

A Look Ahead with Vanguard

Transcript from January 10, 2023, webcast

Massy Williams: Hello, I'm Massy Williams, and you are watching a replay of our recent webcast, "A Look Ahead with Vanguard." We hope you enjoy it.

Tim Buckley: Happy 2023 and thank you for joining us. I'm Tim Buckley, Vanguard's CEO. I'll be joined today by Massy Williams, head of our Wealth Management business. You asked some great questions that we're excited to get to. But before we do, I thought I'd provide some perspective on 2022.

By any measure, last year was a tough one for investors. With the global stock and bond markets rocked by inflation and rising interest rates, the S&P 500 finished the year down some 20%, marking its worst performance since 2008. U.S. Treasuries, well they had their worst year since the 18th century. All in, global stocks and bonds lost more than \$30 trillion in 2022. And unfortunately, Vanguard clients, even those of you with the most conservative of portfolios, were not immune.

But Vanguard investors, all of you, did respond better than the vast majority of investors. First, before 2022, you had already avoided speculative assets like crypto, meme stocks, and undiversified ETFs emphasizing the big tech companies. Second, you did not panic or overreact to volatility. Less than 1% of you went to cash. Third, many of you, especially our Advice clients, took advantage of tax-loss harvesting to reduce your future tax burden. Finally, you rebalanced into the storm and are positioned well for recovery.

Our mission is to ensure you, our clients, have the best chance for investment success, so you can retire comfortably, afford that dream home, and put your kids and grandkids through college, so we couldn't be more pleased with your behavior in these trying times.

For more than a decade, companies had benefitted from remarkably low interest rates, making financing growth easy and pushing valuations higher. The multi-trillion dollar fiscal stimulus we saw during the pandemic raised consumption and company earnings in tandem. With such high demand, the struggling labor market in 2020 went to the tightest I've seen in my career by 2022. Wages surged in a battle for talent, add to that an energy shock from the war in Ukraine, and continued supply chain disruptions; and it's no surprise that, well, inflation hit a 40-year high. Central banks had to act, raising rates dramatically.

The rapidity of the rise shocked the markets and caused a dramatic repricing of stocks and bonds. Are we out of the woods yet? Unfortunately, no. Economically, we still expect a recession. In the markets, expect more volatility. Inflation in the U.S. may have peaked, but it's still well above the Fed's 2% target. The most stubborn driver may be wage inflation, which still burns brightly.

In the past, only recession has undermined wage inflation. If and when we enter recession, don't expect the Fed to quickly lower rates to spur recovery. They will want to make sure all smoldering embers of inflation, from housing, to goods, to wages are extinguished.

The equity markets will be volatile. Investors will continue to speculate about when the Fed will cut rates. FOMO, that fear of missing out, will cause sudden surges. The Vanguard approach to these markets, prepare for the worst, and be ready for the best with the diversified portfolio.

Keep the faith of bonds to mute volatility. Investment-grade bonds just had a tough year, but their higher yield offers a better return and cushion, and Treasuries still remain a haven. As for expecting the best, equities remain your growth engine.

Our 10-year expected return on global equities improved to 7 to 8% a year. The timing of that return is impossible to predict, so don't try. Just stay the course and stay invested.

Now, let me turn it over to Massy to get us started.

Massy Williams: Greetings everyone. Happy New Year, and welcome to this live Vanguard webcast. My name is Massy Williams, Head of Wealth Management within the Personal Investor Division. It is my pleasure to be with all of you today, and I hope that you and your loved ones had a great holiday season.

Tim just shared with all of us some valuable insights on the current market condition. Now, what does that mean for all of you as you think about your investment? Well, in a few minutes, we will have the pleasure to hear again from Tim as he helps us explore these questions and themes in more detail.

