Meet Vanguard’s next CEO and new CIO

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Rebecca Katz: Hi, you’re watching a replay of a recent live webcast with Vanguard’s leadership team. We hope you enjoy it.

(2009 webcast clip.)

Rebecca Katz: We received many questions about you in your new role as CEO and Cheryl asks, “What’s the biggest change that you’ve implemented since becoming CEO?”

Bill McNabb: Well, as you know Jack Brennan, my predecessor and great friend, turned over the reins on September 1, and then the markets of course retreated dramatically proving that Jack’s one of the great market timers in history. But Jack also happens to be an absolutely fanatic Boston Red Sox fan and so for 25 years it’s been “Red Sox, Red Sox, Red Sox” even though we’re here in Philadelphia. So I think the most important thing—what I’ve heard from our crew universally is—the fact that we now have the Phillies first and foremost in our baseball minds, not the Red Sox. In fact, I’m actually really looking forward to seeing the Phillies play the Yankees, not the Red Sox, in the world series and I think everybody here is incredibly excited about that.

(End clip.)

Rebecca Katz: Well, good afternoon, and welcome to this live Vanguard webcast. I’m Rebecca Katz. And yes, that was a snippet of Bill and me doing one of Vanguard’s very first live webcast broadcast back in 2009, shortly after he became CEO. And here we are again, a little older, a little wiser. I think we look the same. But, we are here to talk about another transition. Just a few weeks ago the Vanguard board of directors named Tim Buckley, Vanguard’s chief investment officer, to be president and director of Vanguard, with plans for him to succeed Bill as CEO on January 1, 2018.

Now with Tim stepping into his new role as president, that means that Greg Davis has stepped into the role of chief investment officer. We won’t be saying goodbye to Bill quite yet. He is remaining as chairman of the Vanguard board. But I do think we’ve said goodbye to that Phillies record. So gentlemen, thanks for being here in [our] studio to talk to our clients.

Greg Davis: Great to be with you.

Bill McNabb: Good to be with you, Rebecca. And I’m glad my market outlook has been a little more accurate than my baseball outlook.
Rebecca Katz: So are we.

Tim Buckley: And little did you know, you ended up back with a Red Sox fan.

Rebecca Katz: Yes. Tim . . .

Tim Buckley: So, the era turns again.

Rebecca Katz: There you go. And they’re doing very well so. Now you know, transitions like this don’t happen very often at Vanguard. Actually, Tim will be only our fourth CEO in our 42-year history. So, we wanted to offer the opportunity to you as our clients to ask them questions and learn more about the changes and how they may impact you.

Now as you know, if you watch these webcasts, we like to take lots of questions. Many of you sent questions in in advance. And you can keep sending them our way. You should see a little red widget or icon on your player. Click that and you can send us questions. And we’ll take just as many as we can. There’s also a little blue icon there. That’s for technical support if you’re having any problems. And a green icon to learn more about these three gentlemen. So with that, I have to ask the first question. And that’s to you Bill. Bill, why now?

Bill McNabb: You know, Rebecca, it’s the question everybody’s asking. And you know, for me it’s pretty simple. It’s really three things. It was the right time, you know. I’m in my tenth year as CEO. And I think that’s a long period of time. Started in the middle of the financial crisis, as you remember. And it feels like we’ve been able to accomplish a few things. In a sense, it’s time to let another team, if you will, take the reins. And you get the right people, and you know, having Greg and Tim here, I just feel great. You know, as a client and as somebody passing the torch, I know Tim’s gonna be a phenomenal, phenomenal CEO and continue, hopefully, in maintaining our values, but driving new ways of doing things.

And then, you know, Greg as CIO, I’ll tell you a quick Greg story. I was out on the West Coast last week. And ran into one of our large . . .

Tim Buckley: Greg was wondering where you’re gonna go with this one.

Bill McNabb: Greg doesn’t know this one. So I’m out there and one of our large institutional clients came up to me. And he goes, “You guys put Greg Davis as your CIO.” And I’m like waiting for the “but.” And he’s like, “You’re really smart.” And I breathed a big sigh of relief. And he went on to talk about how he had known Greg at business school and was very clear from that time on that Greg was gonna be a leader in our field. And we’ve seen that. So I think we’re just in incredible hands.

And actually Tim and Greg are part of what I think is the best leadership team in investment management. We have a great group of people here who really have a ton of experience. So you know, again, for me it just felt appropriate given all of that. And
then you know, on the personal side, I’ve got three young, and as I describe them, very boisterous grandsons who would love a little bit more time with me. And I think I’m gonna be able to do that as well.

_Tim Buckley:_ I think he’s pretty excited about that, Rebecca. He’s always had a spring in his step. But he’s like bounding down the halls now.

_Bill McNabb:_ And my daughter has told me my first soccer coaching assignments are coming shortly.

_Rebecca Katz:_ I see. And we’re all noticing your tie. And we wonder if that’s a little bit of a hint of something you might get in retirement too.

_Bill McNabb:_ You know, I am a dog guy. And I’m kinda pining away for my next dog. So that could happen soon, too.

_Rebecca Katz:_ Well you know, Bill touched on the long tenure. I’ve know, you know, all three of you for my two decades here at Vanguard, or nearly two decades. Tim, in your 26 years here at Vanguard, you have been in many, many roles across the organization. So as you reflect back on the things you’ve done and look forward, what kinds of trends do you think will most impact investors?

