FOREWORD BY DAVID SWENSEN

Chief Investment Officer, Yale University

COMMON SENSE ON MUTUAL FUNDS

Fully Updated 10th Anniversary Edition

JOHN C. BOGLE

NATIONAL BESTSELLING AUTHOR

Praise for the original edition of

Common Sense on Mutual Funds

"Cogent, honest, and hard-hitting—a must-read for every investor. Bogle does the American investor a real service by carrying on his crusade. Absolutely terrific, particularly Part IV, 'On Fund Management.' I hope some journalists and the SEC get energized after reading it."

—Warren E. Buffett

Praise for the tenth anniversary edition of

Common Sense on Mutual Funds

"Jack Bogle gave the public two magnificent gifts—Vanguard . . . and *Common Sense on Mutual Funds*, a readily accessible guide on how to manage personal investment portfolios. Take advantage of Jack Bogle's gifts and pass them on to someone you love."

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

"We don't know who first invented the wheel. But the one and only inventor of the first index mutual fund—broadly diversified and investor-friendly—was John Bogle. If you will read only one book on canny personal investing, don't pick Warren Buffett's valuable offering. Buffett cannot make you or me a Warren Buffett. By contrast, John Bogle can help make any of us a canny investor who minimizes wasteful turnover and unuseful selling loads. The only thing better than Bogle's original book is its improved revision. *Bon appetit!*"

—Paul A. Samuelson, Nobel Laureate, Economics;
Massachusetts Institute of Technology Professor, Emeritus;
Professor of Economics, Emeritus; Gordon Y. Billard Fellow

"Were I allowed to recommend only one investment volume to friends and family, the updated edition of *Common Sense on Mutual Funds* would be it; in no other single place can you so easily, and enjoyably, acquire the expertise and perspective necessary to harness the vast power of the financial markets. This is the book that the investment industry doesn't want you to read, and is even better than the first edition was 10 years ago. Read it, and your heirs will thank you."

—William J. Bernstein, author of *The Investor's Manifesto*, *A Splendid Exchange, The Birth of Plenty*, and *The Four Pillars of Investing*

"How do you improve upon perfection? Well, with this tenth anniversary edition of *Common Sense*, the best mutual fund primer just got better. Jack Bogle's work clearly stands the test of time. Bogle's reflections and additions further underscore his timeless insights. This book remains required reading for everyone interested in funds."

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"In this timely update of *Common Sense,* John Bogle improves on what was the finest book on mutual funds ever written. This new edition addresses post-meltdown investing and helps you make your way through the zoo of financial products offered today. Bogle is one of the few to stick up for the average investor all the time. His watchwords—'simple' and 'low-cost'—are the most sophisticated approach to investing you'll ever find."

—Jane Bryant Quinn, financial columnist and author of *Smart and Simple Financial Strategies for Busy People*

"Jack Bogle cares passionately about everyday Americans—and that passion is palpable in these pages. This new edition of *Common Sense* won't just arm you with the investment knowledge you need. It will also inspire you to be a better investor and send you marching into the financial markets with a sense of mission."

—Jonathan Clements, author, *The Little Book of Main Street Money*

"In this latest update of his *Common Sense* classic, Bogle gives us a mother lode of new research and novel insights, which he then combines with wisdom from an amazing array of sources—including the late, great Peter L. Bernstein, the medieval scholar William of Occam, the ancient Hebrew Talmud, and others—to forge a powerful no-nonsense prescription for how individual investors should structure their portfolios in the current market environment."

—Martin Leibowitz, Managing Director, Morgan Stanley

"For more than half a century Jack Bogle has provided investment insights and pioneering products that have helped both small and large investors. When the history of modern investment management is written, he will stand out as one of its towering figures."

—Byron R. Wien, Vice Chairman, Blackstone Advisory Services

"Once again, Jack Bogle has delivered straight talk to investors, just when they need it most. This updated edition—complete with confessional mea culpas when called for—shows why Bogle is not only the conscience of the mutual fund business, but its poet and prophet."

—Tyler Mathisen, Managing Editor, *CNBC Business News*

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JOHN C. BOGLE

WILEY

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Dedicated to Walter L. Morgan
1898–1998
Founder of Wellington Fund, dean of the mutual fund industry,
fellow Princetonian, mentor, friend.
He gave me my first break.
He remained loyal through thick and thin.
He gives me strength to carry on.

