

## BOGLE SPECIAL

BOB LAM

Welcome everyone, I'm Bob Lam, Chairman of the Pennsylvania Securities Commission. I want to introduce my fellow regulators Tom Michlovic and Steve Irwin. And the President and CEO of the Investor Protection Trust Don Blandin will be taking questions from the audience later in the show. Let me introduce our host, Pam Krueger of the MoneyTrack series on public television. Pam?

PAM

Thanks Bob, and welcome to all of you who are in the studio audience and watching at home. Coming to you from the studios of WHYY in Philadelphia. Now this hour is all about money. Specifically, your money. We're gonna touch on the economy, and on the banking and financial systems, and what's happening right now on Wall Street. But we're mostly here in this town hall style meeting, to talk about what's happening on *your* street. Now for most Americans, investing in the stock market is something that we have to do in order to build wealth over a lifetime. And now, most Americans just want to know if the worst is over. Well in just a couple of minutes we're gonna sit down and have a conversation with the one man who's known as the champion of the small investor, Mr. John C. Bogle. First though, let's quickly run through how this hour is going to unfold. John Bogle's gonna give us his explanation of how we've wound up in the worst recession since WWII. He'll give us his opinion if we can continue to invest with confidence, and then we're gonna open it up for your questions. They'll come from the folks right here in the studio audience, along with a few my MoneyTrack co-host Jack Gallagher recorded earlier this week. Now for those of you who are not already familiar with our special guest, here's a glimpse of John Bogle's extraordinary investing career.

[Video]

PAM

Thanks for being here Jack.

BOGLE

Good to be with you Pam, always.

PAM

By the way, John C. Bogle is also known around this town as Jack. And for this interview, it's Jack. Now you have written several best selling books about how to invest. Your latest though is titled *Enough: True Measures of Money, Business and Life*. What do you mean, Enough?

BOGLE

Well, the book is premised on a wonderful story which I really want to tell you. And that is the story of Kurt Vonnegut, the famous author, and Joe Heller, the author of *Catch-22*, an even more successful author. And they went to a party given by a billionaire on Shelter Island, right off

Long Island there, and kind of lifestyles of the rich and famous kind of place. And they get in there and Kurt says, “Joe, see that man over there? Our host? He’s a billionaire, a hedge fund manager. And he made more money today, on this one day, than you have made with every copy of *Catch-22* that has ever been sold.” and Joe Heller looks over at Kurt Vonnegut and says, “That’s ok, because I have something he will never have. Enough.”

PAM

Enough. Ok I get it.

BOGLE

It’s not complicated.

PAM

Now, who are you talking to Jack? Are you talking to bank CEOs? Are you talking to politicians, hedge fund managers, the Federal Reserve, or ordinary Americans who have just been living beyond their means?

BOGLE

Well, we’re actually talking to all of the above Pam. And that is the money section is about the sins of our financial sector in this economy. Too much over reaching, too much greed. Too much lack of awareness of risk. Too much financial engineering, making numbers look better than they are. And then I go from there, from the financial sector to business itself. Where any aspect of professional behavior, professional conduct, and the ethics that go with the role of a professional, have been reduced greatly if not abandoned in many cases in favor of business, business, business. The idea is to make a buck in this bottom-line society and we’ve gotten too much focus on, let’s say the ephemeral, too much focus on charisma, and not enough focus on the eternal, and not enough focus on character. So business, general business, in the US particularly, but all over the world, in part because of greed, human greed, has gotten the message wrong. And then finally the third section of the book is on us, if you will.

PAM

Us meaning the ordinary investor, the...

BOGLE

The ordinary investor, the ordinary citizen. And that’s the part, the life part. How to live a life, an enjoyable life where you have enough. Now, a good question is, what is enough? And I think that’s the question you ask, and I don’t know really how to answer that question. I don’t think anybody, cause it’s a very personal thing. It certainly has a lot to do with things other than money. You know it has to do with serving the community, it has to do with being a part of a family and raising a family. It has to do with how we handle our colleagues. It has to do with whether we make a contribution to the welfare of this great land of ours. And it also does have to do with money. And where money comes up, cause we all want enough so we’re not burdens for our children or whatever it might be, and the best definition I can come up with comes from the

Roman poet Harus (?), couple centuries back there, and he said, “Look for the golden mean.” somewhere between the agony, the ignominy maybe of a ?? And the envy of a palace over here. And I think most investors are in that admittedly very very broad range.

PAM

Couldn't be a better time for it. Now we right now have the luxury of looking back on all of this, meaning the meltdown, meaning the crisis. Now, in your mind, was it deregulation, was it too much money flowing into the system, was it lack of oversight or integrity for that matter, what do you really believe was at the root of this crisis?

