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Transcript: John Bogle

Steve Forbes Forbes Staff

"With all thy getting, get understanding."

This article is more than 10 years old.

[00:08] Steve: Stocks For Winners

Welcome, I'm Steve Forbes. It's a pleasure and privilege to introduce you to our featured guest, Vanguard founder John Bogle. In 1976, Jack created the first retail index fund as an inexpensive gateway for investors to enter the stock market--today Jack is a true legend on Wall Street.

My conversation with John Bogle follows, but first:

One thing Jack and I share is the belief that common stock investing is a matter of common sense. By investing consistently and patiently in good times and bad, people can achieve their goals.

Investing is a step on the pursuit of happiness. It is a step toward forging a fulfilling, creative and philanthropic life.

And, as Jack writes in *The Little Book of Common Sense Investing,* "Investing in equities is a winner's game."

It's easy to lose sight of that in a bear market. Sadly, investors choose to buy or sell stocks and funds based on recent performance. They buy when markets are high and feelings are euphoric. They sell when markets are depressed and depressing. Resist the urge to buy and sell the market based on emotions. There's a logic to sticking with it.

Over the last 10 years, a broad portfolio of stocks, assuming no new investment or re-investment of dividends, has likely given you a negative return. This is discouraging. But it is also unusual. Since 1928 the average annual return of the stock market has been around 10%. For the market to continue to deliver its average historic return, performance will have to improve. Selling now is a sure way to miss it.

"Cast your lot with business," writes John Bogle. His numbers make sense because his reasoning is sound. Business has improved lives and raised living standards in the U.S. and around the world. Wouldn't you want to invest alongside that?

And now, my conversation with John Bogle...

[02:10] When's The Recovery?

Steve Forbes: Well, thank you very much, Jack, for joining us. And I have to start off, since you've seen so much and have warned about the kind of excesses that we see from time to time, and none like this certainly in my lifetime. How long will it be before we get a real recovery? And is this the time--corollary question--for wise investors to come in, in a disciplined way, because they may look like idiots for a while as the market turmoil continues? Over time, markets do recover.

John Bogle: Markets do recover. The mistake we make I think, Steve, and it's wonderful to be with you again. The mistakes we make as investors is when the market's going up, we think it's going to go up forever. When the market goes down, we think it's going to go down forever. Neither of those things actually happen. Doesn't do anything forever. It's by the moment. So there are two pretty different things about the timing, I think.

One is to separate, very definitely, the economy from the stock market. And I would look for a more extended time to take to recover from this mess that Wall Street and other people have gotten us into over the last eight, 10 years.

It's not going to be a quick recovery. It's spreading into the economy in a much more rapid way I think than anybody expected.

And if the economy starts to recover in a year and a half or two years, I think we'd be pretty well served. You don't get over this kind of a disease in a very short time. The stock market, of course, is a totally different idea because the stock market tends to anticipate. And what people who are so bearish on the markets, and I've never seen, I don't think, quite as much bearish as we see now, don't realize that a 50% decline, roughly 52% from the high to the low creates huge value.

And they don't realize the dividend yield when all this started in 2000, that was the beginning of the end, was 1%, and now it's 3%. Well, that's a 200 basis point improvement, two percentage point improvement in future returns on stocks.

Stocks back then, early 2000s, were selling at almost six times their book value of all that plant and equipment and cash and everything else they had, maybe even some patents and good will.

And now they're selling at about 1.8 times that value, a tremendous difference. A level of attractiveness that we really haven't seen since the early 1980s, mid-1980s might be fair. And from here, I think it's easily possible that with the earnings quite depressed, depending on how we measure them and count them, that earnings could grow at 7% a year, faster than the long-term norm of five nominal earnings growth. And if earnings grow at 7% from here over the next decade and there's no point.

Steve Forbes: That's 100%.

John Bogle: One-hundred percent, right. You know the rule of 72, divide the number into 72, any number you want, and that's how long it will take your money to double.