_Tim Buckley:_ Rebecca, I think about three dominant trends out there. One, we’ll be able to state the obvious. The trend, it’s the elephant in the middle of the room that’s going on. There’s another trend that I think will change investing for people in the future, change kind of the cost and complexity of investing to the benefit. And the third will be a trend that, well I sure hope that people embrace and continue to embrace. So with that as the hangar, so what are those trends?

The first would be, you know, the elephant in the middle of the room is indexing. It will continue to win the day. It will rule the day against active investing until active managers lower their fees. And I say active managers outside of Vanguard, because, you know, our fees are already low. And why is that? Over our careers, active management has gotten more and more and more competitive. Going after excess return, Greg knows this, he did this for a living, against professionals, 90% of assets are professionally managed. It is a tough business.

And it’s really tough to get that excess return. And when you get it, it’s usually not outsized. So you’re fees can’t be outsized. And you have to lower those fees. So the simple bid is, like, if you’re excess return is 70 basis points; great. You can’t have a 100-basis-point expense ratio. You’re taking it all for yourself. So you have to lower those expenses, and active management works. And we’re proving that here at Vanguard. So that’s a big trend that will continue until fees come down.
The second is really around advice; in that the cost of advice and the accessibility and ease-of-use of advice is gonna change dramatically. Costs will plummet, ease-of-use will soar. And that's really a question of technology. The technology is making it much easier to scale advice, where you can have an engine that does asset allocation, reporting, rebalancing, and does it, you know, in a way that you can scale and deliver excellence to everyone. Whether you're doing it through an advisor or doing it through our own service here at Vanguard. And we look to, you know, serve our advisors well that way, as well as serve clients directly.

So you'll see that with advice, it will be easy to collect data, easy to show portfolio performance, help people with where they should put their next dollar, all of these different services. Advice, I believe, will change. I think the three of us would say that will change dramatically in the future.

The third one is, you know I'm sure Greg or Bill would agree with this one, it's global investing. You know, we hear a lot of rhetoric from all the politicians around the world that increasing nationalism and global trade, Greg, I think it's basically plateaued and maybe tipping down a little bit. We hope that doesn't happen with people's personal investing. Because when you look at things like, you know, uncertainty in China, there's a mountain of debt in China, what will happen with it. Has Europe really turned the corner from austerity to growth? Or will they fall back? Are valuations too high in the U.S.? All of these questions.

Like the four of us could debate it. And we could have a really good discussion. But at the end of the day, we couldn't give you a certain answer on any one of those questions. Not that you'd want to put your retirement on. Right, fair enough?

**Greg Davis:** That's very fair.

**Tim Buckley:** All right, so that you would put your retirement on, so the best solution there is [is] diversification. And that's that global diversification.

**Rebecca Katz:** Well, let's talk about globalization a little bit. Because Greg, this is actually not your first gig as CIO. You were a CIO in our Asia/Pacific region as well as head of Global Fixed Income. So how has globalization changed the actual practice of investment management?

**Greg Davis:** You know, when you think about our teams, the way we're set up, you know, we have four global teams. One in Malvern, Pennsylvania, one in London, England, one in Melbourne, Australia, and we also have a team at Scottsdale, Arizona. The real benefit is the fact that we have experts in the local markets. So when we're trading JGBs, which are Japanese Government Bonds, or Japanese Equities, we have people in the Asia/Pacific time zone [who] are experts in those markets. So we get the very best execution for our clients.
But it also gives us something else. It gives us access to a broader talent pool. So in the past, our talent pool has been primarily regional, or maybe even national. But now it’s truly a global talent pool. We’re accessing talent all throughout Europe, all throughout Asia. So that’s gonna allow us not just to do well now for our clients, but also do well for our clients for decades to come.

Rebecca Katz: That’s great. We’re gonna actually come back to that thought because we have some questions about indexing later that I want you to address. And some of it does talk about talent. So you know, we heard in the clip a little bit about Jack Brennan’s market-timing skills and getting out as CEO at just the right moment. So for those of you who don’t know, a little history lesson. Actually not that long after Jack Bogle stepped down as our first CEO, you know, the technology bubble burst. And we, you know, had a bear market. And then right after Jack Brennan stepped down as our second CEO, we entered the global financial crisis and Lehman Brothers collapsed, and Bill had to weather through that.

So should we be taking anything away from your stepping down this time? Should we batten down the hatches?

Bill McNabb: No. But you know, I do think, Rebecca, you know, I joked I think back in 2009 that Jack Brennan was the greatest markettimer in history, because literally it was two-weeks before Lehman Brothers. But you know, Tim, and I, and Greg are all pretty cautious about the markets. We did our webcast at the beginning of the year. And we got a lot of questions from the audience, as you may recall, about where we thought valuations were. And we were collectively all on the side that they’re very high right now in the U.S. We’re not in what we would call “bubble territory.”

But we’re certainly at, you know, a very high level. We’re close to being the second longest bull market in terms of duration. You know—

Tim Buckley: Yeah, for any kind of like expansion, by the time you and I switch, transition, right around that time it becomes the second-longest expansion.

Bill McNabb: —and what we know is, you know, business cycles do exist. And bear markets will happen. So we do believe that at some point, there’s gonna be downward pressure on the market. Exactly what the catalyst will be, you never know until after the fact. But you know, we’re pretty cautious about the next decade really in terms of returns, both in the fixed income side and the equity side. And we can talk more about that if we get questions on it.

Rebecca Katz: Well, I mean we have a question from Eric how just said, you know, what do we see, or Tim specifically, what do you see as the biggest challenges over the next five years? Do you both see really the markets and potential either low-return environment or decline as one of the biggest challenges we’ll face?
*Tim Buckley:* I think it’s what you have to be prepared for. Lower-return environment is what you prepare for, [and] you’ll be surprised on the upside. And when we say the lower-return environment, how do you prepare for that? Our great mentor here would always say, “First thing you do is save more.” Right, live below your means, save more, you’ll never regret it. So that’s the biggest thing you control.