Contents

Foreword for the 10th Anniversary Edition

Jack Bogle deserves the profound gratitude of the American public. First, he devotes enormous amounts of time and energy to showing investors how to navigate the treacherous marketplace for financial services. Second, he created Vanguard, a rare financial institution that places the interests of the investor front and center. Without Jack Bogle's efforts, Americans would face a financial landscape nearly barren of attractive alternatives.

Bogle offers disarmingly simple advice: employ low-cost index funds in a low-turnover, disciplined portfolio strategy. Unfortunately, few follow his sensible advice. The vast majority of investors play an active management game in which they lose two ways. First, they lose by choosing actively managed mutual funds that almost always fail to deliver on the promise of market-beating results. The shortfall comes from wildly excessive, ultimately counterproductive trading (with the attendant market impact and commissions) and from unreasonable management fees (that far exceed the managers' value added, if any). And, as Bogle points out, nearly all mutual fund managers behave as if taxes do not matter, thereby imposing an unnecessary and expensive tax burden (that often blindsides the investing public when they deal with the IRS on April 15).

Second, investors lose by trading mutual funds with eyes fixed unwaveringly on the rearview mirror. By dumping yesterday's faded idol and chasing today's hot prospect, mutual fund investors systematically sell low and buy high (which is a poor approach to making money). Moreover, the frenzied switching of funds often triggers a further tax burden. If investors followed Bogle's advice to use index funds, by dint of low costs they would beat the vast majority of fund managers. If investors followed Bogle's advice to take a steady approach to allocating assets, by avoiding perverse timing moves they would benefit from realizing nearly all that the markets have to offer.

Of course, as a financial professional I have my own views and offer two small amendments to Bogle's recipe for investment success. I would place a greater emphasis on the value of international diversification, particularly with respect to exposure to emerging markets. Second, I would limit holdings of bonds to full-faith-and-credit issues of the United States government. The experience of investors in the recent financial crisis (as well as the experience of investors in the market dislocations in 1998 and 1987) illustrates in high relief why exposure to credit risk (and optionality) undermines the very reason for holding bonds in the first place. That said, Jack Bogle gets the essential elements right. Follow his advice.

Bogle's sage advice deserves far more attention than it receives. Individual investors must educate themselves to have any hope of executing a successful investment program. Regardless of the approach that investors pursue, reading provides the essential underpinnings for an investor's education. Jack Bogle belongs to a small group of thoughtful author-practitioners, including Burton Malkiel and Charles Ellis (dare I include myself?), who articulate a reasoned, thoughtful approach to investment. After reading *Common Sense on Mutual Funds*, move on to Malkiel's *A Random Walk Down Wall Street*, Ellis's *Winning the Loser's Game*, and my own *Unconventional Success*. This handful of books competes with the marketing hype of the mutual fund industry, the blathering blandishments of the brokerage community, and the enervating cacophony of television's talking heads. (Even after being eviscerated by Jon Stewart on *The Daily Show*, Jim Cramer continues unashamedly to offer seriously damaging advice to viewers of *Mad Money*. Across nearly every dimension of the investment world, Jim Cramer stands opposite Jack Bogle. Ignore Jim Cramer. Pay attention to Jack Bogle!)

Jack Bogle's accomplishments extend far beyond educating the investing public. His Vanguard offers investors an alternative in a mutual fund industry that overwhelmingly fails investors. As one of only two mutual fund complexes (TIAA-CREF, where I serve on the board, is the other) that operate without a profit motive, Vanguard gives investors a fair shake. Aside from Vanguard and TIAA-CREF, nearly all mutual fund management companies seek to generate profits and purport to serve investors. Unfortunately, when the profit motive comes into conflict with fiduciary responsibility, greed wins and profits triumph. The idea of serving investor interests disappears and the investor loses. As Jack Bogle so convincingly tells us, today's profit-motivated mutual fund companies pay close attention to marketing, make sure to collect high fees, and provide little in terms of actual investment management. Sensible investors avoid the active management morass, embrace the certainty of indexing, and select an investor-centric fund manager.