BOGLE

Well there's an old saying Pam that 'Victory has a thousand fathers, and defeat is an orphan.' This defeat, this great defeat for our capitalistic way of life, has a thousand fathers. Just the reverse of what that saying would tell you. And so there are many people to blame, but I put most of the blame on things like: too many years of easy credit, too much credit made available through our financial system. Number 2, a total lack of concern about the quality of that credit. Particularly in the mortgage industry, but all over. People weren't worried about the quality of the credit. And then we add to that, tremendous financial leverage. So if you have a low quality portfolio of securities, let's say mortgages, low grade mortgages. They call them ninja loans. Loans that are made to people with no income, no job, no assets. That's the ninja, and they cannot work out well, not working out well. So we have that added to it. Then we have Wall Street, where greed took over. They bought these instruments to earn a little bit more money. You know if you could get a 7% yield in a 6% market, you can make an awful lot of additional money. Because it's not just 1% more, but your margin may have been 1%, 1% profit margin...

PAM

Billions and billions of dollars...

BOGLE

Well when you go from 1% to 2% spread between borrowing and lending, you double your income. And so you do some financial engineering to get there, and the price of your stock goes up and of course you the executive, sell your stock that you get all those options for these outrageous amounts of options that were issued, this tremendous delusion to the corporation's earnings, and you get out leaving main street holding the bag. Now that's not very attractive. But beyond all that, I have come to believe, and very few people have thought about this, although most people, when I talk to them, kind of get it. And that is, something else has happened to American capitalism in the last, say, 50 yrs. A fundamental change from what I would call owners capitalism, where the rewards went to those who put up the money, to manager's capitalism, when those who are running the money, either the corporate managers or money managers are first in line, and the poor stock holder sits at the bottom of the food chain. Think about this, you know, if you're investing and you have a money manager, and the money manager takes his or her fee, and you get what's left. You are literally at the bottom of the food chain...

PAM

Absolutely.

BOGLE

And so managers started to look much more at their own personal interest. And what made this possible is something that's really important to understand. And that is, if you go back, say into the early 1950s or mid 1950s, we had true owner's capitalism, we had an ownership society in which individual investors owned 92% of all the stocks out there. That gradually change, I call it a pathological mutation at capitalism, gradually changed to a system in which owners, individual owners share drop from 92%, think about this for a minute, to 75- to 25%. 92% to 25%. And that different gap was made up by financial institutions, agents, who are investing money for other people.

PAM

Third party?

BOGLE

Yeah third party agents, the largest of which are mutual fund shareholders and pension fund beneficiaries. And so when you have that, agents took too much for themselves, and we had what we call agency capitalism, an agency society, where at the beginning, these agents owned 8% 50 yrs ago 8% of all stocks, and now they own 75%

PAM

And this has been a gradual change as you're describing over...

BOGLE

Little bit at a time...

PAM

... the decades but in terms of this most recent crisis that's unfolded so violently, where does personal responsibility come in?

BOGLE

Well to begin with, in this system you kind of lose personal responsibility. You don't invest other people's money the way you'd invest your own. Adam Smith wrote about this 230 yrs ago saying just beware. Your agents don't invest your money, whether it's in the corporation, or investment company or mutual fund, the way you'd invest your own. So personal responsibility kind of vanishes. And you put your own interest first and these agents turned out to be another very unfortunately thing, started speculating with your money or my money, turning over portfolios at the highest rates ever, even higher than the rates in 1929. Far higher, swapping back and forth, stocks...

PAM

Faster and faster and faster

BOGLE

... with guess who? With one another!

PAM

Right, just back and forth

BOGLE

And it's clearly a zero sum game. Right? You win and I lose, or I win and you lose. No not true, it's not a zero sum game. It's a losers game. Because we have that croupier in the middle...

PAM

That's right...

BOGLE

... known as Wall Street...

PAM

... that's the winner.

BOGLE

... Wall Street always wins. You know, it's easy to visualize this. If you go to Wall Street and pay for stocks, who do you think wins? Wall Street. If you pay, with all difference to Gov. Rendell, and you pay the Penn lottery, do you think you win or do you think Gov Rendell wins? Go to Vegas, is it the house or is it you? Go to the race track. Is it that big handle they take outta all the money that gets bets or is it the bettors? In every case the croupiers in the middle are responsible for the tremendous cost burdens to investors. So when you look at investment returns over time, and we see that the market has grown over a very long period of time, at around 9% per yr is sort of the accepted return on stocks. If the croupiers are taking 2-3% of that, that means you're earning 6-7% and that's...

PAM

But you're taking just as much risk and yet you're not getting the premium back for that.

BOGLE

Wrong! Wall Street takes no risk. You put up 100% of the capital, you take 100% of the risk, and you get over an investment lifetime, believe this or not, something like 25% of the return. 100% of the capital, 100% of the risk, 25% of the return. It's easy to disbelieve that, so do a little test and take your little compound interest table out and compound 8% for 50 yrs, that's kind of an investment lifetime these days for young people coming into the market, compound 8% for 50

yrs and see what a dollar grows to, something like \$47. And then compound 6%, and see what that grows to, that's what you get ...

PAM

And that difference, right

BOGLE

... and it's \$11. \$47 of return compounded generated, and \$11 goes to you who put up the money and takes the risk. So I say, and people I think kind of understand this, just about everybody knows about the magic of compounding returns.