The second is control your expenses. Don’t go after some promise of great return somewhere else. Markets aren’t alchemy right? You just can’t create returns where there isn’t. So if you’re gonna have low returns, keep the expenses low. And then the biggest mistake, right Greg, is discipline. When investors don’t stay disciplined. Because low return, what we don’t have right now, we actually have double digit returns in equity markets, and really low volatility. You know, at higher valuations. So that’s odd. So what if you have low returns, it doesn’t have to be a pull back. But say it’s just low returns, but high volatility. You still have to stay the course. You still have to stick to your plan.

*Greg Davis:* The only thing I would add to that, is that I think when you’re in an environment where you have relatively low volatility, investors become complacent. And they ultimately, over time, as equities have done really well, they become overweight [to] equities, and they don’t necessarily have the level of diversification and balance in their portfolios that they should have—

*Rebecca Katz:* Because they get used to the smooth sailing and take on more risk.

*Greg Davis:* That’s exactly it. And at some point—to Tim’s point and to what Bill referenced earlier—there will be bouts of volatility again and investors need to be comfortable with the amount of risk they have in their portfolios.

*Tim Buckley:* You probably should check that right now because if you look where equities in their portfolios, they’re creeping higher than where they were in ’07 or ’99.

*Rebecca Katz:* Right, because the markets have been going up.

*Greg Davis:* Because equities over five years are up almost 15%. You look at bond returns over that period, it’s been slightly under 2%.

*Bill McNabb:* Yeah, and we are at just about record levels in terms of the percent of assets invested in equities. And so it’s, again, one of the reasons we’re cautious about it. And we just think investors need to really be thinking about diversification to Greg’s point.

*Rebecca Katz:* So we all need to go online and look at our allocations and think about rebalancing. You know this does beg the question. So Greg, we actually have a question from Susan in Clearwater, Florida, who said: “What are the chief duties of a chief investment officer?” Some of it is looking out for things like this. And then as you
step into the role, do you think Vanguard’s investment philosophy or investment management will change?

**Greg Davis:** Well, the number one role, again, is to make sure that our teams continue to produce top-tier investment results for our clients in a highly risk-controlled way. But also making sure that we provide, you know, great thought leadership to our clients in terms of what we’re thinking about markets, investment issues, and things of that nature.

But a big part of it also means that we’re developing a team to make sure that we’re ready for the future. So we have a great team in place right now. But that’s good for now. But that’s not good for what’s gonna happen over the next five or ten years. So we always want to be thinking forward about how do we have the right people, the right technology in place, so the returns that we produce are enduring in value.

In terms of the second part of your question, can you repeat, I’m sorry.

**Rebecca Katz:** Just about would you make a change.

**Greg Davis:** I would say our investment philosophy ultimately comes down to the fact that, you know, again, we have this huge competitive advantage to cost. And that impacts the amount of risk that we need to take in our portfolios, right, in order for our clients to get the returns that they’re seeking. And so I think we have a huge advantage by the fact that we have such a lower-cost expense ratio, lower expense ratio. We don’t need to take the same amount of risk, as Tim was alluding to earlier, as many of our competitors. So from a philosophy standpoint, nothing’s really changing.

**Rebecca Katz:** Right, that’s enduring. I mean you get the question all the time, I’m sure, now. And it’s a little unfair to ask you. But you know, William in Paducah, Kentucky, did ask: “What changes are you thinking about making?” And you know, he’s right here, so watch what you say.

**Tim Buckley:** Yeah, he’s still the boss right. So I’d better be careful. No, it’s been unfortunate for Bill, because he’s had to work with me for 16 years. So I’ve been kinda right sitting next to him. And actually it’s great for clients because what you seen happen over Bill’s tenure, he’s involved all of us in. And so as we set out and we look out the next five years what will be different. It’s very much of what we already have set in place and will continue forward with.

Bill has not been an ivory-tower guy, where he sets strategy and then he says, “Go execute.” He’s a very inclusive leader. So the senior team, we’ve all been very involved with, you know, are involved with our growth in the ETF business, our growth in the advisory business, our push into advice and how it can help advisors, 401(k) plans, as well as direct investors. All those things, we’ve been part and parcel with it, working with Bill. I don’t think we’ll miss a beat.
We’ll miss his leadership, but you know, I don’t think the shareholders should miss a beat in terms of that progress. And you know, the number one thing he taught us, and Jack Brennan before him, is don’t be complacent. Keep embracing change. Keep pushing.

Bill McNabb: Yeah, if I could just put an exclamation point on that last point that Tim made. You know, from my perspective a phrase we live by here, we really, you know, try to make it part of everything we do every day, is preserve the core while stimulating progress. And what I mean by that is the values, the philosophies that have made Vanguard really unique have not changed. You know, you go back to Mr. Bogle and the founding principles of this firm, and the ownership structure, and so forth. Those values are still part and parcel of everything we do.

But we’ve stimulated progress in terms of how we do these things, and how we deploy technology, what kinds of people we need, and so forth. And, you know, my advice to these guys is, you know, keep the values close and core to what we are, but you know, always be thinking about how can we better-serve our clients. Because that’s really what we’re here to do.

Rebecca Katz: Right, I mean there’s so much change. Just this live webcast, we like look back and laugh a little bit. But that was hot new technology back in 2009 that didn’t even exist.