So earnings could easily double from these levels, these depressed levels, relatively depressed levels over the next 10 years. So I don't mean to be a Pollyanna about it because we are facing incredible challenges in the economy of the U.S. and the economy of the globe, but the stock market, we never know whether it's over-discounted or under-discounted or got exactly right its anticipation. But I'd say it's probably over-discounted, the stock market is over-discounted, the economic troubles, the deep economic troubles we're going to have for some time.

Steve Forbes: Because really as you point out, dividends at 3%-plus, you look at Treasuries, they're yielding just above 3%, we haven't seen that since, what, post-World War II.

John Bogle: Well, I think 1958 was the last time yields on stocks were higher than the yields on Treasuries. So it's quite remarkable. And if you go into short-term treasuries, they're now auctioning our valued nation's debt off for an interest rate of zero. And I think we could agree, that's a very low interest rate.

Steve Forbes: Japanese-like.

John Bogle: Yep.

[06:09] Emotion Is The Enemy

Steve Forbes: Well, this gets to an important thing, and you've hammered on this for years. Your advocacy of indexing is how do you get people to realize their emotions are their enemy? When the market goes up, is it too late to get in?

John Bogle: Yeah.

Steve Forbes: And then they take unnecessary risks. When the market goes down, is it too late to get out?

John Bogle: Yeah.

Steve Forbes: How do you get people to overcome those kinds--

John Bogle: Well, the first thing you have to think about is, and this is an issue that I've almost never heard discussed, Steve, and that's the first question you have to ask yourself is: Am I an investor, or am I a speculator? An investor is a person who owns business and holds it forever and enjoys the returns that U.S. businesses, and to some extent global businesses, have earned since the beginning of time.

They have capital, they earn a return on their capital and that capital grows over time. It's not complicated. That's the business of investing. Speculation is betting on price. I think I can buy this for 10 and sell it for 12 or 14 or 20 or 100. Speculation has no place in the portfolio or the kit of the typical investor.

Speculation leads you the wrong way. It allows you to put your emotions first, whereas investment gets emotions out of the picture. You own these businesses, they're still sound, if the market doesn't think they're worth as much as they were, well, pity, the market doesn't know everything. So that's the first thing.

The second thing is how do you minimize the role of emotions because, of course, even the hardest-skinned, thickest-skinned investor has an emotional component to his or her behavior. And the way I think you do it is make sure your asset allocation is intelligently set depending on who you are and where you are in life.

A good rule of thumb I've used for a long time is have your asset allocation to bonds equal to your age. So if you're 20, you would be 20% in bonds, maybe that's a little high if you're 20, but if you're 80 don't even want to get into the possibility anybody would ever live to that ancient age, but you would be 80% bonds.

And so in this year that we're having right now, that kind of a portfolio is probably down less than 15%. You know, not fun, but not as debilitating as it would be if you were 100% in equities. So get your asset allocation right. And then if you're still working, still putting money away, you want to continue to put money away and just do it regularly every month and don't worry about what the market does on that day, and just do it time and again.

I think that is, for almost all of us, a better strategy than saying, "well, we thought that the end was here, or near, and now we know it's not, so I'll take everything out of my bond account and put it into my stock account."

I don't know, no, I don't know anybody who's been able to do that right. And Steve, actually, I don't even know anybody who knows anybody who has been able to do that right over time.

Steve Forbes: Outside of summer cocktail parties.

John Bogle: Yeah, there's a lot of talk about it.

Steve Forbes: Yeah, everyone's a genius.

John Bogle: I was looking more at the action.

[09:20] Classic Indexing

Steve Forbes: Well, when you make the distinction between speculation and true investing, that gets to the whole thing--you're seen as the apostle of index funds. And the nice thing about index funds is because you have so many businesses, you don't have to worry, "Is this one right or this one wrong?" You've spread your risk into the market as a whole.

John Bogle: Yeah.

Steve Forbes: But indexing, first, remind us of why indexing is good and then I want to get into how you think it might have been perverted in recent years, because now there seem to be as many indexes as there are equities.

John Bogle: You are exactly right. Well, to me, Steve, classic indexing is owning the entire U.S. stock market. When I started that first index fund way back in 1975, a long time ago, it happened to be called Bogle's folly, everybody said it wouldn't work. How could it not work?

