

**Straight Talk on**  
**INVESTING**  
**What You Need to Know**

**Jack Brennan**

**with**

**Marta McCave**



John Wiley & Sons, Inc.



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To Cathy and the kids. The best family anyone could ever ask for.  
And to my dad, a straight talker who has been a continual inspiration to me.

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# PREFACE

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The last five years have been extraordinary in the history of investing. We saw a record bull market swell into one of the biggest speculative bubbles in history. Then we saw the bursting of that bubble and the onset of a prolonged bear market, the worst one that the U.S. stock market has experienced since World War II. If many investors seem shaken and unsure of what to do, no wonder. Within half a decade, we have been presented with a lifetime's worth of lessons about investing.

Experience may be a good teacher, but it is also a hard one. Ironically, one of the reasons that investors have found the events of the last five years so confounding is the very abundance of financial information available to them today. An explosion of news reports, data, and analysis has developed in response to the enormous growth of interest in personal finance and investing over the last two decades. Bookstores are bursting with financial how-to books, and the media blanket the airwaves, the newsstands, and the Internet with coverage of the markets and investing topics.

Yet amid this profusion of information and advice, there has been little sensible, truly *useful* information stated in ways that ordinary people can understand. In fact, some of what passes for investment advice is downright *dangerous to your wealth*. And much more is simply irrelevant to “real people”—my term for the many millions who don't earn a living managing money. Nonetheless, far too many people remain glued to the TV day after day, following the ups and downs of the financial markets in the confused belief that they have to do so in order to manage their investments effectively.

Several times through the years, people who have heard me discuss successful investing for real people have suggested that I write a book. My answer had always been an emphatic *no* until recently, when I began to fully realize how much damage the information gap was causing. Then came a second catalyst for this book: the approach of a personal milestone, the completion of my twentieth year at Vanguard in July 2002. Anniversaries *do* have a tendency to make you reflective, and as I thought about how much our clients and my coworkers have

taught me about investing in good markets and bad markets over two decades, I realized that perhaps those lessons should be shared.

In truth, the lessons of the past five years are not new ones. And therein lies the final impetus for this book: Having reached middle age, I am seeing my own children (as well as nephews and nieces and the kids I've coached in community sports programs) move into adulthood, and I know they can definitely use the sort of timeless, down-to-earth advice we share here.

So I decided to put my thoughts on paper. And rather than taking an academic approach, I decided to try creating something as close in tone as possible to the hundreds of investment discussions I've had with clients, coworkers, and friends over the past 20 years. This book is based on a series of conversations with my collaborator, Marta McCave, about topics that we think are very important for our readers to understand. I hope my experience and Marta's skill at fine-tuning my words make this an enjoyable read for you.

At root, this book is derived not from what I learned at Harvard Business School but from the wisdom of thousands of ordinary people who have successfully accomplished their own personal financial objectives, largely as do-it-yourself investors. Much of what I have to say may seem obvious, but it bears repeating today because of the barrage of "noise"—the chatter of contradictory opinions, information, and facts that focus almost exclusively on short-term events. Most of this noise will do nothing to help an individual accumulate wealth over the long run. Indeed, it too often has the opposite effect—prompting action that reduces the chance of success.

Make no mistake. Acquiring some basic knowledge about investing *is* very important for tens of millions of Americans. Not that long ago, investing in the stock market was something that only wealthy people did. But today, thanks to the democratization of Wall Street, anyone can be an investor. That's a great thing. More people should be investors, because sensible long-term investing is an effective way to achieve financial security. As a society we've removed many barriers that once kept the average person from investing—obstacles such as high costs, regulatory hurdles, and a lack of accessible information. And we've created wonderful incentives for long-term investors through changes in tax codes and retirement legislation. But the easy access to the markets has a downside, and it's that there are many more opportunities for individual investors to go astray.

So, what are the goals for this book? Only three.

First, it's intended to be the type of book that parents give their children when they strike out on their own. Like many of my contemporaries, I wish I had had such a book.