Tim Buckley: He wasn’t quite as gray either.

Rebecca Katz: Well, neither was I. But you just can’t tell.

Bill McNabb: Another reason for stepping down.

Tim Buckley: I shouldn’t be throwing stones, but…

Rebecca Katz: So, you know, so thinking back to, you know, to the beginning of your tenure, or even before. You know, Vanguard’s obviously grown a lot. And you know, we were a little bit under the radar before as a challenger brand. And now we’ve emerged as one of the leading brands. So, are there new types of risks that have emerged since now that we’re more in the spotlight? You’ve touched on that a little bit. And maybe we can take that from sort of a business perspective with Tim. And investment risk perspective with you, Greg. And this question is from Bryan in Philadelphia.

Tim Buckley: So, for Bryan, and Greg, you’ve got the investments, right, so happy to give that to Greg. On the business side; break into different parts. First it’s, versus ten years ago, the first thing that pops into my head is cyber risk. And that runs for every company; big companies, small companies. It is ever-present. And we have to watch it, watch it, invest, invest, invest. And that will never go away. It’s unfortunate. There’s not a lot of value added there. But it is absolutely necessary that you do it. And that you stay ahead of the curve on cyber threat. So put that right up there.

The next one would be I’d say versus ten years ago, there’s more of a regulatory risk. And I don’t mean that in a negative sense. It just means you have to have different
relationships with the folks in Washington with our regulators and with legislators to make sure that changes to the industry are to benefit clients and that they’re fully educated in the changes that they make. And Bill’s been great at forging those relationships, educating. And we’re very active when we talk to people about things like either client disclosure or market structure or such.

Then the other one, which is the competitive threat. There’s competitive risk. You mentioned we were below the radar, right? You know, when you joined Vanguard, it was probably like when I joined Vanguard it was, “Hey did you join an airline?” “Who is this company?” Now everyone sees Vanguard. And they see the cash flow and the success of Vanguard. And for us, not so much for our clients, there’s the risk that competitors could target Vanguard. And why do I say it’s not bad for our clients is its strategy by imitation. There are a lot of people trying to imitate what Vanguard does. They don’t quite get it, but they’re trying to compete on low cost at least with select products. They won’t take low cost across their business and all their offerings. You know, pay the highest rate in your cash, and give you kinda of a low cost on active and passive products. Give you low-cost advice. No one does the whole sweep, but they’ll pick pieces of it.

That’s a risk for us, but for the clients it means that we’re helping to lower the cost of investing for everybody. And we talk about this a lot. Like yes, we’re competitive, we want to win. But we want our clients to win first. And if it means industry is getting better, then we’re having the impact we want.

Rebecca Katz: That’s great. What about on an investment perspective?

Greg Davis: On the investment side, you know, go back to my fixed income background. I’d say that there’s a lot of concern about investors having abandoned bonds in general, just because the yields have been somewhat unattractive for a lot of investors. You know, you look at where ten-year U.S. government bonds are at about 2 ¼%. A lot of investors have lost faith in owning bonds because the yield just isn’t there. And we’ve seen investors migrate into high-dividend yielding stocks, or REITs, or other things on the equity side that produce a yield that can be more attractive than what you see on the bond side.

But the reality there is the fact that those are still equities. And the reality is when there’s a downturn in the marketplace, high-dividend yielding stocks, REITs, those types of things will still have a pretty negative return in a downturn in a broader equity market. And so again, we would say that investors, again, need to make sure they have that diversification and that balance. And make sure they aren’t abandoning their holdings of bonds because they provide valuable balance to their portfolios.

Rebecca Katz: Well, one way we help investors have that balanced portfolio is through advice. We touched on advice a little bit. But Bill, I mean if you had to, you know, put your crystal ball in place, what does the future for the U.S. advice market look like? And we can take it from both, you know, you talked a little bit about technology, but also for financial advisors.
Bill McNabb: Well I think, you know, I think advice is gonna become even more front and center than it has been. And it’s certainly been a very important part of the landscape for the last decade. But if you look at the baby boomers in particular, Rebecca, and you know, I’m pretty representative of it at this point. As the retirements begin, this is where we see people need the most help. You know, I could argue and make a great argument that if your dollar-cost averaging into a highly diversified target-date fund on the way up as you’re accumulating; it’s a pretty good solution for most people. And you know, there are lots of variations on that.

But when you get into the drawdown where you’re actually having to live on a fixed set of money, you know, some of the things Greg talked about earlier around, you know, lower yields, people get very nervous about that. And if you get a low-return environment coupled with higher volatility that actually makes drawdown strategies even more difficult.

That’s where I think advice is gonna really take off. And you know, we’ve invested an incredible amount of resources and money in really two ways here. One, we’re trying to help financial advisors who do this for their clients. So we’ve broadened our lineup of ETFs and funds for them and the kinds of services to help support them.

And then for our direct retail clients, we’ve developed our personal advisor service over the last couple of years, which has had just tremendous acceptance in the marketplace where we’re using technology and highly talented people to provide a really world-class experience for investors.

The big thing with personal advisor service is it’s being done at a fee structure unlike most others. You’ll hear the term “robo” used a lot. But the breadth of service we provide is much greater than the so-called “robo advisors.” But it’s at the same price. I think price competition will come to the broad advice market over time as well because, again, I think investors are gonna demand that.

Rebecca Katz: Well let’s talk a little bit more about the competition and price. We have a question from Bryan in Fort Lauderdale, Florida. And Bryan says: “We have all heard the push for passive investing. Something we popularized years ago. But we have a lot of competition setting up low-cost index funds as well. So how do we stay at a competitive advantage compared to other companies?”

