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An Inside Look at Jack Bogle's Portfolio

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Jack Bogle is known for many things: his longstanding advocacy of indexing, his pound-the-table passion for low costs, and his true commitment to fighting for investors' rights.

I've had the privilege of talking with Jack over the years about how he invests his own money. Without a doubt, Jack is consistent in his approach and forthright with his observations about how he executes a lifelong investment strategy.

Recently I had a chance to exchange e-mails with Jack about how his portfolio has changed in the last year or so, his expectations for future market returns, and what he's been up to lately.

Portfolio Structure

Just as many of you have, Jack has two parts to his investments: his retirement plan (the Retirement and Savings Plan at Vanguard) and his taxable accounts.

He's been investing regularly in his retirement plan since 1951. "My first investment, in July 1951, came to $37.50—15% of my $250-per-month salary. With rising compensation and tax-deferred contributions and earnings ever since—heavily in equities until the late 1990s—my, how it's grown!" writes Jack.

So for those of you out there who don't think your savings will ever amount to anything significant, take heart. Even the greatest investors had to start somewhere.

The second pool of money is Jack's taxable accounts. This is the money he's saved personally over the years. "I look at this portfolio in part as a 'rainy-day fund,' and it is the (significantly) more conservative of the two."

Asset Allocation

When you think about what's an appropriate asset allocation for your situation, you need to consider how much risk you want to take, whether you are still in your working years, and what your immediate cash flow needs will be. For example, Jack is a conservative investor, is still working, and doesn't need income from his portfolio at this time.

"My current asset allocation overall is about 60% bonds and 40% stocks. There's a fair amount of money involved here, and I feel no need whatsoever to overdo equities. After all, if stocks (surprisingly) soar—I'll do just fine, not in percentage terms but in dollar terms."

The last time we took a look at Jack's portfolio was July 2004. At that time, his asset allocation was 65% bonds and 35% stocks. The higher stock allocation he has now comes "not because I've gotten more aggressive, but because we've had three years or so of good stock returns and modest to puny bond returns. I've just let the equity ratio do what it does, and haven't rebalanced."

This may come as a shock to some of you, but the right course of action for your portfolio may be to do nothing. If you are still within the parameters you've set for your portfolio, you can keep transaction costs low by making rebalancing changes only when you see that you are moving outside of the parameters set by

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Sue's Four Golden Rules for Financial Success
The principles behind *Practical Finance:*

- **Control Costs**
- **Acknowledge Your Uniqueness**
- **Conquer Taxes**
- **Idiot-Proof Your Financial Decisions**

your Investment Policy Statement (for more on Investment Policy Statements, go to http://news.morningstar.com/article/article.asp?id=79486).

Tactical Allocation Changes

You may have heard other investors talk about "strategic" and "tactical" asset allocation. "Strategic" allocation is your broad approach to mixing asset classes—like a 60% bond, 40% stock mix. "Tactical" allocation is making smaller shifts inside the asset classes in your portfolio. Generally you make tactical shifts to take advantage of market opportunities. Last time we talked to Jack, he had shifted away from long-term bonds and GNMAs.

This time, we see that Jack is moving into TIPS (Treasury Inflation Protected Securities). "In fact, the only investment change I've made in the past few years is a move of about 6% of combined assets from **Vanguard Intermediate Bond Index** VBILX to **Vanguard Inflation-Protected Securities** VAIPX. This is essentially a similar index fund, but with a possible advantage if inflation heats up more than the present discount suggests. Probably should have done so earlier."

Passive vs. Active Management

Jack Bogle stands for index funds. So it's no surprise that the vast majority of his portfolio is invested in index funds. (Investing through index funds is known as "passive" investing.)

On the stock side of his portfolio, Jack prefers to index the entire stock market rather than just the S&P 500. About 60% of the stock portion of his portfolio is invested in either **Vanguard Total Stock Market Index** VTSAX or a combination of **Vanguard 500 Index** VFIAX plus **Vanguard Extended Market Index** VEXAX (which covers mid- and small-cap stocks).

What may surprise some of you is that not all of Jack's portfolio is indexed. About 24% is invested in actively managed funds. "I own roughly 6% in **Vanguard Explorer** VEXRX (with its low costs and multiple managers, sort of an index fund cousin) and the equity portions of three 'legacy' funds that I just can't bear to sell (**Vanguard Wellington** VWENX, **Vanguard Wellesley Income** VWIAX, and **Vanguard Windsor** VWNEX). More importantly, these funds are broadly diversified largely with a value orientation, which is deliberate on my part."

So Jack tilts his portfolio to the value side of the style box. That style tends to be more conservative and puts more emphasis on stocks paying dividends.

Keep in mind that as you design your own portfolios you can choose to hold a mix of active and passive funds. It's not an all-or-nothing proposition.

Bond Funds and the Yield Curve

Knowing what to do about the fixed-income portion of your portfolio has probably been puzzling in the last six months to a year. The yield curve has been flat or inverted, which means that you aren't being rewarded for taking positions in longer-maturity bonds. (If a longer-term bond is paying less than a shorter-term bond, why take the greater risk of owning a longer-term bond?)

We saw interest rates raised eight times in 2005. Each time that happened, you probably saw your bond funds drop a little more in value. Strangely enough, cash (i.e., money markets) beat the vast majority of bond funds in 2005.

So what should an investor do? A combination of short- and intermediate-bond funds seems to be a winning combination. "I'm about ½ short- and ½ intermediate-term bonds overall. My largest investment remains **Vanguard Limited-Term Tax-Exempt Bond** VMLUX, as it has been for some years," says Jack.

