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Vanguard founder Jack Bogle's advice to fretful investors: Shut your eyes and let indexes do the work

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John C. Bogle, founder of the Vanguard Group. Bloomberg

If the stock market's September-October flip-flop scared you, Jack Bogle has some advice on how to tackle what's about to happen next: Close your eyes.

Bogle, the founder of the Vanguard Group, the world's largest investment company, and patron saint of low-cost, long-term index investing, has not changed his tune in the 40-plus years since he started the company.

At age 85, Bogle's not about to change his ways now. And not because he's past learning new tricks or adjusting his thinking, but because decades of being right have created an unshakable courage in his convictions.

Many of his disciples share Bogle's audacity, but he laments the financial fortunes of all the people who haven't gotten the message yet.

This week, Bogle did a two-part interview (listen [here](#) and [here](#)) on my radio show, "MoneyLife with Chuck Jaffe," and while he did not break much new ground, it's always worth plowing important territory with someone who knows the lay of the land. Here are some highlights:

On markets:

"What's going on in the market is domination of short-term speculation over long-term investment," he said. "Long-term investors simply are not affected by the comings and goings of the market, where it looks like it goes up 100 points on odd-numbered days and down 100 points on even-numbered days.

"As I have said before, the daily machinations of the stock market are like a tale told by an idiot, full of sound and fury, signifying nothing," Bogle added. "One of my favorite rules is 'Don't peek.' Don't let all the noise drown out your common sense and your wisdom. Just try not to pay that much attention, because it will have no effect whatsoever, categorically, on your lifetime investment returns."

On why investors should ignore the noise and just aim for the index return over a lifetime:

"Returns are created not by the stock market, they are created by U.S. business, our corporations," he explained. "The formula I use for that is today's dividend yield, which is around 2%, and the subsequent earnings growth which could be around 5% — we're not sure but that's probably not a bad guess — and that's a 7% nominal rate of return on stock in terms of fundamentals.

"If you go back and look at the history of American business over the last century, you will find the [price/earnings] effect of stocks is zero. All of the returns are created as investment returns, dividend yields and earnings growth, and p/e effect — the speculative return — goes up and goes down and goes up and down for 100 years and ends up just where it started.

"So try to ignore these machinations and stick with getting the underlying returns that provide stocks as good investments," Bogle said.

On how many experts have declared indexing the winner over active management:

"This year, 2014, so far happens to be one of the great years for S&P 500 indexing. I hope nobody thinks it will be that way forever because it won't be.

“I am sorry to say it, fellow shareholders, but it doesn’t get that good. Over the long run [indexing] should beat the competition by 150 to 200 [1.5% to 2.0%],” Bogle said. “Confidence in the mathematics — the relentless rules of humble arithmetic — enables you to get through...”

On how bond investors should look at the potential for interest rates to rise (several years ago, Bogle warned of a building bond bubble):

“When you talk about bond investors getting hurt when bond yields start to rise, the answer to that is really yes and no. Certainly yes, absolutely, on a short-term basis, but you shouldn’t be investing in bonds on a short-term basis.

“Use the intermediate maturity around 10 years exemplified by the high-quality 10-year U.S. Treasury note,” he added. “Basically today you are entering into a contract with the Treasury to give you 2.2% every year for the next 10 years. The Treasury will be good for that; there’s no risk in that deal falling apart that I can see. The price of that Treasury [note] will drop a lot if rates will go up, however if you are reinvesting your income, you will have a higher total return over the 10-year period. So in a certain respect if you can stand the pain, we all should want rates to go up.”

On exchange-traded funds:

“They’re fine just so long as you don’t trade them,” Bogle said. “It’s the ability to trade that distinguishes them [from a traditional index fund], and then there is the kind of Looney Tune section of the ETF market pursuing things that no investor should ever do....Anybody who plays that kind of game [using leveraged or niche products] is a damned fool.

“The ETF is the greatest marketing innovation of the 21st century so far. Whether it’s the greatest investment innovation of the 21st century so far, I can’t imagine. I think it’s counter-productive.”

Advice for investors who can’t be satisfied with shutting their eyes, doing nothing and letting indexing work in their favor:

“Divide your money into your long-term investment account and your funny money account for short-term speculation. Guess on funds, guess on markets, guess on stocks if you want to, because that gives you an opportunity to act on your speculative impulses.

But they will hurt you a lot so I recommend you have a funny money account of no more than 5% of your portfolio. I also recommend that after five years, check it out. Has it done better than the long-term investment or worse? I’d be astonished if at least 95% of those funny money accounts don’t do worse.”