So we talked a little bit about the lower cost and growth of indexing as a positive for investors. But are all index funds the same? Is it really all about that cost and the expense ratio that we talked about?

Greg Davis: That’s one aspect of it. I mean the reality is you have to understand the quality of the team and the folks behind those funds. I mean it’s not as easy as, oh, we just go out and you press a button and all of a sudden you have an index fund. There’s a lot of expertise that goes into making sure you’re managing the risk properly on the equity side and on the fixed income side. Understanding the market impact. The rebalancing techniques that happen by the index providers.
So there’s a lot of work and a lot of technology in place that gets used to do it really, really well. But then there’s also the other things in terms of if investors are buying ETFs. What’s the bid-offer spreads associated with the underlying ETFs and how much liquidity is in there? So there’s a number of factors other than just that top-line factor that you pointed toward.

**Tim Buckley:** Rebecca, if I could come in on the cost side. Our clients will often read the headlines that say, you know, so and so has, a competitor has matched Vanguard on price, or tried to undercut Vanguard on price. If you just went over the past five years and notice how many times that competitor has had to cut price to match Vanguard. And what you realize is we’re built to keep lowering price because our clients own us. Our mutual structure that they own the funds, the fund own Vanguard.

**Rebecca Katz:** If we could turn back to advice for a second. You know, we have both a mix of financial advisors watching, and individual investors watching, and some institutional plan sponsors watching. And one of our advisor clients, Joe in Austin, Texas, wanted to ask us about our position on the DOL [Department of Labor] fiduciary rule, which you might need to give a little synopsis to what that is for others who might not be as familiar with it. But you know, there’s a little uncertainty around that rule and what impact it might have in the advice industry. What do we think about that?

**Bill McNabb:** So the DOL fiduciary rule, the first time it got talked about is really about five or six years ago. And it was this concept at the highest level, if you really want to boil it down, that somebody who is involved with your money should act as a fiduciary. At the highest level that seems like a pretty simple thing. But you know, a lot of the discussion was around what does that actually mean in their different definitions and so forth.

Over the last several years, you know, there were a couple of different versions of the rule and then, you know, the DOL issued it a year or so ago and basically said the industry needs to adhere to this. Some of the headlines recently have been maybe there’s gonna be a pull back and so forth. Our view is it’s inarguable that people who manage money on behalf of their clients are fiduciaries and should act in what’s the client’s best interest. And that’s really the driver of the rule.

There are some nuances and technicalities of the rule that need to be ironed out, so that they can be implemented in an efficient way and the technology to do so is in place. So there’s been some commentary, including some from us, to just make sure there’s enough time for implementation. But by and large, we think it’s a good thing.

Second, even though there’s some uncertainty as to how far the current administration is gonna push this, most of the major providers have decided, “You know what, this is a really good thing for investors. And we’re just going ahead with it.” So we’re seeing pretty wide adoption by most firms.

**Rebecca Katz:** That’s great. I mean it’s in our DNA to support clients since we’re client-owned, right.
Bill McNabb: Yeah, we believe this is a good thing.

Rebecca Katz: Great. Greg, we’re gonna mix it up a little bit here. We have some live questions coming in. And this one is back to you. So Mark, kind of reacting to some of what you talked about already. And he says: “Regarding the bond market and the bubble we’re in now...” I’m not sure it’s a bubble, but, “What are your thoughts on holding bonds when the fed starts to work on their balance sheet?” So fed’s got some work to do. What is the impact to bond investors?

Greg Davis: I think the feds have been very good in terms of communicating their approach. So it’s very different than what we saw with the taper tantrum that we saw over in Europe and also back in 2011 and the 2013 time period is that, you know, they’ve been very communicative with the marketplace in terms of telling us about the approach of how they’re gonna start to unwind the balance sheet, over what time horizon. And they’re also gonna be very thoughtful in terms of what impact it’s having on the economy.

So as long as the data comes in strong and the economy’s still growing, they’re gonna continue on with their process. So as long as it’s well thought out; the economy is still relatively strong; we’re not expecting it to have any kind of major disruptive effect to the overall bond market.

And in terms of them raising interest rates, the market’s pricing in that they’re gonna raise rates one more time in the next 12 months. And one to two times over the next 24 months. You know our view of that, it’s very likely you’ll get another rate hike out of the Federal Reserve this year after they start the balance sheet normalization process. But again, we think it’s gonna be very well controlled and a function of how the economy progresses over time. So we don’t think investors should be greatly concerned about the overall bond market at this point.

Bill McNabb: And Greg, fair to say, you know, if you’re a bond investor, if your time horizon is longer than the duration of the fund that you’re in, you actually want rates to go up.

Greg Davis: That’s a great point, Bill. That’s a great point. And the best way to describe that is just taking a, you know, single security as a thought. If you have a five-year bond that has a 1% yield on it; if you hold it to maturity, you get 1%. But at year 5.1, the yields go up to say 2%. Now you’re earning 2% for the following period. So investors, again, with that longer-term time horizon are absolutely benefitting by reinvesting those coupon payments, reinvesting those principle payments to ultimately give them a greater total return over time.

Rebecca Katz: Great, that’s a good rule of thumb. You can look up duration on our website and see if it aligns with your time horizon. So we have a few questions that have come in about corporate governances. And I know Bill’s passionate about it. I know you guys, actually all three of you, are passionate about this. You know, Walter in Arlington, Virginia, says: “Vanguard has grown into a financial behemoth,” which is very
illustrative. “This means it also shares a greater responsibility on corporate governance. So how do we think about that responsibility?” And I know this has been something that we’ve been talking about for a long time, not just as our size has gotten larger.  