In spite of his gloomy message about the fund industry's structural, operational, and performance failures, Jack Bogle retains an optimistic view of the world. I like to think of myself as a positive person, but I worry about the individual investor's chances for success. In recent years, the burden of providing for retirement has shifted dramatically from the employer to the employee. This policy shift creates a number of issues. First, individuals do not save enough. Second, not surprisingly, those who save tend to enjoy high incomes. Stunning statistics from the Federal Reserve Board's Survey of Consumer Finances indicate that 88 percent of the top-income quintile participate in defined contribution plans, in which they hold an average balance of more than $260,000; less than 11 percent of the bottom-income quintile participate in defined contribution plans, in which they hold an average balance of less than $2,000. Are retirement programs only for the rich? Third, rich or poor, investors face a substandard set of choices dominated by for-profit mutual funds. Fourth, investors take those substandard investment vehicles and use them to make consistently flawed timing decisions. The net result, as Jack Bogle points out, is that investors fail to capture a fair share of the rewards of investing in the world's security markets.

Jack Bogle gave the investing public two magnificent gifts—Vanguard, a rare investment management company that acts in the best interests of the investors, and *Common Sense on Mutual Funds*, a readily accessible guide on how to manage personal investment portfolios. Take advantage of Jack Bogle's gifts and pass them on to someone you love.

DAVID F. SWENSEN
Chief Investment Officer, Yale University

Foreword for the Original Edition

Why This Book Is Unique

Jack Bogle has written a book on investing unlike any investment book that I have ever encountered, because he discusses sensitive matters that other authors ignore. I hesitate to speculate on why these topics receive such short shrift elsewhere, but I suspect that other experts have horizons that are more limited than Bogle's, or they have less concern for their readers' best interests.

People often forget that Bogle is much more than an investment professional who is deadly serious about how individual investors should manage their hard-earned wealth. He is first and foremost a fabulously successful businessman who has built one of the great mutual fund empires with skill and determination, always driving it in the direction of the vision that inspired him when he launched forth on this adventure many years ago. Readers of this book are therefore treated to a unique and unvarnished exposure of the nature of the mutual fund world and how it affects their pocketbooks.

Despite all the high-minded talk we hear from the corporate spin-masters, conflict of interest between seller and buyer is inherent in our economic system. Jack Bogle's goal was to build a business whose primary objective was to make money for his customers by minimizing the elements of that conflict of interest, but at the same time to be so successful that it would be able to continue to grow and sustain itself. That has been no easy task. The complexity of the job that Bogle set out for himself, however, has enabled him to look at the competition with a very special kind of eye. One of the loud and clear messages in this book is that he is less than pleased with what that eye sees.

We must look at the investment management industry (yes, it is an industry even more than it is a profession) as a *business* and within the framework of the economic system as a whole. The investment management business is extraordinarily profitable. As such, it responds to the iron law of capitalism that capital will flow to those areas where the expected return is the highest. Over the past 10 years, the number of mutual funds has increased from 2,710 to 6,870, and the number of investment managers has exploded from 1,260 to 5,810. On the other hand, investment management defies the rest of the iron law of capitalism, which is that the very process by which high returns attract new capital inevitably brings down the rate of return as new competitors strive to take market share away from the old. Joseph Schumpeter, in a famous aphorism, referred to this process as "creative destruction." It is the essence of why our economic system has been so successful and why, despite its many glaring flaws, it continues to command such wide public acceptance.

Investment management firms never heard of such a thing. The growth in the number of managers far exceeds the rate of growth in the number of customers they serve. Willy-nilly, more and more people enter the field without in any way diminishing the profitability of those who have established themselves. Occasionally a startup will fail to make it or an established firm goofs up in some horrible fashion and disappears from the scene, but the great mass of investment managers go right on earning a return on their own capital that most other industries can only envy.

Bogle's skill in dispensing uncommon wisdom about how to invest and how to understand the capital markets would be reason enough to read these pages. But the big message in this book is that what happens to the wealth of individual investors cannot be separated from the structure of the industry that manages those assets. Bogle's insight into what that structure means to the fortunes of the individuals whose welfare concerns him so deeply is what makes this book most rewarding. It is not only fun to read: It has a big payoff as well.