PAM

Now you just used 8% which is interesting, because we're not living in a world right now of 8%. We'll get into investing a little bit further into the show, but that is an interesting historical sort of percent we like to use.

BOGLE

Well we should realize that history has nothing to do with it. Actually it's about 9 but I try to be a little conservative. But as Samuel Taylor Coleridge observed a long time before I was born, 'history is but a lantern over the stern, showing you where you have been, but not where you're going.' So what people don't realize, they do realize the magic of compounding returns, but they fail to realize what I call the tyranny of compounding cost, and that's that gap between your return over time and the market's return.

PAM

And getting back to Wall Street for just a second. Some of that excessive, I mean all of that speculation, all of that excessive risk taking that happened with other people's money and then right down to the food chain, right down to the borrower who took out the mortgage that he or she really couldn't afford. It all helped to create the mess we're in right now. And de-leveraging is a big process. It's not gonna happen over night. What's a realistic expectation?

BOGLE

Well when you get to a totally over-leveraged economy, and I could give you some data that says debt in the economy was once one time our gross national product or gross domestic product, and now it got up to 2 ½ times a staggering increase. I don't know the exact numbers, but that's not a bad indication of the numbers. So to get back to where we have to be in the first place, because debt has carrying costs, as dare I say every credit card holder knows, as every mortgage holder knows, anyone who borrows anything knows it has a big cost over time and the number has to come down. I would say that we should probably see, as a very rough guess, and nobody knows that maybe by the middle of the yr 2010, this economy will have bottomed out and start to come back. Some of the debt will be paid down, it will take longer than that to get paid all down and maybe we'll be moving forward again.

PAM

Well one of the consequences of having enjoyed the party is now the payback, which unfortunately includes higher unemployment rates and it's a huge concern for the entire economy, but at the same time, those tiny green shoots of hope are showing up. The stock market is not quite as despondent as it was a few months ago, and consumer sentiments been surprisingly upbeat just recently. So in the end it's really investing has more to do with confidence than anything else, doesn't it?

BOGLE

Well it has to do with confidence, but I think a good rule for everybody to observe is that the stock market is a poor place to expect hope to bail you out. Because hope does not spring eternal in the stock market. So basically, the stock market is not even the right way to look at what you are doing as an investor. Now I've made the distinction many times, I think you know this. When people say, what should I do? I said, first thing you have to do is answer this one simple question for me. You have to tell me whether you are an investor or whether you are a speculator. What's the difference between an investor and a speculator? Well a speculator, that's the easy one, is buying and selling stocks, trading with somebody else, hoping to outsmart this person, day after day after day, so in every speculation, there's a winner and a loser, and we won't go through the croupier winning again, we've had enough of that. But it's betting on the stock prices, betting on the short term, betting on perception rather than reality, betting on expectations, all that relates to speculation.

PAM

Yeah, cuz you're betting betting betting

BOGLE

What is betting, what is investing? Investing is buying and holding stocks for the long term, not a stock, let me very clear on that cuz at this day and age, buying and holding a stock is I believe, more risky than it has ever been in human history.

PAM

One single stock, versus...

BOGLE

And the reason is, first we have this financial crisis, which has put a lot of people out of business, number 2 we have global competition for the first time, and powerful companies in the US isn't going to make it when a powerful competitor arises in Europe or China or India, Japan, whatever it might be. And number 3, we have this information age revolution. Revolution and technology. And a big, smart, successful technology company may open the doors, let's say today, and when they close the doors tonight, they're outta business, somebody's got a better idea. So for those three reasons the financial crisis, global competition, and the rapid change in technology and innovation, it's not safe to hold a stock. So what do you do if you can't hold a stock? What you do is hold all stocks by, I would argue, every American business. Every single company in

America and hold it in terms of how big or small it is in the market, you'd have more Microsoft and GE than you would have, what we call some over the counter, an unlisted company that doesn't even trade. So, place your bets for the large sizes is, I think the best thing to do, cuz that will give you the same ownership as we all have collectively. We all own more Microsoft as a group, than anybody else, or Exxon is now the biggest company in America. Since the world owns more of that we just want to own our fair share, say 4% of our portfolio in their case. So own the market portfolio, own American business, and hold it forever!

PAM

Diversification wins all battles. Don't bet on one horse, bet on the whole race. Now getting back to ...

BOGLE

Actually stay outta the race track.

PAM

Just stay away from the race track altogether. [Pam/John/crowd laughs]. OK! But confidence. How important is confidence to the overall market in a time like this?

