Financial Analysts Journal ›

Volume 72, 2016 - Issue 1

Viewpoint

The Index Mutual Fund: 40 Years of Growth, Change, and Challenge

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Pages 9-13 | Published online: 27 Dec 2018

Cite this article https://doi.org/10.2469/faj.v72.n1.5

Abstract

The author marks the 40th anniversary of the creation of the first index mutual fund (now the Vanguard 500 Index Fund) by examining decades of data, which reveal that passive index funds have consistently outperformed their actively managed counterparts.

Editor’s note: This article was reviewed and accepted by Executive Editor Stephen J. Brown.

Author’s note: The views expressed in this essay are solely those of the author and do not necessarily reflect the opinions of Vanguard’s present management.

Notes

[1] Paul A. Samuelson, “Challenge to Judgment,” Journal of Portfolio Management, vol. 1, no. 1 (Fall 1974): 17–19.

[2] In the interim period, 30 June 1975 to 31 December 1985, the annual return of the S&P 500 was 13.3%, bringing its return to 12.3% over the full 1945–2015 period—a remarkable era in stock market history. It would be unwise in the extreme to expect such a generous past return to be prologue to the future.

[3] The SPDR (Standard & Poor’s Depositary Receipt, or “Spider”) S&P 500 constitutes the largest ETF, which is, day after day, the most widely traded stock in the world. With $150 billion of assets, the dollar volume of its annualized trading volume in 2015 was running at an annual rate of $6 trillion, a turnover rate of 3,300%.

[4] In the spring of 1991, the late Nathan Most of the American Stock Exchange visited me in my Valley Forge, Pennsylvania, office. He had designed a novel approach to indexing—what would become known as the ETF—and he wanted to partner with us, using our Vanguard 500 Index Fund as the trading vehicle. He was a fine gentleman and took with equanimity my on-the-spot decision—without much reflection and with no consultation with my staff—to relinquish the opportunity for yet another Vanguard “first” that would have combined Most’s innovative structure and Vanguard’s largest index fund. But I believed then—and I believe now—that buying and holding a broad US stock market index fund is investing that will serve long-term index investors well. I also believe that trading any index fund “in real time” is speculation that will, finally, poorly serve short-term index traders. Many who know this story describe it as a major failure on my part. I consider it a major success and have no regrets. Standing on principle is the right course of action.