PETER L. BERNSTEIN*

*Peter Bernstein died on June 5, 2009, at the age of 90. No individual made more influential and generous intellectual contributions to the field of economics and portfolio strategy.

Preface to the 10th Anniversary Edition

What a difference a decade can make! And in the first decade of the third millennium—the decade that followed the 1999 publication of the original edition of *Common Sense on Mutual Funds*—the difference was extraordinary. During the two preceding decades, the U.S. stock market had experienced the highest returns—averaging 17 percent per year—in its two-century history. During the past decade, with major bear markets in 2000–2002 and 2007–2009, stock returns turned negative on balance—*minus* 1.5 percent per year, one of the two *lowest* returns recorded for any decade during that two-century span.

Similarly, our economy moved from an era of prosperity that was long and strong to a new era of unknown length, beginning with the sharp recession of 2008–2009—now seemingly coming to a close—followed by a sober recovery in which the "new normal" of real (inflation-adjusted) economic growth will likely look more like 2 percent per year than the "old normal" of 3 percent that characterized our economy over the preceding century.

Those are just a few examples of how our world has changed. Globalization is now taken for granted. War—indeed, wars—have followed peace. Political change has been rife, as Democratic leadership has superseded Republican leadership in our federal government. Borrowing has soared to unprecedented and unsustainable levels. But while our citizens strive to reduce their debt levels, the federal debt is virtually exploding upward, with few signs of diminishment on the horizon.

To one degree or another, all of these recent changes have impacted the mutual fund industry. The returns earned by equity funds have, on average, paralleled those of the stock market, although inevitably falling short. But the stock market momentum of the 1990s carried well into the twenty-first century, and mutual fund assets, having grown from $1 trillion to $5 trillion during that decade, grew to more than $12 trillion by the autumn of 2007, only to tumble to $10 trillion in the aftermath of the stock market crash. Nonetheless, mutual funds continued to attract shareholders; the 50-million-person army of fund investors a decade ago is now 92 million strong.

Times have changed, yes. And the fund industry has become an even more important factor in our nation's financial, retirement, and economic systems. So it is more imperative than ever that it operates, using the words of the Investment Company Act of 1940, "in the national public interest and the interest of investors."

With the passage of a decade, 2009 seemed a natural time not only to bring out this updated edition of *Common Sense on Mutual Funds*, but to evaluate its message. In doing so, I have not altered a single word of the original edition, but have chosen instead to update its voluminous data, and to comment on significant developments that have occurred since then—a retrospective, if you will. The comments are interspersed within each chapter, highlighted in red for ease of identification. I've tried my best to be candid in describing occasions when experience confirmed my insights of a decade ago, and when experience failed to do so—in essence, where I was right, and where I was wrong.

I'm delighted to report that my first goal, "to help readers become more successful investors . . . [by] developing a sound investment program through mutual funds" has been confirmed. The principles that I set out in the 1999 edition remain intact—and then some. Yes, intelligent asset allocation—the appropriate balance of your portfolio between stocks and bonds—is key to success. Yes, simplicity rules. Yes, the stock market ultimately reflects the performance of the real economy and of corporate business, and of earnings growth and dividend yields. Yes, the costs of investing matter. (So do taxes.) Yes, passively managed low-cost stock and bond index funds continue to outperform their actively managed peers.

And yes, the returns earned in various investment sectors (including U.S. and international markets) still revert to the mean of the market or below. Yes, returns of individual funds also continue to revert to the market mean, as yesterday's high-performing funds become tomorrow's laggards. These simple principles—which I later came to describe as based on "the relentless rules of humble arithmetic"—had to hold. And so they did. After all, "the fundamental things apply as time goes by."

Alas, my second goal, "to chart a course for change in the mutual fund industry," failed to materialize. Despite my zeal for such reform—and the powerful evidence that demands it—things have gotten worse. The good side of technology—speed, efficiency, information—has played second fiddle to the bad side—enabling the creation of financial instruments of incredible complexity and risk, for example, and encouraging investors to treat funds as if they were stocks and trade them with alacrity. The dominance of marketing over management remains, as does the triumph of salesmanship over stewardship. Fund directors continue to forget that their job is to serve as fiduciaries for fund investors, and the industry's governance structure remains stacked against fund investors and in favor of fund managers. So I humbly concede that my hope that "time and reason" (using Thomas Paine's formulation) would combine to force reform in the fund industry remains unfulfilled.