Second, I want this book to serve as a useful refresher about the basics of sound financial planning and prudent investing. No matter what one's age, so-

phistication or experience, a back-to-basics course is always helpful—particularly during difficult times, when conflicting advice typically abounds.

Finally, this book is aimed at helping people to think about their *serious money*—the dollars that they set aside for long-term goals such as retirement or the education of their children. Frankly, this book won't do much good for those who are seeking guidance about managing their household budget or tips on how to “play the market.”

The fact is, making your wealth grow is not that difficult. It's really quite simple. I hope *Straight Talk on Investing* conveys that message of simplicity in a way that real people will easily understand and want to put into practice. In today's challenging market, that message is needed more than ever.

*Jack Brennan*  
*Valley Forge, Pennsylvania*  
*July 31, 2002*



# ACKNOWLEDGMENTS

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Many people have had a hand in crafting this book. However, my first acknowledgment goes to the investors at Vanguard, with whom it has been my pleasure to be associated for 20 years. The knowledge and the experiences—good and bad—that clients have shared with me through the years have provided me with inspiration and many invaluable lessons. In turn, many of those lessons have served as the basis for *Straight Talk on Investing*. Real people invest their hard-earned money with Vanguard, and we take our responsibilities to those clients very seriously. If you are an investor with us, you are part of the Vanguard family. This book would not have happened without those family members' contributions.

A second acknowledgment goes to my two predecessors as chairmen of our funds, Jack Bogle and the late Walter Morgan. As a young man at Vanguard, I had the advantage of receiving a great tutorial on the history of the markets and our business from two giants of our industry. No question of mine was too naive; they (especially Jack) always took the time to teach. I'm ever grateful for the experience and knowledge they shared with me—valuable source material for this book.

Obviously, it takes an awful lot of assistance to turn a series of conversations into a full-fledged book. I previously mentioned my collaborator, Marta McCave, with whom I've worked closely for several years and without whom this book would not have been possible. Several members of our extraordinary team of writers and editors at Vanguard—particularly Craig Stock and Mary Lowe Kennedy—have been vital to ensuring that the content of this book is as clear and comprehensive as it could possibly be.

Numerous other members of the Vanguard team have provided assistance. Recognizing that I won't be able to name all of them, I mention a few here—Meg Shearer, Ker Moua, and Kimberlee Crater, along with Lynne Brady, Joan Carlson, Mike Hernan, Andy Clarke, Jeanene Boggs, Fran Kinniry, Colleen Jaconetti, and Matt Walker. I thank them for their hard work in the background to ensure that we produced a high-quality book that will provide good value to our readers.

Many Vanguard officers provided counsel and comments throughout this project. John Woerth, Tim Buckley, Bill McNabb, Jim Gately, Heidi Stam, Jeff Molitor, Kathy Gubanich, and Mike Miller, especially, gave their time and energy (and constructive feedback) to bring the project to completion.

Of course, none of this happens without a great support team: Gail Mellon and Vickie Leinhauser have helped Marta and me through every phase of this project to, again, turn conversations into a book. Their assistance is always valued, but never more so than on this project.

Finally, our editor at Wiley, Pamela van Giessen, has been a constant source of support to us as we took a concept to reality. I'm grateful for her efforts.

P.S. It's my view that successful investing represents a journey without a destination, in that the investor never "arrives" at a point where no more wisdom or knowledge can be attained. Although it's probably a bit odd to do so at the beginning of one's own book, I'd be remiss if I didn't offer a suggestion for next steps on your path to knowledge. Through the years, the two books that I have most often recommended to people who want to move beyond the basics of investing are *Winning the Loser's Game*, by Charles Ellis, and *A Random Walk Down Wall Street*, by Burton Malkiel. Both Charley and Burt serve as members of Vanguard's board of directors, and I can tell you that our investors benefit from their wisdom regularly. You can, too, if you would like to continue your intellectual journey.

