Funds	68
Stock Funds	32

Core Holdings

Fund Name	%
Vanguard Limited-Term Tax-Exempt VMLTX	16
Vanguard Intermediate-Term Tax-Exempt VWITX	13
Vanguard Short-Term Bond Index VBISX	10
Vanguard Total Bond Market Index VBMFX	9
Vanguard Intermediate-Term Bond Index VBIIX	7
Vanguard Total Stock Market Index VTSMX	8
Vanguard 500 Index VFINX	5
Vanguard Extended Market Index VEXMX	3
Vanguard Tax-Managed Capital Appreciation VMCAX	3
Vanguard Windsor VWNDX / Vanguard Equity Income VEIPX	7

Note: The funds listed above are not a complete list of Jack Bogle's holdings.

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Words of Wisdom

Jack also offered some perspective on the current market environment. I've included some of the notable excerpts from our talk below.

"Don't blindly stay the course."

Jack Bogle is famous for urging investors to "stay the course." But he is quick to point out that if your asset allocation is at odds with your risk tolerance, you need to take steps to adjust it. "Just because you've been doing it wrong for years doesn't mean you should keep doing it wrong," he says. The moral of the story: If your asset allocation is out of whack, consider making some changes to better reflect your risk tolerance, and then stay the course.

"Consider not only the probability of reward, but the consequences of risk."

In putting this market in perspective, Jack spoke about the importance of remembering that risk and reward go hand in hand. Says Jack, "In bull markets, it's easy to forget about the risk part of the equation. In bear markets, the reverse is true—we get so focused on risk that we lose sight of the rewards. If you still think American businesses will continue to prosper in future years, then you should have a portion of your portfolio in the stock market. But when the news reports tell of more and more betrayals of the public trust, these are tough judgments to make." Just remember, even though we're hearing a lot of bad news right now about corporate America, there are rewards for long-term participation in the U.S. stock market.

"A stock doesn't know what you paid for it."

In my business as a financial planner, I see many people afraid to sell even the most risky stocks in their portfolio because they continue to hope they will come back to the levels where they bought them. But Jack asserts, "The market is not a good place to rely on hope."

Jack's comments highlight the fact that you need to worry less about realizing losses and more about creating a mix of stocks and bonds that allows you to sleep well at night. And those losses don't have to go to waste! You can use them to offset gains, and losses you can't use in the current tax year can be carried forward.

"Times of extraordinary turbulence are poor times to make decisions."

The bottom line: Don't let your emotions dictate your investment policy. You may have decided that you need a more conservative portfolio, but don't let the latest news reports drive your decision-making. If you've made prudent investments in high-quality companies and/or funds and your asset allocation is in line with your goals and time horizon, then you just need to to ride out the rough patches.

"Investing is an act of faith."

Jack reiterated these words from a speech entitled "Rebuilding Faith" (found at The Bogle Financial Center at www.vanguard.com). He goes on to say, "Perhaps it goes without saying that in recent years these three articles of faith—faith in the stock market, faith in the corporate executives who run our publicly held enterprises, and faith in the trustees who manage our money—have been tested. And found wanting. If there is a single overriding task that lies before us, it is restoring faith in investing."

Perhaps we have learned something from the challenges in the stock market the past two and a half years. If something looks too good to be true, it probably is. Slow and steady consistent growth can still get us to our goals. Says Jack, "Remember that what we're living through right now is a historical event. Don't assume this is what the future will be. The market has swung to greed and when it swings back the other direction it won't stop at fair value, it will lead to fear. But remember, it's always darkest before the dawn."

What should we take away from these words of wisdom? Don't let fear drive your decision-making process. Focus on the fundamentals—set an appropriate asset allocation, use realistic stock valuation measures, and watch for signs of economic recovery. Prepare yourselves for short-term pain, but don't lose sight of reaching longer-term rewards.