Our goal today is really three-fold. One, we want to give you a clear understanding of the market dynamics. Then we would like to address the key themes that we know are top of mind for all of you, whether it relates to how deep and long the recession will be or the implication on your portfolio. And finally, we would like to share some best practices and time-tested strategies to help you navigate these challenging times.

Around 50,000 of you are joining us today. Thank you for your interest, for your time, and for your trust. We have received close to 3,000 questions. To get us started, I tried to sort through all of them. We will get to the key themes though. But if at any point you would like us to clarify or explore anything a bit further, please send more questions our way. This is your time, and we want to hear from you.

Now, a few housekeeping notes before we dive in. Please direct any technical questions that you may have to the Q&A widget below, and to get a copy of the Vanguard economic and market outlook for 2023, titled, "Beating Back Inflation," please click on the green Resource List icon on the far right of your player.

With that, let's get started. Hello, Tim.

Tim Buckley: Great, Massy.

Massy Williams: Happy New Year.

Tim Buckley: Yes, it's going to be a good one.

Massy Williams: Absolutely.

Tim Buckley: Let's finish strong.

Massy Williams: We will finish strong.

So, Tim, we have one question here from Catherine in New Mexico that I believe can set the stage for this conversation. And Catherine is asking, "What other economic downturn in history will you compare to the economic time that we live in right now?"

Tim Buckley: Yes, Massy, Catherine asks a tough question because, as you know, every recession is unique. You know, its sources, its causes, and its ramifications. Dare I say we're not in a recession or we don't know that we're in one yet. You know, it's always backward looking.

Massy Williams: Yes.

Tim Buckley: But should we enter in a recession, it's probably going to look more like 2001 than any other recession that, at least, you and I have been through. It's certainly not going to be 2008 and won't be 2020. Those were, dare I say, violent and born of crisis – a financial crisis and a healthcare crisis. Now they had to be rescued with extreme monetary actions, and you're just not going to see that.

So what do we think going forward? We think in 2023 there's about a 90% chance that we'll enter into a recession. And that will be a more, dare I say, garden variety, end of a business cycle recession where the Fed's, if we think about it, the Fed's got to get on top of inflation. You just mentioned the title of our economic outlook "Beating Back Inflation," they've got to get on top. That means they've got to keep raising rates to 5, 5.25%. And with that, what you have is like, it becomes more expensive for businesses to expand, for consumers to spend with debt. And so an economy starts to cool as businesses contract a bit.

The downside of that is that unemployment's going to kick up, and it will kick up a few percentage points, and where will you feel that? You'll probably feel it in the sectors that enjoyed the most during the pandemic. They were the tightest if you think about the job market for IT or for real estate. Those sectors had a big run; they'll probably feel the drop. They'll feel the pain the most.

So if you think about that, you know, businesses are going to get more conservative, employment's going to tick up. It's a typical end of the business cycle, and you'll feel it more concentrated in some sectors, especially in IT. It echoes like 2001.

Now Catherine asks, "Well, what can we learn from that?"

Massy Williams: Yes.

Tim Buckley: Well, I'm not sure you can. It's tough to play that in your portfolio, and I'm sure that's a theme we'll talk about tonight. Why? Look, that recession, I believe, was from March to November of 2001. Well, you know what happened in 2002? You think, hey, the recession's over. The market's going to take off. No, it went down some 20%. So, and then it rallied for five years.

So it's really tough to say what's going to happen once the recession ends. You don't know exactly when it ends because you have to judge that in a rearview mirror. It's really tough. Like what are those lessons learned? Lessons learned is stay with your diversified portfolio. You don't know when it's going to take off.

Massy Williams: I love that, and I think in addition to diversification, in times of volatility like this one, a consistent call to action to all of you is tune out the noise, like Tim just said, and reduce volatility with a diversified portfolio and stay invested because I think people panic and get out of the market.

Tim Buckley: Yes, yes. Well very few at Vanguard do it; but other people, they will panic. And fortunately, most of our viewers tonight, they stay the course.

Massy Williams: So great job.