But we used the S&P 500 index, and that's almost as good, very close to as good, as the total market, but sometimes small-caps and mid-caps will do better, sometimes worse, in the long run; it doesn't matter. So I think the total U.S. stock market is the preferred choice.

I'm a little apprehensive, we can talk about maybe later, the idea of international diversification, too, but that's an option to index the markets outside of the U.S. if you like that strategy.

I have some problems with that strategy. So let's just look at the U.S. and say you own every company in the U.S., and it's more important, I believe, the advantages of indexing are more important today than they've ever been before.

Because what are we dealing with today that's different? One, a global financial crisis and trying to pick out what sectors are going to do well and what sectors are going to do ill in the middle of this global financial crisis is simply, I don't think it's something any of us can really do very well.

And No. 2, we have global competition and we didn't have that 25, 50 years ago. It's very extreme and adds to the rate of change and the failure rate of U.S. companies.

And third, we have this technological revolution where a company that has the world at its fingertips on day one lost its franchise on day two because someone else has an idea just a little bit better.

So with those three reasons, owning everything in a market, you will own the good ones and the bad ones, you will own those that are creatively destroying others and those that are being--using Schumpeter's wonderful phrase--"the victims of creative destruction."

And so you own everything and hang on. Now the advantages of that are really simple. One, you can do it for almost nothing. The cost of indexing can be done for about say five to 10 basis points around a tenth of 1%, let's say.

So you eliminate all those management fees that don't get you anywhere. And No. 2, it's very tax efficient because it's not turning over the portfolio.

No. 3, it's turnover cost efficient because the index doesn't have that 5, 6, 7% turnover.

[12:18] Wall St. Hates Jack

Steve Forbes: This gets to something that, I love some of your colorful phrases, is if indexing was widely adopted, the financial services industry would be a fraction of the size it is today.

John Bogle: Small fraction.

Steve Forbes: You used words like "croupiers" and things like that. Can you go into how much money we spend on what you think are services that we, perhaps, really don't need?

John Bogle: When you think about it this way, Steve, for a minute, the financial markets generate...

Steve Forbes: And how you came up with the word "croupiers" for some of these guys.

John Bogle: Not a lot of people on Wall Street here really want to be seen anywhere near me, but I start off with how does the financial system work? What can we not control, we investors and speculators together? We cannot control the return on the stock markets, the bond markets to deliver.

They're going to do it without any help from us. So let's assume, for the purpose of argument, to make the point clear, that stocks deliver, let's say an 8% annual return. So we all divide up all investors as a group divide up 8%. I mean, the mathematics are not exactly complicated.

Then the croupiers take their 2.5 to 2% a year, which is around the cost of the financial system. So we earned 5.5%, maybe 6, in an 8% stock market. Well, that doesn't sound terrible. I mean, it certainly doesn't sound very good. But compounded, we're back to Einstein, the miracle of compounding interest, it turns out it's the miracle of compounding returns is overwhelmed by the tyranny of compounding costs.

Because when you get out a compound interest table maybe some of your viewers will want to do that and compare 8% over, let's call it an investment lifetime of 50 years, compared with 5.5%, which is the after-cost return, and I haven't even taken taxes out of that second return, it would make it much worse.

It turns out that you get about you who put up 100% of the capital, you took 100% of the market risk, are getting about 25% of the market's return. And the croupiers, who of course put up 0% of the capital and took 0% of the risk are getting 75% of those compounded, long-term returns.

So to not pay attention to the cost is probably the biggest dumb mistake investors can possibly make. So indexing triumphs because it doesn't have transaction costs, it doesn't have management fees, it has extremely low operating expenses, it has no sales loads, about two-thirds of all funds you've got to pay 5% to get in and 5% every time you turn around. And so you get costs out of the equation. And when you diversify to owning everything you're going to capture the return earned by business.

And that brings me to another statement I put in one of my books, which I really like, and that is when you think about these variations in this most speculative of all stock markets in U.S. history, it turns out that the stock market is a giant distraction to the business of investing.