In sum, while my investment principles have indeed become "sufficiently fashionable to procure them general favor" (again using Paine's words)—at least among intelligent investors, responsible advisers, and informed academics—my crusade for industry reform has clearly failed to do so. But please believe me when I say that time and reason continue to remain on my side, more than ever in this post-bubble environment, which will inevitably reshape investment thinking over the decades to come.

As my dear friend the late Peter Bernstein perceptively wrote in his Foreword to the 1999 edition, "what happens to the wealth of individual investors cannot be separated from the structure of the industry that manages those assets." That structure has proved to be deeply flawed, and has subtracted wealth from far too many investors who place their trust in mutual funds. While building the fund industry anew is obviously essential, widespread industry vested interests will make reform a hard conflict to win. So I console myself with Thomas Paine's words, cited at the close of the preface to the previous edition: "the harder the conflict, the more glorious the triumph."

JOHN C. BOGLE

Valley Forge, Pennsylvania
October 2009

Preface to the Original Edition

In writing this book, my objective is to accomplish two goals: first, to help readers become more successful investors, and second, to chart a course for change in the mutual fund industry. My first objective is familiar terrain. In *Bogle on Mutual Funds*, published in 1993, I set forth a commonsense approach to developing a sound investment program through mutual funds. Similarly, this book focuses exclusively on mutual funds, for I believe that a widely diversified portfolio of stocks and bonds is essential to long-term investing. For nearly all investors, the most sensible and efficient way to diversify is through mutual funds. *Common Sense on Mutual Funds*, however, even as it covers some of the same ideas as my previous book, addresses the significant changes in the investment landscape that have since taken place.

My second objective marks new literary, if not professional, terrain for me. In the past decade, as strong financial markets have made mutual funds the investment of choice for millions of shareholders, the industry has embraced practices that threaten to diminish seriously their chances of successful long-term investing. Amid the mutual fund industry's disorienting promotional din, *Common Sense on Mutual Funds* identifies these practices and presents simple principles for implementing a sound investment program. These investment principles also form the basis for my call for industry change. If mutual funds are to remain the investment of choice for America's families, change is imperative.

It is time for investors to examine these issues. Mutual fund shareholders are now 50 million strong, and their ranks are growing rapidly.

Industry assets exceed $5 trillion, compared with $1 trillion when the 1990s began. Mutual funds have assumed an increasingly central role in our financial lives; for most investors, they represent the best hope of reaching important goals such as a secure retirement. It is imperative that we consider the issues that will determine the success of fund shareholders and the fund industry in the coming century.

This is a book with a strong point of view. Its point of view is increasingly endorsed by mutual fund investors, but only rarely endorsed by other fund industry leaders, at least in their public pronouncements. Indeed, my position more likely receives negative responses: grudging acceptance, marked skepticism, downright opposition, and even bitter denunciation.

Because my position is a minority view in this industry—perhaps even a minority of one among industry leaders—I can rely only on common sense and sound reason as I seek its acceptance. I have relied heavily on a careful analysis of the facts as they appear in the historical record. History is only history, so I have explained not only *how* my investment philosophy has worked in the past, but *why* it has worked. The investment theories set forth in this book have worked in practice simply because both common sense and elementary logic dictate that they *must* work. Indeed, intelligent investing turns out to be little more than common sense and sound reason. The sooner investors realize that elemental principle, the better will be their ability to accumulate the maximum possible amount of capital for their financial security. Indeed, I chose the subtitle of my book to convey the timeliness of the principles I shall express: *New Imperatives for the Intelligent Investor.* Time is indeed money for fund shareholders.