BOGLE

Well, confidence has many many aspects, but let me give you a few. One, one reason our economy is suffering now is people do not have the wherewithal to spend. They've lost their jobs, they're worried about losing jobs, they've lost a lot in their 401k or their investments, if they were overwhelmingly invested in equities which we can talk about later on, not the best of ideas, we need some kind of balance there. But spending is also, not just wherewithal, but the confidence to spend, and that confidence has been badly shaken. So, confidence basically, yields, lack of confidence yields further lose in confidence because it slows the economy down, and builds the circle of those who are worried about the future. So we have to restore confidence. That's not gonna be easy. But my own personal view is that with good leadership in Washington, and I think our President is providing good leadership. Not so sure about Congress, they seem to be doing some funny things to me, I don't think they should be running the accounting profession for one thing, but that's another story. But I think we need to set up a program which I think the administration is desperately trying to do, the most extreme circumstances we've ever faced ,a program that will be stabilized, that will not change from day to day. People know what to rely on and make their decisions based on a pretty sound plan. It's gonna be long in duration and hard to get through this mess. I'm convinced we will get through it, but not without strong leadership.

PAM

I can see why this could go a long way for confidence, now what about trust? These are supposed to be the smartest guys in Wall Street and they took excessive risks with other people's money, as you point out. Some of these structured investments were nothing more than, especially to the credit swaps, were nothing more than side bets, glorified side bets, and that didn't work out. So

now, the divide between Wall Street and my street seems wider than ever. What's it gonna take to restore trust in the system?

BOGLE

Well first just think about what you just said and that is, and you're correct by the way. The problems were created by Wall Street, and the problems are being borne by main street. So if people don't have trust, I think they are very good judges of character. I do not like what I see in wall street, I don't like the short term focus. I don't like the grotesquely excessive compensation. And those things are very difficult to fix, we have compensation consultants out there, it doesn't matter if we say you cant have another nickel, somebody will find the nickel. Somebody somewhere, I'm sure. So it's basically, trying to, my big hope for this country to go a little bit beyond your question, is that the young generation coming along is a lot stronger than the generations that came before them. That's our big hope and that will take a little time to happen. But to rebuild, trust and confidence is not gonna be an easy matter.

PAM

Well I've heard you say and I've read and I love this expression, you like to say that Wall Street blew itself up by it's own dynamite.

BOGLE

That's actually a statement I stole from one William Shakespeare, and he said blown up by it's own petard, hoisted by it's own petard. And that means blown up by your own dynamite. And the problem with Wall Street is if they have to blow themselves up with their own dynamite that suits me just fine, but I don't like a lot of innocent victims out there that did nothing to create this mess and are paying an extreme financial and personal price and it is not fair and it is not right. And it is not just.

PAM

But you know, Ben Stein is pretty well known for his opinion on all things economic wanted to add to your remarks about Wall Street blowing itself up, take a look at this.

[Video]

PAM

Well that's Ben, and ask people in any city across America and I bet a lot of them will tell you that this crisis and the govts response to it are total game-changers. In other words, that everything going forward will be different now. And that the old rules of capitalism are not going to apply. Do you agree?

BOGLE

Well I agree with that in terms of the economic system that we need new rules. We need to reform capitalism and my own personal view is what went wrong in this agency system that I described and you recall it was an ownership society that's gone, it's never gonna return to an

agency society that serves the principals that it's supposed to serve, those fun shareholders for example to a new, what I call, fiduciary society. And that is a new requirement. Now I'm not a big believer in regulation but I don't see another way to do this, a federal requirement that all money managers observe traditional standards of fiduciary duty. A federal fiduciary standard for money managers. Which says what? Simply put it says, put the clients first. Don't charge those excessive fees. Participate in corporate governance, enforce those corporations out there to operate in the interests of their shareholders, focus on the long term, we'll call that investing, and not the short term, we'll call that speculation.

PAM

Got it

BOGLE

And don't let big financial conglomerates come in here and own your financial company, because those financial conglomerates, which own  $\frac{2}{3}$  of the mutual fund management companies. Do you think Pam that those financial conglomerates buy a mutual fund company for a billion dollars to earn a return on the capital of the mutual fund shareholders?

PAM

I don't think they know who I am.

BOGLE

Or to earn a return on their own capital, but that whole different set of stockholders, and that gets to, you can see this coming very clearly here. Here are the mutual fund shareholders, they're on the rumble seat, if anybody remembers that phrase. Or should they serve the shareholders of the management company, conglomerate? And I think Matthew and Luke put it pretty well, no man can serve two masters. And so we've got to not allow, these financial conglomerates to get into this money management field and they could not do so if the rule was you, you're fine fella, but you can't serve two masters. You have to choose.

PAM

You have to be. Alright now, we've gotten a sense of what's happened on Wall Street, let's now turn our attention to your street. Jack you point out in the book, that we, meaning ordinary investors, really do need to understand that the difference between investing and speculating, the huge difference. And as I listen, it sounds pretty basic. But it kind turns out the the payoff the biggest payoff always seems to be, when it comes to investing, sticking to the basics. I guess the questions on the minds of those who are staring at their 401k statements right now is, where do we go from here?