And that's because of croupier costs and speculation. Because speculators obviously break even with one another. I mean, there's somebody on the other side of every one of those trades. But the only sure winner is not A or B, Peter or Paul, it's the man in the middle, the croupier, Wall Street and Wall Street's costs, a few years ago, were around $600 billion a year. They took their $600 billion and you got what was left because the investor is inevitably at the bottom of the food chain of investment returns, whereas the market creates a certain return.

Steve Forbes: Now that $600 billion number is staggering. I could see $60 billion. How do you head up to that over time?

John Bogle: Well, no, that's one year. One year. That would be at that rate, $6 trillion every 10 years in a stock market that's presently worth $9 trillion. A little excessive, one might say. I mean, overwhelming. And what it is, I mean, we just published data, I wouldn't swear to its precise accuracy, but we know that the mutual fund industry takes around $100 billion a year, no argument about that.

We look at the securities industry data and Wall Street, you know, direct Wall Street investment banking and brokerage, takes in the in order of magnitude $300 billion a year. Hedge fund managers, up to another $50 billion, investment advisers to individuals take X, variable annuities have another cost, and you add it all up, and you get to about $620 billion.

It may be a little on the high side, but it's not $100 billion, and it's not $200 billion. You know, maybe if I'm wrong, and nobody really knows the number, but if I'm wrong, maybe it's as low as $500 billion, and of course, it could be more.

And equally, of course, it doesn't include the taxes that are paid on all those transactions. And in a giant bull market, those taxes probably cost another, let me just say for the purpose of argument, $300 billion to $500 billion a year. And that's everybody owns the same stocks before and after, but Uncle Sam.

Steve Forbes: Sounds worse than Las Vegas. At least the house lets you get 90 cents on the dollar back.

John Bogle: Well, in Las Vegas we all know that it's the croupiers who win. At the race track, it's those who control the handle who win. State lotteries, does anybody think the participants in the lottery win? No. The state wins.

Steve Forbes: Big time.

John Bogle: Yeah, big time.

[17:42] Too Many Indexes

Steve Forbes: Now, getting on indexing from what you've said, you'd only need maybe a handful of index funds. You like the U.S., and then we'll discuss international in a moment. But now there are tons of indexes, not to mention exchange-traded funds. First, proliferation of index funds. What are your thoughts on that?

John Bogle: Well, I'd say to express it with my usual reserve...

Steve Forbes: They have index funds for neckties now.

John Bogle: It's ridiculous. Yeah, it's ridiculous. Classic indexing, as I call it, is owning an entire giant sector of the market. Let's say all U.S. stocks or all non-U.S. stocks and holding on forever and doing it at low cost, eliminating the transaction impact that we talk about.

And it happens that this year that kind of an index fund, let's call it for the purpose of simplicity the S&P 500 index fund is outperforming about 80%

of all equity funds, 80%. Think about that. In fairness, international has done badly and small-cap has done badly.

So if you look just the large-cap index funds, which is more what S&P would be like, the S&P 500 index is outperforming about two-thirds, maybe 70% of all the large-cap comparable funds. So it's having a banner year by doing it right. What we have here is this whole idea of what I call indexing nouveau. Index funds that are very narrow, sometimes microscopic sectors.

Small cadre of funds who have new kinds of indexes. Don't market weight like the Standard and Poor's 500, don't weight your index by the market capitalization, weight it by our idea of who's going to earn the most or who's going to pay the most dividends, whatever it might be, they aren't working out very well this year either.

And then you can isolate out a single country index. You can buy commodity indexes. Only down 55% this year. It's quite unbelievable. And ETFs are index funds, exchange-traded funds are index funds that you can trade all day long in real time.

And that's the way they are average, they are advertised. And Steve, when someone says you can trade the S&P 500 index all day long in real time, I can only ask, "What kind of a nut would want to do that?" I mean, I would say, "Get a life."

You know, take your wife out to a movie, it's better to take the kids to the park. Read a book if all else fails. But trading the S&P 500 index all day long? And trading narrow sectors is even worse.

So it's a throw back to Wall Street entrepreneurs because they, I believe, I don't mean to be unfair about this, but the reason all these new things are started is not to enrich the clients of the investment system, but to enrich the marketers and entrepreneurs and promoters of the investment system. And that's how we got into credit default swaps, that's how we got into collateralized debt obligations, always a new, easy way to do better. Well, those latter fixed-income things are not easy ways, we now know, and neither have the index funds, the ETF funds have worked very well.