"Common Sense" Defined

The Second Edition of the *Oxford English Dictionary* (OED II) captures the essence of these principles in its definition of common sense: "The endowment of natural intelligence possessed by rational beings . . . the plain wisdom which is every man's inheritance . . . good sound practical sense." Throughout this book, I try to honor these qualities, confident that plain-spoken reason makes not only a powerful case for common sense in mutual fund investing, but a persuasive argument for change in the mutual fund industry as well. The OED II also offers this fitting citation, published by *The Times* of London in 1888: "The general demand was for intelligence, sagacity, soundness of judgment, clearness of perception, and that sanity of thinking called common sense." I believe that mutual fund investors will eventually make this same demand, and that it will become increasingly imperative as the ranks of fund shareholders, and the level of assets invested in mutual funds, continue to grow.

I chose the title *Common Sense on Mutual Funds* not only to emphasize the importance of common sense as it is defined by the foregoing words, but also because "Common Sense" is the title of a remarkable tract written in 1776. The author, Thomas Paine, a Philadelphian and one of the country's Founding Fathers, was eager to end the governance of the American colonies by George III of Great Britain. Perhaps more than any other man, this author set the stage for the American Revolution. In the opening paragraph of the first of four pamphlets that were to constitute "Common Sense," Thomas Paine acknowledged the challenge he was facing:

> *Perhaps the sentiments contained in the following pages are not yet sufficiently fashionable to procure them general favor; a long habit of not thinking a thing wrong, gives it a superficial appearance of being right, and raises at first a formidable outcry in defense of custom. But the tumult soon subsides. Time makes more converts than reason.*

My sentiments about this industry, too, "are not yet sufficiently fashionable to procure them general favor." Nonetheless, I believe that the formidable consensus that exists today in accepting without question the status quo of the mutual fund industry will soon subside. But I expect that it will take both time *and* reason to make converts, and that common sense will eventually prompt the conversion.

And so I ask you, dear reader, to bear with me as you explore new and important ways both of investing successfully in mutual funds and of thinking about the mutual fund industry. I offer these ideas in the same sense that Thomas Paine offered his ideas:

> *In the following pages, I offer nothing more than simple facts, plain arguments, and common sense; and have no other preliminaries to settle with the reader, than that he will divest himself of prejudice and prepossession, and suffer his reason and his feelings to determine for themselves; that he will put on, or rather that he will not put off, the true character of a man, and generously enlarge his views beyond the present day.*

A Five-Part Approach

The book is divided into five distinct parts. The first three are devoted to the examination of commonsense principles in the three prime areas that should most concern investors in the establishment of their mutual fund portfolios: investment strategy, investment selection, and investment performance. Part I, "On Investment Strategy," emphasizes the need for a long-term focus, an understanding of the nature of the returns earned in the stock and bond markets, and the important role of asset allocation in investors' portfolios. Each chapter in this section leads to the conclusion that common sense and simplicity are the keys to financial success. The same conclusion holds in Part II, "On Investment Choices," in which I first cover index mutual funds and then describe choices among individual stock and bond funds and among various investment styles in each category. I also explore global investing in some depth, emphasizing the additional risks entailed in that strategy, but again finding that common sense carries the day. I reach the same finding when I discuss the search for the "holy grail"—mutual funds that provide predictably superior returns. Part III, "On Investment Performance," includes some sobering reminders of challenging investment realities, including the profound—but rarely discussed—tendency of past fund returns and past financial market returns, whether high or low, to revert to long-term norms in the future. I also discuss the current, but dubious, focus on short-term relative (rather than long-term absolute) returns, the surprisingly negative implications of fund asset growth, and the extraordinary tax inefficiency of most mutual funds. Part III concludes with a study of the vital role played by time: It enhances returns, reduces risks, and magnifies the baneful impact of investment costs as well.

Many readers will find the content of the final two parts surprising in a book about successful investing in mutual funds. Were it not for the fact that the issues discussed in Part IV, "On Fund Management," are a major cause of the generally inadequate fund returns discussed in earlier chapters, they would indeed be inappropriate here. But this industry has moved away from its traditional principles. Its focus today is on marketing rather than management, and it often uses today's wondrous information technology in ways that are detrimental to investors. All told, the interests of fund shareholders are not being well served. The root of the problem, I suggest, lies with mutual fund governance and the industry's peculiar operating structure, in which fund directors delegate all of a fund's operations to an external management company. Again, I point to common sense and simplicity as the solutions to these problems; one option would be a restructuring of the industry so that it could far better serve mutual fund investors. Recognizing, however, that even the best corporate structures inevitably reflect the values of the individuals who constitute the corporation, in Part V, "On Spirit," I take the liberty of discussing my personal experience in the entrepreneurship and leadership involved in the establishment of a major, but uniquely structured, mutual fund firm. I then conclude the book with a presentation of some reactions from some of those human beings who have served in that unique environment, and those who have been served by it.