**Bill McNabb:** Yeah, you know a lot of people think because a lot of our equities are indexed that we’re in, the term passive often gets used. That we’re passive owner. And we don’t think that’s appropriate. You know, we own a large percentage of many companies that are index funds. And the way we think about it is what governance principles need to be in place to give companies a good chance, if you will, at earning good, long-term returns, and helping us create value for our clients.

And so we’re going to be vocal in situations where we see there being a mismatch. So if we think a company is applying principles in a way to their own governance that actually could detract from long-term value creation, we’re going to speak up.

The headlines tend to focus on proxy votes and so forth. And you know, the reality is that’s a very small percentage of the engagement that goes on. In the past 12 months, we have actually met with more than a thousand portfolio companies that are in a stewardship team. And they have very active dialog around the principles that we think are really important. And those principles tend to be around board composition, alignment of compensation with long-term value creation. A lot of talk about engagement and actually being willing to talk to large shareholders and so forth.

And where we see, you know, there being a disconnect there, we’ll speak up. And I would say in my time in doing this, there’s been an unbelievable change in attitude on boards, especially in the last five years. When we first started having these conversations, they were pretty awkward actually. It was kinda like being at the seventh-grade dance and the boys stood on one side and the girls stood on the other. It was like the investors stood here and the boards or portfolio companies stood there. There is really good engagement because I think everybody is aligned and wanting the markets to work better.

**Rebecca Katz:** Great. Guys, need to add anything?

**Tim Buckley:** Just to say it was amazing when the announcement came out about the transition between the two of us, some of the companies, you’d say, are the well-respected companies, I got a note from a few of the CEOs saying, “As one of our largest, if not our largest owner, I think that we should be talking with you. Would love to meet with you. And maybe you and Bill, would you mind meeting with us?” It just shows you the engagement that’s been built. That people recognize, “Yeah, you may be an index fund, but you are an owner.”

**Rebecca Katz:** Right. And a long-term one at that.

**Bill McNabb:** You know, one last important point, Rebecca. We had a lot of discussions with clients around this, and this is where I would say corporate stewardship gets difficult; it all is for us; is around long-term value creation for the investors in our funds. And so we will sometimes find ourselves in disagreements on, you know, social issues
that may or may not have an impact on the long-term value creation. And so what we ask people to do on the activist side in particular is to link, you know, those issues with, you know, either value creation or value destruction. And then you can address it appropriately.

_Rebecca Katz:_ Right. That makes sense. We actually have more of an individual investor question. Again, I think this one's fair about having all their assets at Vanguard. I mean I think you guys have all of your assets at Vanguard. But Karen actually is a little concerned about that. She said: “You’ve always been told not to have all your eggs in one basket. So am I not diversified by having all of my assets with one firm?” I don’t know, maybe Greg you want to take on that one.

_Greg Davis:_ I mean if she’s owning multiple funds, right, each one of those funds is a separate entity, you know, basically, and ultimately protected by the assets of that funds. So although it might be all with Vanguard, each individual fund is a separate entity from that perspective.

_Tim Buckley:_ And the value of the fund, for Karen, is determined by all the underlying holdings. So she’s holding a fund, but that fund’s value is determined by the 5,000 stocks that it holds if you’re holding a total stock, or total bond market. If you’re holding these total funds, your diversification is all the companies in the equity market. All of the companies that issue bonds. That is fantastic diversification from a risk standpoint. And it’s held in a fund, which is a separate company with a custodian that is not Vanguard. So those assets are held somewhere else. So if Vanguard has a problem, that fund still has Karen’s money segregated off. And the fund can go on existing even without Vanguard.

_Bill McNabb:_ That’s actually a really, really important point, because we do get this question a lot from investors. And it’s actually a strength of mutual funds in general. This isn’t Vanguard-specific. Each mutual fund is structured as a separate entity, and as Tim said, with a separate custodial arrangement. So assets from one fund to another cannot be commingled. And there’s a complete separation. So, if you’re in Wellington™ Fund and Index Trust 500, while they’re both managed by Vanguard, they’re two completely separate entities with two completely different custody arrangements. And the assets are completely segregated.

And that’s true whether it’s Vanguard, or Fidelity, or T. Rowe Price, or whomever. And that, to me, is one of the most powerful elements of mutual funds overall. This was a brilliant, brilliant, you know, set of regulations and structures that were put in place, you know, after the Great Depression. And you know, through the Investment Company Act of 1940. And it, to me, is something that really makes funds very distinct from other types of financial instruments.

_Rebecca Katz:_ Great. We got a lot of these questions on webcasts right after, or during the global financial crisis. And what’s been interesting to me is over the years that we’ve been doing this, we still have this threat of uncertainty. I think there’s still a lot of uncertainty out in the marketplace. You know, Kristen in Atlanta, Georgia, [says]:

...
“Uncertainty is always dominating the news coming out of Washington. Congress hasn’t moved on much. So why haven’t we really seen that uncertainty reflected in the markets right now?” Greg do you want to take that one?

Tim Buckley: Yeah, we’re very interested in your answer.

Bill McNabb: I’m sitting on the edge of my seat.

Greg Davis: I think a big part of it is the accommodation that you’ve seen by the various central banks around the world. You have easy monetary policy in the U.S. You have easy monetary policy in Europe. Easy monetary policy in Japan. And I think all those things are contributing to a great deal of, you know, a great deal of strength in the overall markets, because that money needs to get put to work. And you’ve seen it in terms of inflating the value of asset prices. Whether or not it’s in the bond market, the equity markets. So a lot of it is bad news coming out of D.C., is still being overwhelmed by all these other things that are happening from a monetary policy standpoint.