[20:49] ETF Abuse

Steve Forbes: On the ETFs, if somebody used it right because they are very low cost you could, in effect, sometimes they have lower costs than regular mutual funds.

John Bogle: Right.

Steve Forbes: So if you just took it and threw it in the drawer, that would be fine, but that's not what people do.

John Bogle: No, exactly. I mean, if someone said they wanted to buy the total stock, let's say the Vanguard total stock market ETF, and not trade it, it's just as good, it could even be a little bit better. We don't know that, time will tell, but it's not going to be much different than the standard Vanguard total stock market index fund. And that's a perfectly intelligent thing to do. Reasonable people disagree on the extent to which these ETFs are used in that specific kind of case. I think I'd be surprised if it was 10% used in the proper way and 90% used in the wrong way.

[21:36] Investing Abroad

Steve Forbes: Now, on international, if somebody feels in this globalized market that they want to have exposure overseas, are there proper index funds, you think, where people can do it in a way and get the same kind of benefit you do with the S&P 500 or the Wilshire 5000 or whatever?

John Bogle: If you do it in the long run, I believe that there's not any inherent reason that diversified international markets and maybe emerging markets even a little bit better, won't do roughly what U.S. markets do. You know, the markets, the financial markets, I hardly need to tell you, the king of all this, how financial markets work, but they anticipate. And so they're priced to capitalize on future earnings growth whether it's the U.S. or emerging markets or the developed markets outside of the U.S. So international as such is not bad.

The problem with international is two. One, when people get interested in international, it's not because they want a diversification, but because they have done very well in the past.

People talk about the benefits of less correlated asset classes, but they talk about it after international has done well. So a year ago, the previous year, two years, roughly in 2007, something like 85% of all equity mutual fund capital flow in something like $400 billion went into international funds, 85% went international. And then, of course, when 2008 came along we have the U.S. market, probably the best-performing market in the world, off about 35%, the developed international off 45%, the emerging markets off 55% and, as a wise man said about international diversification a long time ago, Steve, the problem with international diversification is it lets us down just when we need it the most. It falls apart in down markets.

Steve Forbes: That gets to a point you make in terms of when people put together these new products, it always works in the past.

John Bogle: Yeah.

[23:43] Historic Returns

Steve Forbes: But doesn't mean it's going to work in the future.

John Bogle: It's so ridiculous and so much of the system is based on this, Steve, that for example, the long-term return on stocks has been 9.5%. That's a 4.5% dividend yield and a 5% earnings growth. The 9.5% means nothing when the dividend yield is 1%. It means that you've lost 3.5% age points of future return. So instead of 9.5%, the future return at a 1% yield level should be about 6%.

Nobody takes this simple, self-evident fact into account when they look at history. So I think Lord Keynes warned us about this in 1936, not to pay any attention to past returns until you have examined the sources of those returns.

And for stocks, it's dividend income, earnings growth and then that's what I call adding them together, investment return and speculative return is a bet that people will pay more for a dollar of earnings or less at the end of a given period. But over time, speculative return turns out to be zero.

[24:46] Unknown Unknowns

Steve Forbes: Now, best financial lesson you've learned, you've always said, is be ready for surprises.

John Bogle: Yep. The other one I mean, there are always surprises. I guess we have come to call them after maybe Don Rumsfeld the "unknown unknowns" as compared to the "known unknowns." And it's been popularized by the idea of a black swan.

Originally the idea that just because you have never seen anything but white swans doesn't mean a black swan doesn't exist. Of course the fact they were found later in Australia is a kind of tragedy to the metaphor. But that's another story.

And the black swans are quite likely, these unimaginable events, with a huge, a very nonrecurrent, maybe recur every 50, 75 years. When those things happen, of course they're unexpected. Of course we can rationalize them later, but they are much more likely to happen in the financial markets rather than in the economy itself. The economy doesn't usually move in fits and starts. I mean, that's why we compare this economy that we're in right today with 1929.