Tim, you mentioned in your opening that the inflation numbers that we have seen across multiple economies have actually been at multi-decades high; and what we have seen the central banks do, including the Fed, is actually having more and more restrictive policies to combat inflation and even at the risk of recession.

So we received a lot of questions, and I will go over that of Diane from New Jersey who is asking, "In your opinion, how deep should we expect that the 2023 recession will be?"

Tim Buckley: Well, our outlook would be that it would be a shallower recession. I think the bigger question, Massy, is how long would the recession last? Let me hit the shallower part. You look at household balance sheets, they're a lot stronger than they were say in '07 going into '08. So, sure, people have mortgages, but they're 30-year fixed at low rates, not adjustable rates that are going to spike as rates go up as they did in '08. So they feel good there.

If you look at credit card debt, it's a lot lower than that '07-'08 time frame. Importantly, the savings rate has actually been very high. During the pandemic, we had a huge savings rate. And there was a surplus; people had a surplus of savings. Now that's come down and that's been spent down, but the household balance sheet is better. Companies, sure they've issued a lot of debt in the past ten years, but the debt service is really low because it's at a low rate.

So what does that tell you? That tells you that if you go into recession, consumption won't dry up overnight. So it won't spiral downward quickly. And when you think about credit events, defaults, they'll be significant, but they should be manageable.

So that means it's shallow. The flip side of that, if consumers aren't going to just stop spending, that means that the economy, well, it's not going to cool down as quickly as the Fed may like. So they're going to have to keep rates higher for longer, and that's where the shallow recession may last a while because you need companies to start expanding again; and they're not going to do that until the Fed cuts rates because they want that debt to be cheap. So that's where it's a shallower but probably longer than you expect.

Massy Williams: All right shallow, but uncertainty around the-

Tim Buckley: About the length.

Massy Williams: -length of it. All right, and it's fair, so I feel like, Tim, to say that nobody, including the Fed, actually wants a recession. But they just understand that right now the bigger risk is inflation, and they're ready to do everything to combat that.

Tim Buckley: It's very true, and they have to make sure, I said in my opening remarks, that it's extinguished because you don't want to be- Look, ten years from now, no one will really remember if the Fed kept rates high for three or four months longer than they needed to. But we all would remember a Fed that didn't defeat inflation and let it come back. So when they look at that, they want to make sure that inflation, it's done with.

Massy Williams: Thank you, Tim. So, Tim, we just talked a little bit about the Fed; and I think it's probably reflective of some of the things that we have seen with the different central banks across many economies. But beyond the Fed, we have a lot of questions here coming through around what else should the investor be watching? And Gary in Texas wrote, "What are the two or three significant developments that may reduce or increase market volatility in the coming years?"

Tim Buckley: Yes, Massy, it's a tough one. When you talk about, for Gary, like volatility, the thing about volatility is that it comes from unexpected sources with a high standard deviation. So almost by definition, you know, you should be taking what I say with a grain of salt because from watching it, it may not be the thing driving volatility.

That said, I'm pretty confident in the first driver, which I mentioned in my opening remarks, is this FOMO, this fear of missing out. And unfortunately, we see it with professional investors. Massy, you've seen it. The professional investors, they want to time when is the Fed going to cut rates? Okay, the Fed's going to go, and they're going to try to defeat inflation and keep raising rates. Eventually, they'll plateau and they'll wait, and hopefully cut them. Everyone wants to be in the market before that comes.

So what they'll try to do is predict when the Fed's going to cut those rates. The Fed doesn't even know when they're going to cut rates. They're going to be data-dependent. And so people into the market thinking they've got it. They know when the Fed's going to cut rates, and then when it doesn't happen, they'll come out of the market. They'll be in, they'll be out, and you'll get volatility like this. Like no one should follow that strategy. It's not a good one.

Massy Williams: Yes.