BOGLE

Well, you know, to me there's a wonderful saying out there that says, 'investing is simple but it is not easy.' It sounds like a little twist of words but it is actually much more than that. What's simple about the stock market is if you believe what I believe, and that is owning not a stock, but

a stock market and holding it forever, and apply that only to your stock position now, that's the way you run your stock portfolio, in my opinion. Called an index fund, been around, actually I started the first one in 1975. And it's worked just the way it should, beats most of the managers most of the time, can't beat it if it's low cost. But even before you get to how you want to handle your stock portfolio the first thing and the unchanging rule and the simple rule is think about asset allocation. How much for stocks, with growth and the risks that come with it, how much in bonds with incomes and a fair amount of safety that comes with them. And balance off those things, and I use the rule, I've used it for like 20-25 yrs certainly as long as I can remember. How much in stocks, how much in bonds, and my simple rule, a rule of thumb really, is to begin to think about it, is have your bond position equal your age. Now it must have occurred to you as I'm saying that for someone who is 111 yrs old that I'm feeling not badly about the recent decline in the market. [crowd/Pam laughs] because I was, I was not 111% in bonds, no I can't do that. But ever since the beginning of the 90s when the stock market was ridiculously high, at that point I was about 65% in bonds, roughly my age then, and now, these years now, I guess, I'm approximately 77 or 80% in bonds and 20% in stocks.

PAM

With that asset allocation that you're pointing out is so important, it is so essential and so overlooked. How much to put in real estate, how much to put in stocks, how much to put in bonds, and when

BOGLE

Well the when is not that much of a problem cuz you should be doing that at all times, think about this for a minute just think about what happens, and I said this is personally affecting me, what happens when you get older, you have less time to recoup your mistakes you have more money at stake and therefore you have to be more careful, and you want to think as you get toward retirement, and I'm not suggesting that I'm getting near toward retirement cuz I don't expect to retire, as you get closer to retire you're gonna think about investment that produces income and it's relative security. As opposed to an investment that produces capital growth and it's tremendous fluctuations between it's ups and it's downs. And finally when you get older as compared to when you're young, I think you get a little bit more nervous when the market goes through something like it's going through now. We have never had, I'm just gonna give you one more number just to show how speculative this market is, in the last 50 yrs, there were 28 yrs, well over half, in which the market never moved once, in any single day, by 3% in a day. In the last 6 months, there have been 58 3% moves, from 0 to 58, and that is rank speculation and of course it ends badly.

PAM

Tremendous volatility. Absolutely. I've been in and around the industry for about 30 yrs, now I have always thought of you and I think most people do, as a "buy and hold" kind of guy, and maybe even the poster child for investing in a diversified way, with proper asset allocation, for the long haul. I think a lot of people want to ask you, what do you mean when you talk about long term investing? I mean exactly, in years?

BOGLE

I'm talking about Warren Buffet's favorite holding period: FOREVER! Now think about that, and let's say to put a number on it, 50 yrs. Now for somebody my age, I'm not sure I have 50 yrs left but who knows really. As you get older, that time period obviously shortens. But it should be, investing is a lifetime affair, and it's doing simple things: owning a diversified stock portfolio, owning a diversified bond portfolio, a little more in the latter less in the former as the yrs roll on, getting costs outta the system, keep the croupiers at bay, if it takes a double barreled shotgun to do so, if you have to go into the gambling casino once you made you bets, get out and never go back again is the way I would look at it. So these things are all pretty simple. Why it's not easy, to complete that phrase, is because we are our own worst enemies. We are greedy, we believe that the past performance of a mutual fund or even a stock is gonna tell you how it will do in the future. Nothing could be further from the truth. So we look back and buy the wrong funds at the wrong time. We also love to buy stocks when the market is at an all time high, apparently thinking the market will go up forever. And we love to sell stocks when the market goes down, thinking that the market will go down forever.

PAM

It's so much about emotions and behavior. And it's interesting when you think about the basics because what you're saying if you really think about it, is quite simple. In essence...

BOGLE

But not easy.

PAM

... but not easy to do, we can't get out of our own way when it comes to investing. Alright, now the toughest question of the evening for you: is "buy and hold" dead or alive moving forward?

BOGLE

Well it's alive forever. It's so funny you read about it in the paper they have these shorthanded headlines, and the people that say well what about buy and hold, the stock market has done nothing for 10 yrs, actually nothing for about 13 yrs, and that's true. But I'm not talking about buying and holding the stock market, I'm talking about buying and holding a balanced portfolio allocated between stocks and bonds. And that is eternal! And what people, this has been a little unusual, very unusual up here, and that it's not just this decade, the first decade the new millennium, that stocks are down maybe an avg of 2-3% a yr I don't know the exact number but that will be close, but in the previous two decades, stocks were going up at 17% a yr. Well...

PAM

Could get used to that!

BOGLE

Well we get used to that, but think about where that 17% came from. It came not from American business generating larger and larger returns, it's because investors in their unwisdom were paying more and more for each dollar of earnings. Now to give you just one more mathematical number if I may, if the price earnings multiple, and that you pay for a dollar of earnings, goes from \$10 to \$20, that's over a decade, that's 7% a yr on your return, so the real return on those stocks is 10 and you thought it was 17. In the next decade, unprecedented in American history, that price earnings multiple went from \$20 to \$40. It doubled again. Another 7% return on top of a business return of about 8 or 9%. That's not gonna happen again, unless you're crazy enough to pay \$80 cuz that's what's required for it to be done the next time, the next decade. Not only cannot happen but you have to have what we call reversion of the mean. Stocks have to come back down to Earth.