Before we proceed further, a few words about this book. Although I have organized the chapters to be read consecutively, with the later material building on principles established earlier in the book, my goal has been to make each chapter a freestanding and independent essay on a particular issue. Thus, it was sometimes necessary to reiterate certain themes and statistics. This reinforcement, I hope, will be more than compensated for by the convenience of enabling the reader to focus on particular issues as interest and time dictate. Portions of these chapters may be familiar to some readers, for some of these themes, first tested in speeches or in journals or magazines, have been more fully developed here. However, much of the material appears here for the first time in any form.

Common Sense Redux

Despite the fact that the commonsense investment principles and the commonsense principles of industry structure that I express in the coming pages are, like the arguments expressed by Thomas Paine, "not yet sufficiently fashionable to procure them general favor," I hope that readers will not fall back on a "formidable outcry in defense of custom." Paine's impassioned arguments—backed by little more than common sense—finally met with the favor of the citizens of the colonies, and the American Revolution ensued, even as I hope that my commonsense arguments will soon meet with the favor of mutual fund investors.

Common Sense on Mutual Funds will demonstrate that the ills and injustices suffered by mutual fund investors are not dissimilar to those our forebears suffered under English tyranny. The mutual fund industry is rife with "taxation without representation" in the form of the high fees charged by fund managers, facilitated by boards of directors that acquiesce to counterproductive management policies and excessive fees, with inadequate consideration of their powerful negative impact on the returns earned by fund shareholders. Fund shareholders, like the citizens of the American colonies, should be responsible for their own governance.

As Thomas Paine pointed out, "The king is not to be trusted without being looked after . . . a thirst for absolute power is the natural disease of monarchy." Mutual fund management companies seem to have gained the power of kings in ruling the investments of the fund shareholders. If the English aristocracy in the eighteenth century was acceding to the king's every whim, cannot the same be said of fund boards of directors? I have no quarrel with management companies' focusing on their own profits. But the trade-off between the profits that accrue to fund shareholders and the profits that accrue to the fund management companies seems subject to no effective independent watchdog or balance wheel, despite the fact that the shareholders actually *own* the mutual funds. As in every other corporation in America, they ought to control them, too.

Principles and Practices

Mutual fund investors should return—and insist that the funds that they own return—to the sound investment principles and practices that are described in the first three parts of this book. And because the corporate structure of the industry has given rise to the abandonment of those investment principles and practices, fund investors should insist that mutual funds alter their organizational structures to mend the rift between ownership and control that exists today. In a commonsense manner, I have tried to reason through these issues with you, in the hope that the returns you earn on the assets you have entrusted to mutual funds will be meaningfully enhanced.

You haven't quite heard the last word from Thomas Paine. As you reflect on the critical issues discussed in this book, without doubt you will think some of them strange to contemplate and difficult of accomplishment. So it was, too, in 1776, when Paine concluded the fourth pamphlet of "Common Sense" with these words:

> *These proceedings may at first appear strange and difficult; but, like all other steps which we have already passed over, will in a little time become familiar and agreeable; and, until an independence is declared, the Continent will feel itself like a man who continues putting off some unpleasant business from day to day, yet knows it must be done, hates to set about it, wishes it over, and is continually haunted with the thoughts of its necessity.*

I am under no illusions. It won't be easy, and surely won't be fully accomplished in my lifetime. But I hardly need to remind you, using Thomas Paine's most famous words, written one year before General George Washington's battered army bivouacked in Valley Forge, enduring the bitter winter of 1777–1778: "These are the times that try men's souls. . . . 'Tis the business of little minds to shrink; but he whose heart is firm, and whose conscience approves his conduct, will pursue his principles unto death . . . . Tyranny, like hell, is not easily conquered, yet the harder the conflict, the more glorious the triumph."

John C. Bogle

Valley Forge, Pennsylvania
February 1999