## Notes

In this book I use several examples from the Vanguard funds to illustrate principles of investing. I cite Vanguard funds in part because I know them better than any other funds, but mostly on the merits of the lessons provided by the data. One of the primary lessons I hope you'll get from this book is to never make investment decisions based on incomplete information, so if you become interested in one of the funds I mention (or in any other funds, for that matter!), consult the fund's current prospectus before taking any action.

We've relied on a number of data sources for this book, including Morningstar, Lipper Inc., Lehman Brothers, Standard & Poor's, Salomon Smith Barney, Frank Russell Company, Wilshire Associates, and Crandall, Pierce & Company. Our thanks to all of them.

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PART ONE

# Master the Basics

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# chapter one

# **SUCCESSFUL INVESTING IS EASIER THAN YOU THINK**

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Successful investing is not that difficult. It's just intimidating. Some people assume that you have to be rich or possess an important-sounding degree to accumulate wealth as an investor. They think you have to be able to understand all the topics covered in *The Wall Street Journal*—the ups and downs of the stock market, the interest-rate decisions of the Federal Reserve Board, corporate earnings announcements and dividend policies, economic indicators, and so forth. It's true that all of those things have meaning, but you don't have to follow them closely to invest well. Investing really is easier than most people think.

The purpose of this book is to give you the understanding you need to accomplish your financial goals through investing. Over the past 20 years, I've talked to tens of thousands of successful investors. They come from all backgrounds and all stages of life. Some are young; others are old. Some are experienced; others are beginners. Some have advanced degrees, while others never went to college.

Despite their differences, all the successful investors I've met share several traits, beginning with a very important one: They invest with confidence. Confident investors are people who make decisions based on their own personal financial situations, goals, and ability and willingness to take risks. They don't spend their lives haunted by the thought that somewhere out there is a get-rich scheme or investment gimmick that will lead them to a pot of gold.

## The Environmental Forces Are with You

This is a great time in history to be an individual investor. There are a wide variety of investment vehicles, including thousands of mutual funds and thousands of individual securities. Educational material has never been more accessible, which means you'll have no trouble learning about the subject. If you have a computer, the Internet makes it easy to manage your investments at any time of day, no matter where you are. Finally, legislative changes have provided many attractive tax incentives for investors. Thanks to individual retirement accounts, 401(k) plans, and other tax-deferred savings vehicles, Americans get extra rewards when they put away money for their future.

Given all these factors, it's no wonder that millions of people have begun to invest for themselves in the last two decades. The explosion of awareness about investing among ordinary people is the most impressive thing I've witnessed in my 20 years in the business. The interest and knowledge are evident in the caliber of questions that Vanguard investors ask when they call our toll-free lines, in the letters I receive from shareholders, and in the questions people ask while making small talk with me at children's soccer games.

So today's environment offers great advantages—but investors must also steel themselves against two environmental challenges. The first one comes from the news media and all the others who make a living sharing their market wisdom with us. They all pay far too much attention to short-term events in the financial markets. In fact, news stories about the markets read a lot like the articles in the sports section. Who's ahead today? Who are the hot players with the golden touch? Who's going to have the best season? What's the best mutual fund this quarter? With so much excited commentary about every market move, it's no wonder that ordinary people sometimes feel intimidated or overwhelmed.

The second challenge comes from my own industry, sad to say. Remember, it's in the interest of many financial services companies to make you think that investing is difficult. They make money by selling investment products and advice. As you've no doubt noticed, there's no shortage of brokers, investment advisers, and financial planners eager to sign you on as a client and charge you for their services. There are financial professionals who want to make you think you can't make your own investment decisions. Don't believe them.

Your task is to recognize those environmental challenges and not to let them stop you from taking charge of your financial life. The reality is, you can succeed at accumulating wealth without spending every moment of your spare time trying to keep up with events. When you feel intimidated by the so-called experts, remember that they *don't necessarily know more than you do*. Indeed, we've all seen the headlines about financial hotshots who have lost millions and even billions of dollars through complicated trading schemes. What you don't see in the