PAM

It's kinda like the laws of physics when it comes to investing.

BOGLE

Exactly! What goes up must come down and this, in this speculative sense, american business doesn't need to go up and down, sometimes it's mainly the stock market, and that's why I've always said, what happens in these markets in all our speculative flavor in all this growth that's created and created what I call phantom wealth. That wasn't real wealth we had as this decade began, it was wealth that was way over stated because of the values people put on stocks. So when we watch the stock market as I've said in one of my previous books, it turns out, think about this for a minute, with all the stuff we see on TV and the paper everyday and prices are up and this is down and he's in and she's out and so on down the line, it turns out that companies are this and that and nobody really knows where the earnings come from, that the stock market is a giant distraction to the business of investing.

PAM

... of investing.

BOGLE

Because investing is corporations earning a return on their capital, paying dividends, and taking what's left to earnings growth over time. And that's what is simple.

PAM

Great. Now you know, you would think that people who have access to the highly, the most highly sophisticated investing strategies, I mean far too complex for the average person to comprehend, you would think that those strategies would beat the buy and hold description that you're describing by a long shot.

BOGLE

I would not think that, I've been around too long. First you have to understand something that's very simple. If you're trading in something that's I don't know, collateralized mortgages

obligations, something like that. And you're going short, as one of the hedge fund managers did and made himself I think 3 billion dollars in a single year. It's a living it's a living. And someone else is on the other side of that trade, he was short that collateralized obligations, somebody else was long, so if he made \$20 billion for his clients, somebody lost \$20 billion for his or her clients. There's no way around the fact that the market is a closed system. And when you read in the paper, think about this for a minute, money poured into technology of stocks and into bank stocks today. Poured into technology of stocks means everybody bought technology stocks and nobody sold them. I mean really? Think about that, and then everybody sold bank stocks but nobody bought them, well how do they sell them then? The market is essentially a closed system and what we read about and look at in the news and the headlines, is simply not worth paying attention.

PAM

It's a really difficult perspective that way. Right. I can understand that. Now we're ready to take some of your questions. Let's get started right here in the studio. Don Blandin who introduced us earlier has our very first question

DON

Thank you very much Mr. Bogle. The first question is from Lucy Brown who lives in suburban Philly.

LUCY

Hi. Umm well you've talked about stocks and I was wondering. My 401k is worth about half of what it was a yr ago and you've talked about confidence, and I know you can't tell us when the market is going to recover, but should I still continue to contribute to my 401k plan?

BOGLE

The answer to that question is absolutely. Just think about it this way, you're out buying groceries and all of a sudden the price of milk or eggs or steak is cut in half is that a good thing for you or a bad thing? A good thing. The stock market may go lower we don't know that, but you have to continue investing when you're buying stocks at half the fundamental value that you were buying at when it was at the high. But your emotions are leading you the wrong way. The time for you to get out was when you were so happy and optimistic was when your 401k account had it's previous double the value. So your emotions betray you. Now I'm not trying to tell you, be very clear on this, that this is the time to jump into the stock market, but it is time, always time to keep your plan going. And eventually you're gonna want to add a little bonds to that, I would, for someone that's relatively young, always have a bond position personally speaking, just because having a little, what do we say, anchor to windward maybe, a little dry powder can help keep you from making mistakes that you shouldn't otherwise make. So you might want to think about not in any rush, but gradually getting a little bond position, I'm guessing your age here like that guy down at Atlantic City boardwalk, you should probably have I don't know 10-15% in bonds, I don't know exactly, but think about a little bit of safety there in an appropriate way. Don't do anything, don't ever do anything in a hurry in the stock market.

PAM

Great. Let's take another question now, this time from my co-host Jack Gallagher who was outside, out and about in Philly

[Video]

BOGLE

Advice to an older person. The safety you find is in bonds. But we now have a very complicated bonds situation where there's been such heavy bidding, often from abroad, for US Treasuries. The US Treasuries is where you want to be from a credit standpoint. The full faith and credit of the USA is still good, certainly the best credit in the world, no matter if you argue if it's good or not, it's still the best in the world. And corporate bonds in the US, high quality corporate grade investment bonds, are yielding much more but have that default risk. Right now the spread, we have two bond markets, the Treasury bond market, let's call that a 3% yield, and the corporate bond market, let's call that a 6 ½% yield, very roughly to illustrate the point. So I would not limit myself to treasuries. I happen to believe that, this will maybe not surprise anybody, that a bond index fund that includes the entire US bond market, which is part treasury and part corporates and part govt-backed, Ginny Mae we call them

PAM

Are those corporates considered AAA? Highest grade?