And what about the low rates of return we've been seeing? "While bond returns have been stinko in the past three years, they were wonderful (as well as great protection) in the prior three. Today's yields, however, are pretty good, strongly suggesting decent returns in the next few years. **Vanguard Intermediate-Term Tax-Exempt** VWIUX is now at 3.7% and Vanguard Limited-Term Tax-Exempt is at 3.3%—taxable equivalents

of 6.2% and 5.5% (using a 40% tax rate). Don't knock it!"

Slow and Steady Wins the Race

One of the biggest pitfalls of investing is looking too closely at near-term results instead of focusing on the long term. Even modest annual returns can accumulate to meaningful sums over time.

"I looked at my past returns on the Vanguard Web site—about 4.5% (after taxes!) per year for the past five years, and I believe about the same for the past six years, the 1999-2005 era, including the burst in the bubble. May not seem like a fortune, but that's about 30% on a cumulative basis, and I'm not embarrassed by what may seem to some like excessive prudence (if there is such a thing!). Applied to my admittedly non-trivial capital (except by the standards of mutual fund manager, investment bankers, and hedge fund wizards!), how could I not be smiling? In fact, I believe I've had a positive capital accumulation in each of the past six years, though 2002 may have been barely positive."

So for those of you out there who are feeling bad about single-digit returns, take heart—consistent, positive returns do add up year after year...without the hair-raising volatility of riskier strategies.

If Index Funds Are Good, Are ETFs Better?

Exchange-traded funds (ETFs) are hot. More and more investors are using them—in part because of rock-bottom expenses and in part because they offer a similar passive approach to indexing. I was curious to see what Jack would say about ETFs.

"No, no ETFs in my accounts. I'll never be a trader (sic) to the cause, and it simply isn't worth the trouble—and commission costs!—of going from Vanguard Total Stock Market Index (9 basis points for Admiral shares) to **Vanguard Total Stock Market VIPER** VTI (7 basis points)."

Well, for 2 basis points, it probably doesn't make sense to change a successful strategy. But personally, I think ETFs may be a good solution for some investors, assuming they aren't "traders" who are trying to time the market.

Investing for Retirement

Even though Jack is over age 70, he's hardly retired. He enjoys his work and is making a positive contribution to the industry he loves. Let's take a closer look at what he's doing with his time and his portfolio.

"Approximately 99.5% of my investment assets remain at Vanguard, and exclude the value of our home and summer place. I've never had a pension plan, but my experience suggests that, done properly, a defined contribution plan can be even more effective than a defined benefit plan. (Of course, we get our Social Security checks each month, pretty generous since we deferred payments until age 70.)

"I should note that I'm not required to take distributions from my Vanguard retirement plan since, while over age 70 ½, I remain full-time (and more!) working for Vanguard and our shareholders. But my bond-oriented portfolio is well-positioned to provide me with a nice payment stream when I retire. Which I'm going to do. I just have absolutely no idea when.

"Right now, I'm reveling in my crusade to build a better world for investors, and excited about the success that *The Battle for the Soul of Capitalism* is enjoying in the marketplace for book sales, yes, but, far more importantly, in the marketplace for ideas (and ideals!). I'm also thrilled to see the success of *The Bogleheads Guide* (and the attendant bobbleheads—a collector's item around here)."

Market Expectations

I always find it useful and instructive to see what leaders like Jack Bogle expect from the markets. In my experience, their forecasts are more often right than wrong. Certainly, Jack's prior expectation of lower stock market returns for future years has been correct.

"As Alan Greenspan and millions of others know, this is a time of low risk premiums, and quoting the Maestro, 'history has not dealt kindly

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with the aftermath of protracted periods of low risk premiums.' Under my peculiar 'bottom-up' methodology, I see stocks returning about 6%-8% in the coming decade (dividend yield 2%, earnings growth 5%-6%, maybe with 1% deducted to account for a lower P/E ratio at the end of the period.) If we use 6.5% for equities and 4.5% for bonds (today's yield on the 10-year Treasury), that's only a 2% risk premium, versus a historical (100-year) average of 4.3%. Pretty skinny! (But I could be wrong...alas, either way!)

"Result for a generic 60/40 stock/bond portfolio: a 5.75% nominal return. With the present imbedded inflation-expectation rate of 2.5%, just 3.25% in real terms. And that's, gulp, before investment costs. Minimizing costs is crucial in such an environment—not to say that minimizing costs isn't crucial in any environment!"

Summing Up

A few final words from Jack: "In all, my portfolio could have well been designed by any serious Boglehead. Sure, I may be too conservative, but that's who I am and always have been. But I know—I know!—that whatever returns the stock and bond markets are kind enough to deliver in the uncertain, risk-laden era ahead, I'll earn my fair share. That's good enough for me. So I shall 'press on, regardless,' and 'stay the course!'. No surprises there."

John C. Bogle, 75, is founder of The Vanguard Group, Inc., and president of the Bogle Financial Markets Research Center www.vanguard.com/bogle_site/bogle_home.html. He created Vanguard in 1974 and served as chairman and chief executive officer until 1996 and senior chairman until 2000. He had been associated with a predecessor company since 1951, immediately following his graduation from Princeton University, magna cum laude in economics.

In 2004, *TIME* magazine named Bogle as one of the world's 100 most powerful and influential people, and Institutional Investor presented him with its Lifetime Achievement Award.

Bogle's latest book, *The Battle for the Soul of Capitalism*, takes an in-depth look at what's gone wrong in the mutual fund industry and what needs to happen to fix it. Says Eliot Spitzer, Attorney General, New York, "Jack Bogle has written a brilliant and insightful book that highlights the many ways that our economy has suffered because managers have placed their own economic interests ahead of those of owners and investors. Bogle offers prescriptions that, if enacted, will help prevent a repeat of the scandals that we have witnessed over the past five years." M