And the other fact is that economic growth, if you look at the U.S., we’re actually seeing growth that’s coming at trend or slightly above. Europe’s doing better than what people had expected for this year. So, there’s positive signs in terms of the global economy. Plus you have the monetary policy. And I think all those factors are somewhat overwhelming the bit of dysfunction that we’re seeing in D.C.

Rebecca Katz: I see. So politics and economics doesn’t always line up one-to-one.

Tim Buckley: Look, what we worry about is the equity markets, not the fixed income markets, heard the good news. Post-election, we talked about the pro-growth agenda. And the market heard that. When that didn’t materialize, the market has not given anything back. And so maybe it is the monetary policy or whatever. But the equity market seems to hear the good news, they don’t necessarily price in the bad news. And that’s the lack of volatility. Because it’s not all good news out there.

Rebecca Katz: You know, Tim, let’s stay with you. And Bill you might actually have perspective on this. Steven in New York, wondered: “What is the biggest change going from, in your case, CIO to CEO?” I must add, you’ve been CIO twice. You were chief investment officer, and you were chief information officer overseeing our technology group. So what do you think the biggest challenge will be there? And Bill, you probably have more perspective.

Tim Buckley: He’s probably the one to answer. I’m not in the seat yet.

Rebecca Katz: What’s Tim’s biggest challenge?

Tim Buckley: A lot of people are giving me wisdom of what to expect. But I don’t think there’s anything like being in this seat. So I think it’s better that Bill talk about what was his biggest challenge. And what am I in for?
Bill McNabb: Well, I’m gonna make an umbrella statement and then, you know, I’ll answer the questions, you know, more specifically. But I think in general, CEOs get too much credit when things are going well, and too much blame when things aren’t. It’s the reality of the world that it’s much more complicated than all of that.

But I do think the biggest change, if you will, is at the end of the day, you are the one when there are really contentious issues. And even in an organization as collaborative as ours, and you know, we have such a team orientation at Vanguard. But you do have differences of opinions. And ultimately as the CEO, you do break those ties. And you have to be willing to do that. And you have to be willing to make those decisions and then move forward.

I think that’s, you know, until you actually do it, you don’t really appreciate what the person who’s doing it has done. I know when I had just admiration and great respect for Jack Brennan. And I thought I really knew what he did because we worked together for so long. And then six months later I’m going, “Whoa, I didn’t appreciate him for all the things he did,” because there is a difference.

Tim and I have actually talked a lot about, you know, the role. And you know, I would say the most important advice I got was don’t let the role go to your head either. So the fact that you are, you know, sometimes having to break these ties, or whatever, that’s great, somebody’s got to do it. But no one, and I don’t care who you are, how successful you’ve been, has all the answers. And so one of the most important things is to make sure that you’re surrounded by people who will tell you the truth, and who will debate with you as a peer not as their boss.

And one of the reasons he’s in the role now is he did this as well as anybody I’ve ever seen for the last, you know, first with Jack Brennan and then with me. And our whole team is like that. And you have to create that kind of culture. And you know, as Tim moves forward, one of the things I think he wants to hopefully continue is that kind of an environment where you can really get that kind of input and that kind of debate.

And by the way, I talk about it from a leadership standpoint and working with your own team. But it also comes from getting feedback from clients, getting feedback from regulators, getting feedback from competitors for that matter. You know, I try to put myself out there in all of those different venues so that you’re always gathering input. And then you have to sort of, you know, work with your teams to sort of work through it and so forth.

Rebecca Katz: And I imagine on the investment side of the house, we built in that debate and the ability to collaborate in a more formal way, actually.

Greg Davis: Absolutely. I mean that’s a big part of how you come to the best investment decision is actually having a lot of different opinions, getting them on the table, having a
robust dialog and debate about it. And you know, getting those great ideas implemented in the funds.

Rebecca Katz: You know, Greg, one question I didn’t ask you is, can you talk a little bit about who is succeeding you as head of Global Fixed Income.

Greg Davis: Sure, so it’s John Hollyer who’s been at Vanguard almost 30 years. He started off as a money market portfolio manager at Vanguard and eventually set up our entire risk management group within the investment management division. And he’s been someone who’s been intimately involved with our active process, and a member of our senior strategy team for probably a decade or so. So he’s someone very familiar with fixed income; very familiar with risk. And I couldn’t think of a better person to take on that role.

Rebecca Katz: That’s great. Tim, you know, I did touch on your other CIO role, your head of technology many years ago. Do you have a thought on what role technology will play in Vanguard’s future? Maybe beyond a little bit about we talked about in the advice space.

Tim Buckley: Vanguard at the core is an investment company. But we’re also a virtual company. And so we interact with so many of our clients, whether a 401(k) participant, or advisor, or an individual, through technology. Greg’s team leverages technology to make better investment decisions. Quicker investments, better trading, more efficient trading. Technology at Vanguard is everywhere.

And that won’t stop. I mean, we have to be great at technology. Because it’s how we interact with clients. It’s how we can improve service to clients. Whether it’s just how someone does a transfer of assets, or how we can give them advice. It’s how we interact with our advisors. How we can give them thought leadership. How we can communicate webcast to clients. Or it’s how Greg could use machine learning for better trading. Or he can actually start to use big data. They tap into big data to improve everything from compliance operations to better equity decision-making. So I could go on. But I’m trying to think of the places at Vanguard where you wouldn’t find technology. Maybe the galley?