Well, that's an 80-year gap between those two really monumental economic events. I don't think, by the way, to be clear, that we're facing a depression this time, but I think we're facing a more serious recession than I happen to have seen in the 10 bear markets that I've witnessed.

[26:19] The Agency Society

Steve Forbes: So what do you think is the one big, misplaced assumption in business today?

John Bogle: Biggest misplaced assumption in business today? Well, let me give you a couple. What I'm really bothered about is we haven't taken any account in our overall financial system and I have never seen anybody make this point, that we have moved distantly away from an ownership society into what we now have as an agency society.

And that is when I came into this business back in the early 1950s, about 8% of stocks were owned by financial institutions, and 92% by individuals. Today, institutions own not 8% of the market but 74%. And individuals own the remaining 26%. So we have institutions behaving just as Adam Smith warned they would, handling other money other people's money in a very different way than they would ever dream of handling their own.

So the misplaced assumption is this is still the same old, same old thing and we have this whole new institutional element where these institutions, I regret to say, but I will say it nonetheless, are looking after their own financial interests before the financial interests of the principals, princi-*pals* whose interests they are really bound to observe first.

And that's a tragedy, and we have to do something about it as a society to establish one of my recommendations, which is the one of the less popular ones, and it's a long list of unpopular ones, is to have a national standard of fiduciary duty for those handling other people's money.

Steve Forbes: This gets to a point about Wall Street itself. A number of years ago, firms started to go public, public shareholders. Do you think we're going to go back to an era, and is there any way to bring it about where you have partners' money at stake, and therefore, you know when you take these out-sized risks, it's your money that's at risk and not somebody else's.

John Bogle: Yeah, that's actually a very, very important extension of the point that we were just talking about, and that is that nobody seems to have recognized that these investment bankers, basically relatively small firms, would never have had 33 times leverage in a portfolio that's a long way from a portfolio of treasury bills, believe me, of assets. They don't want to take the blame for not knowing how to value those assets, but I don't know who else to blame it on if you buy an asset that can't be valued.

So the transfer of Wall Street from private ownership to public ownership has been a big step backward. In my previous book, one of my previous books, which is called *The Battle for the Soul of Capitalism,* I had one little section entitled, "Bring Back Glass-Stiegel."

Bring back the separation between banking and investment banking. It served us well for 70 years or so, and the way the system is going today, that can't be brought back. There's barely an investment bank that's independent left, couple of big ones, as you know, Morgan Stanley and Goldman Sachs, but the other investment banking and brokerage firms are now part of giant banks. And so we have this tremendous concentration.

And the only way you're going to be able to, I don't know any way to do that, although it may happen naturally in a really competitive capitalistic economy and that is you've got to have a smaller unit size for financial institutions if you're ever going to have a private partnership. How can regulation compensate for this tremendous change in the way banks and investment banks are handling other people's money?

This tremendous amount of public ownership where the idea the bankers, very relevant again to just what you've said, the bankers forgot to look at their own balance sheets. You know, when we were young, when I was young, anyway, balance sheet was the first thing you look at.

They're looking at their profit and loss statement and they're trying to make more earnings by fair means or foul, and they often do it by fair means or foul, because that takes up the value of their compensation, their year-end bonuses, their stock options, which they exercise and sell stock immediately.

Steve Forbes: Which leads to a question: Should there be provisions now we're starting to hear the word "callback." Get a bonus one year, but if you've done trades that turn out not to have worked out well in two or three years down the road, you've got to give it back.

John Bogle: It's a good idea conceptually. It's like an awful lot of good ideas, it's hard to know exactly how to make it work. There is, as you may know, actually, a callback section in Sarbanes-Oxley.

If you've misstated, if your company's earnings are restated you have to give back the earnings that you were paid on those higher earnings. But it requires evidence of fraud. And that's very hard to prove. And so, conceptually, I like the idea of callback, both for the traders and for the people that are running the firms.

Steve Forbes: So maybe you have a provision where you get the bonus over four years or something?

John Bogle: Sure. You know, or even longer. I mean, I don't see any reason not for not stringing it out, and maybe that would get investors to hold shares for longer because the average, you know, the turnover in our exchanges suggests that the average shares it's going to be about 340% this year.