BOGLE

Very few AAA, but quite a few AA and a very diversified portfolio where you own maybe 500 bonds 300 bonds, none of which are over 1%...

PAM

Again, even though there may be a concern down the road that interest rates may go up at some point you're not really concerned at owning a bond fund? You don't want to go out too far?

BOGLE

No you can make your choice, bond funds are short term bonds, intermediate term bonds, or long term bonds. I favor some mix of short and intermediate, I don't like the long risk.

PAM

So short and intermediate in a nice diversified mix?

BOGLE

And you can buy a mutual fund with that kind of portfolio just make sure it doesn't cost much.

PAM

Cost, exactly!

BOGLE

Bond yields in these ranges, with a mutual fund manager taking a % out of your yield of 4% that means the manager is getting 25% and you're getting 75.

PAM

It's math. Just don't do it.

BOGLE

... out of 100. Or 95.

PAM

It's just math we never do. A lot of times it's cuz the fees are buried but let's take another question right now.

BOGLE

Could I just make one more little amplify cuz it's a very important thing to think about. And this is another reason why the choice among bonds is difficult. We actually have in the US the ultimate inflation hedge. And it's pretty close to perfect. We have US treasury bonds, you can buy short, intermediate, or long ones that are hedged against inflation. So if inflation goes up, your interest rate on those bonds, these inflation protection bonds, will go up too. That is the ultimate protection. Ahh, alas there's a catch, there's always a catch to everything. And that is: because of that protection, those inflation protection bonds have been bid up to the point where that 10 yr bond...

PAM

Now those are high, right?

BOGLE

... is about 1 ½% yield not much more than that. So if inflation is 1 ½ you're getting 3%. And if inflation explodes and you get say 6% inflation, well you'll add 6 to that 1 ½ and you'll have 7 ½ but you start off at a pretty modest level.

PAM

To, yeah, I can understand that, so stick with the shorter and more intermediate. Now let's take another question right now from Jack Gallagher. This time it's from a high school student who's asking you about trust.

[Video]

PAM

Jack?

BOGLE

Sure, well the answer to that is, of course we can trust Wall Street again. But not the Wall Street we know today. People have lost their trust in WS, and they are gonna demand, the people who have been hurt will demand a better WS. They will demand, to refer to a previous conversation a previous topic we touched on, they will demand that WS behave as fiduciaries for your money. And would invest your money the way you would do it yourself and not the way they do with speculative risk. So trust can be restored but there's an old saying and it could never be more true than where we find ourselves right here, right here this evening, right here in this studio, and that is, "trust is an awful lot easier to destroy than it is to create." creating or restoring trust is a long range proposition, and WS was able to destroy it in a matter really of months from 2007 to Sept 2008, it took a yr and a quarter for that trust to be destroyed.

PAM

Right, I really really appreciate your answer there. Let's take another question from right here in the studio now, Don?

DON

Yes this is Lt. Christine Darius from McGuire AFB

CHRISTINE

Hi sir, obviously I'm a military member and I currently contribute to my TSP and I was wondering if there are any investments I should stay away from?

PAM

Well the TSP for people who don't know is just like a 401k, for all federal employees and service members.

BOGLE

Well first of all I think I would be totally derelict n my duty if I didn't say thank you for your service of our country. We really depend on ppl like you and I really thank you from the bottom of my heart for that. To get to your question, I really like the TSP. I've been familiar with it for a long time, I knew some of the executives down there. It's run at an even lower price than Vanguard is run. The ultimate accolade! And I like that cuz I like competition. And their prime offering is an index fund, a stock index fund and they do offer a bond option. So yes, that's the way to go, they got into I think real estate, you'd remember this or not, real estate finds a few yrs ago. I'm not so keen on real estate and of course this yr real estate has just blown up. So stick down the center. Stick with the stock index fund, stick with the bond index fund, balance them the way I've suggested here, and don't be tempted by, you know the grass is not always greener on the other side of the fence. In this case the grass is pretty terrible on the other side of the fence. So stay on the good side of the fence Christine.

PAM

And again diversification wins all battles. So let's go back to Jack, he's at a diner in Media, Penn.

[Video]

BOGLE

Well, first of all, it's not a very attractive situation, and I have the same kind of outrage that I think Steve shares, or I share Steve's outrage. But you know our system, before you can take property away from somebody, they really have had to commit a crime, or have gotten the property by illicit or illegal means, for example, stealing. And these kinds of white collar crimes, let's call them, are deeply disturbing, but there are no criminal behavior that we know of, now I'm not talking about Mr. Bernard Madoff, and I guess Mr. Stanford, and a half a dozen other Ponzi type people who have come along the street here, but I'm talking about these executives who will argue they had to do a lot of, you know, I mean and this is what makes the system a problem, well we had to do a lot of leverage in our bank, we had to buy these lower quality investments because everybody else was doing it. And we had to keep up with them or WS would say, look you're not running your bank well enough. There was a lot of pressure to make banks grow, even beyond expectations, which brings me to a point I would like to make here, Pam which is, the whole ethics of our society, and the ethics of our business community have really gone quite to seed here. And they way I like to express it is, and the older people in the audience will understand this, you know wasn't very many yrs ago when the standard of conduct, there were some things one simply did not do. You just don't do that, that's all! You don't need a rule to tell you, and that changed to if everybody else is doing it, I can do it too. And I call that the difference between moral absolutism over here and moral relativism over here, and I don't like it. There are some things that are not negotiable, there is not just a nation of gray, a world of gray. There is black and there is white, and we darn well better figure out what the difference is.