Rebecca Katz: Oh no.

Tim Buckley: Even there, that’s how we order. That’s self-service. There isn’t a spot at Vanguard without it.

Rebecca Katz: Yeah, like the galley is our cafeteria. We name everything at Vanguard in nautical terms since that’s our theme. So we exercise at Ship Shape and eat at the galley for those who are watching.

Bill McNabb: You know, Rebecca, on the technology front, one thing, and I won’t get the numbers exactly right here, but in 2000, we had roughly 12,000 crew members and $500 billion under management. I think the average expense ratio across all the funds was probably in the high 20s to maybe close to 30 basis points.
Today, we manage, you know, four-and-a-half trillion, we have 16,000 people, and the expense ratio is, you know, well under 12 basis points across the board. You know, approaching 10, I think. Some of that, obviously, is just scale and organic growth. But a ton of it is due to unbelievable deployment of technology and efficiencies that have been gained. It makes our people smarter, makes our operations run more effectively, and allows us to do more for clients at the same price.

You know, Tim was one of the chief architects of our whole move to the web, which actually was transformational during that 2000 time frame. And I think, you know, in a sense, we’re in the first third of the game when it comes to the deployment of technology. We’re at a place now, if you think about, you know, Moore’s Law which is, you know, computing power. The curve is accelerating.

And so I think what our clients should expect from us is accelerating pace of change in terms of the kinds of things we can provide them, and the services we can provide, and the effectiveness, if you will, through technology. And again, I think it’s gonna be really exciting.

_Rebecca Katz_: One of the other big changes, not just technology, but for Vanguard over the last decade, has really been our global footprint. I remember back to when I started 20 years ago and we had one, or maybe two international offices. And they were tiny. And we’ve done a lot in the international markets. I know a lot of that happened under your tenure, Bill. But I would like to ask Tim; I mean, what do you think about Vanguard’s future global expansion? How we’re gonna change the way the world invests?

_Tim Buckley_: Well, we really say like the Vanguard value proposition doesn’t really know geographic boundaries. And so they’re a great opportunity. Whether it’s Europe, or it’s in Australia, or in Asia. There are so many great opportunities for Vanguard. And Jim Norris runs our international, our non-U.S., businesses [has] done a fantastic job of growing them. And it’s over $300 billion, right? We have assets overseas outside of the U.S. That in and of itself is a huge asset manager. Jim has the kind of unfortunate comparison point of the success of the U.S. business. So, it looks small relative to the rest of Vanguard. But he’s been enormously successful in growing that value proposition outside the U.S.

And we see it growing. Our biggest area right now is serving people through advisors. But we have a nascent direct business in the U.K. We have one growing in Australia as well that we’ll continue to invest there. So I think you can expect to see Vanguard grow, continue to grow globally. And that growth will help investors back here; our clients back here . . . Gives us that added scale we talked about that can keep pushing prices down.

And you know, we’ve already benefitted from having a global investment team; huge. Our shareholders already see increased excess return in our active funds in just Greg’s group from our global operation that would have made it all worthwhile.

_Rebecca Katz_: And I imagine when you were overseas living in Australia for Vanguard, you must have had many interactions with clients there. Do they really seem to
understand and embrace, you know, indexing, and low cost, and the Vanguard way of investing there?

**Greg Davis:** They absolutely get it. It makes complete sense. You know, it's one of the things that you can control. You can't control the market returns. But you can control what you pay for investments. And they absolutely believe in having high-quality, low-cost products is, you know, a great way to invest. So I think it's a worldwide phenomenon. Not just a U.S. phenomenon

**Rebecca Katz:** Well unfortunately we are really out of time. And I do think that it's only appropriate to let Bill have the last word. So, Bill, if you would like to say anything to our clients, we would appreciate your wisdom.

**Bill McNabb:** Well, most importantly, I just want to thank everybody for tuning in. These kinds of webcasts for us are really important. Because it is a chance for us to hear what's on clients' minds. And we did get lots of other questions, which we will go through and we'll internalize, you know, what some of the themes are and issues are and try to get back out to people with, you know, what we're doing in those regards.

But most of all, you know, I've spent more than half my life at Vanguard. It's been an amazing experience for me. And probably the most rewarding part of it is the number of clients I've gotten to deal with both directly and indirectly. So on behalf of myself and my family certainly, I want to thank all of our clients for all of their, just incredible, incredible support.

And you know, for being such an important part of who we are as a firm because we really are different in the fact that through our funds, as Tim described, we're owned by our clients. But it does drive everything we do. And I just can't say thank you enough.

**Rebecca Katz:** So, well, I can't thank you enough. All three of you. And congratulations. And thank you for spending your afternoon with us today. We'll have many more of these in the future.

**Tim Buckley:** We're happy. We'll miss doing them with Bill. But he'll still be chair, so we can drag him back, right?

**Rebecca Katz:** That's right. He can send us tough questions to answer. So in just a few weeks, we will actually send out a replay of and highlights of this broadcast with the transcript for your viewing or reading pleasure. And if we could just beg your indulgence for a couple more seconds, that little red widget that's on your screen, there's a little survey. If you could respond to that survey, let us know what you thought of today's webcast. But more importantly, let us know what you want to hear about next, so that we can bring these gentlemen back and have a longer conversation.

So you know, that's it from us here in Valley Forge. It's really been a special treasure to spend the afternoon with you. And we hope to see you again next time. Thanks.
All investing is subject to risk, including the possible loss of the money you invest.

Investments in stocks and bonds issued by non-U.S. companies are subject to risks including country/regional risk and currency risk.

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