In 1929, it was 140%, and in my early years in this business in the '50s and '60s, it was about 30% a year. So this is the greatest orgy of speculation that we've ever had in the financial history of the U.S.

Steve Forbes: So sort of a financial version of an X-rated movie, I guess.

John Bogle: Yeah, exactly.

[31:47] Self-Interest Can Save Us

Steve Forbes: So what is your bold prediction for the future? You've seen so much, you're seeing so much. You've, obviously, thought a lot about it, written about it.

John Bogle: My biggest prediction for the future is that people are going to start looking after individual investors, are first going to decide speculation doesn't work and if they think it still does work, they're not going to have any money left, so they won't be part of the market participants group. But realize the economics of investing and act; if investors, Steve, would simply act in their own economic interest, none of this would happen. If institutional investors would act in the economic interest of their clients, I'm coming back to that point, and not their interests as principals in the firm, or agents of these investors, I should say, that we need to change that, but like mutual fund investors should buy intelligent mutual funds.

I would argue index funds or something like index funds, but in any event, mutual funds that are, in fact, investing rather than speculating. The list is not laced with such funds that operate at low cost rather than high cost, that sell at no load rather than load, that have low portfolio turnover rather than high, and have high tax efficiency rather than low.

If people would look at those things and think, what is best for me and my family over the next 30, 40, 50 years, or 20 years, whatever the period might be, that will bring about change.

However, that's going to take a long time, and as we now know, time is money; we don't want to spend $600 billion a year forever. So I believe strongly that we need to take a whole look at the financial system and get back to forcing trustees of other people's money, pension, particularly pension fund managers and mutual fund managers to put the interests of their clients first. That's this whole fiduciary duty idea, and that's not going to be an easy thing to get done.

This industry hates the idea, and I think they're just going to have to get used to it. So the big idea is let's make the system start working for the investor on Main Street and stop working for the principle benefit of the marketers and innovators, whole people of all this complex financial system who put it together of Wall Street.

And if we can get Main Street first and a democratic society a democratic, and I should say capitalistic, society, that's the way it should work. The market should clear at the best clearing point, and the best clearing point is not today. Too much taken out of the system.

Steve Forbes: I just can't resist asking one final question. And that is: People are very careful with their money when they buy a car, they go online, find out what the prices are, they have coupons when they go to the supermarket, and yet when it comes to money management, you say with funds, by golly, 1,000 here, 2,000 there, a percentage here, a percentage there, what is it about human nature that accounts for that?

John Bogle: Well, what it is about human nature is I think our self confidence basically says, look, I don't give a darn about your index fund that charges a tenth of 1%, I'm going to buy a fund that's charging me, all-in, sales charges and so on, turnover costs, 2.5% a year because they will do more than enough better.

As one of the senators asked me when I testified in Washington, I think it was Sen. Sununu, said, "Wait a minute, wait a minute, here, wouldn't you rather pay 2.5% a fund for a fund that made 25% a year than a tenth of 1% for a fund that made 10% a year?"

Well, of course I would, Senator, but I don't know how to pick that other fund, I don't know how to know its risk, and what happens is we chase past returns. And past returns overwhelm cost. There's always some wild man or woman out there that's outperforming the market itself.

So I think investors have to have a little less self confidence and realize--to put it in a very harsh way--that the mutual fund industry in particular is not only an industry where you don't get what you pay for, it turns out. Examine the data--you get precisely what you don't pay for.

And therefore, if you pay nothing, you get everything. You get the market's return if you don't pay anything to get it. So the index fund is giving you the market return less a tenth of 1%, and that has to be the answer. And I feel a little guilty talking about index funds because I did create that first one all those years ago, but facts are facts, math is math and, quoting Brandeis here, the relentless rules of humble arithmetic remain the relentless rules of humble arithmetic.

Steve Forbes: Thank you very much.

John Bogle: Great to be with you. It was fun.

Steve Forbes: Thank you.

Steve Forbes

Steve Forbes is Chairman and Editor-in-Chief of Forbes Media. Steve's newest project is the podcast "What's Ahead," where he engages the world's top newsmakers,...

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