PAM

Better define those. Well Don has another question right here in the studio, Don?

DON

Yes this is Tom Sundstrom from Philly

TOM

Hi good evening Jack, I have a question about the nat'l debt. I'm planning to start a family soon and I'm really concerned about their future and the impact of the debt on it. What's gonna happen with the debt with the value of the dollar and also, are my kids and their kids gonna end up footing the bill for it?

BOGLE

Well that's of course a very profound and good question, which I worry about to, cuz I have six children and 12 grandchildren, and who's gonna pay off all this debt? What's gonna happen to the value of the dollar? And the answers to those questions are by no means self evident. We're borrow, the federal govt is borrow or guaranteeing at a level beyond anything ever remotely done before. And so what we have to do is try to have a plan to keep those deficits under control, and

that will mean, there are only two ways the financial system of the treasury is very simple, there are two ways to work on a budget deficit, and one is to raise revenues and the other is to reduce expenses. This is not complicated, simple but not easy I guess I could say again. Because when you think about it I think it's gonna be very difficult to raise taxes, I think the administration is going in the right direction by raising taxes among the better off among us, the 5%, think that's appropriate. And they're gonna have to focus on trying to cut back expenditures at a time when it is awesomely difficult to do so. Just think about this for a minute. You can't just not give our troops enough in Afghanistan, for a while at least, Iraq. Over there without weapons and protection. We have to do something about our educational system, that's a long term project, but the longer you wait to get working on it, the US is gonna fall behind. Our health care system has a lot of room for improvement and I think we can generate some savings there. But it's a tough long job and we have to hope that we can grow ourselves out of some of the problems that have just been raised. But that's not gonna be easy, not gonna happen overnight, but with a little fiscal discipline and a little intelligent planning, and good leadership and a terrific generation coming along, I don't think it's impossible.

PAM

I like the optimism. Alright we have time for one or two more questions, I want to try to squeeze in two if we can, but our next question comes from right here in the studio, Don?

DON

Yes, this is Lisa Baylen from Chatsford, Penn

LISA

Hello Mr. Bogle. I'm divorced and I have been using the services of a financial planner, but in light of what's happened recently, with the Madoff and the Stanford disasters, I wanted to know if I should still depend on my financial planner or can I do it myself?

PAM

That is a great question right now. Not only that, how do you work with a financial advisor, do you turn your money over to that advisor, what's the best way to have a relationship with a financial advisor?

BOGLE

Well, I guess I'm tempted to quote former President Clinton, he said, "It all depends on the meaning of what 'IT' is." [crowd laughs]. Can you do it yourself? And the answer is yes you can. If the 'it' is a simple program, and asset allocation program diversified equally in stocks and bonds, that you forget, you put your money in regularly, you make sure it's very low cost keep putting your money in. Don't peek, you don't need to look at the darn thing everyday, or when that ghastly statement comes in, at least ghastly at the moment. And just hang in there, and I should say much more parenthetically, that's what I've been doing since 1951. In July of 1951, my first job with Wellington Management Company, I was making \$250/mo and 37.50 with my defined contribution pension plan there. And I've been doing it ever since then, 57 yrs! And yo

would be, in the Wellington and Vanguard funds, stocks in the beginning, bonds at the end, you would be amazed how much money is in that plan. I break my own rule once and a while. There's so much money in there, I peek every once and a while myself.

PAM

[laughs] Ok maybe another way to put it too, is trust but verify maybe if you're working with a financial advisor.

BOGLE

But if you're trying to beat the system which I don't recommend, and you want to get into more exotic instruments, what we call alternative investments, maybe a little hedge fund here, some commodities there, trying to pick the latest hot manager, you can't do that by yourself ... so if you're comfortable doing that, if you're comfortable going the simple way, I think you can do it yourself.

PAM

Well listen thank you everybody so much for your questions, they were all really on point. Now let's review what we've learned today, we do this at the end of every MoneyTrack episode. First, we've learned that what got us into this mess was a lack of oversight, and integrity that led to excessive risk taking which we are now all paying for. Number 2, we learned that confidence and trust are essential elements in order for the financial markets to work. And finally, we learned from Jack Bogle, that asset allocation is the key to successful investing. Buy and hold may be alive and well, but asset allocation, diversification, are key. And be very mindful of the cost associated with investing. Fees matter. Jack Bogle...

BOGLE

Good summary...

PAM

[laughs] Thank you! I want to thank you so much for taking the time to be with us today. And one more thing...

PAM/BOGLE

Booyah!