Tim Buckley: The second area that's talked about is becoming less of a source of volatility is weather and weather in Europe specifically. So we all went into this winter knowing with the tragic war in Ukraine, right, that there is a natural gas shortage. With the sanctions against Russia, etc., natural gas shortage for heating in Europe.

Well with that, if there was a really cold winter, well, there could be a shortage of natural gas; and you'd have further inflation from energy prices. Unless you own a ski resort, you're pretty happy it's been a mild winter in Europe so far. So the longer that lasts, the less that becomes a factor.

The third one, well, let's talk about China. In China, largely because China's been closed since the start of COVID; and it's finally opening back up. And with that, how will it open? What will consumption look like? How will companies behave? Supply chains have changed. How will China reenter, and will they reenter and close back down? That could change volatility as well.

But I'll hit one last final note. I'll go back to those three answers are unlikely to be the true drivers, because I hate to call us on this, but if you look back at volatility we had in the past three years, when we were doing this in January of 2020, we weren't talking about the pandemic. And when we did this last year, we weren't talking about a full invasion, a Russian invasion of Ukraine and what that would mean for energy prices. So it is that bit, that bit that's unexpected that tends to drive that volatility.

Massy Williams: Yes, that's so true, and none of us could have predicted that. And I would say we would continue to keep an eye not only on the central bank movement and see where they're going but also on geopolitical risk and the supply shock that can be coming from any of those unexpected events that you just talked about.

Tim Buckley: For sure.

Massy Williams: And I think for the viewer's again, it's maybe an opportunity for us to pause to say that in any period of high uncertainty, like Tim just talked about, and volatility, you should really pause and reflect on your goals, on your time horizon, on your liquidity need, and your tolerance for risk before taking any action. Because if those elements haven't changed, you should stick to your investment policy and strategy.

Tim, we received a question from Christopher in Kansas, and Christopher is asking, "I can invest or take advantage of a down economy and actually increase the value of a portfolio?" So do you have a crystal ball?

Tim Buckley: Well, I don't know. Massy, I guess I'll tell Christopher I've been doing this for 30 some years, and I haven't figured out how to take advantage of a down economy. But we do know how to take advantage of a down market.

So the down economy, I'm going to share with you my favorite statistic research stat from 2022 from our research team. And it's one around knowing kind of economic surprises. So the team went back really over the past three decades, which just happens to align with kind of my experience in the markets. And they went back and they said, "What if you knew?" So what if Christopher knew all of the economic surprises? Right, think about nonfarm payroll. If you knew surprises to that, like if you knew those numbers ahead of time, what would that mean to your portfolio?

So say you knew the numbers, and if you said, "Hey, I think it's positive news, a positive surprise," you could tilt 80% to stocks. And if it's going to be a negative surprise, you could go 40% to stocks. If you did that before that news, how much better would you have done? 20 basis points a year, 0.2%. That's it.

It's crazy. At first you're like, "Really? With a crystal ball? You wouldn't do better?" Actually, you don't. It's because, look, markets look past the month-to-month, the quarter-to-quarter, and they're pricing in things that are going to be five, hopefully, ten years out. And so short-term economic events aren't always the best predictor of what that return is going to be.

So you look at that and say, "Okay, if you have the crystal ball, it's not going to help." What about, you're going to turn on the TV, you'll be flipping through some articles, and you're going to read about or hear about, "I've got the strategy for you coming out of a recession. It's going to be cyclical, so it's different this time. When the Fed cuts rates, those large cap tech companies are going to take off again."

Everyone's going to have their strategy and why it's going to work, and they'll give you the data of how it worked in the past recession. We've looked at that. We've looked at that, and we know like when we look at that, there is no silver bullet. There's no strategy that is full proof coming out of recession. It might have been cyclical at one time, but as soon as everyone knows that, guess what, it's priced into the market. It's gone. So if you tilt your portfolio and say, "You know what, I'm going to go heavy in this direction," you may end up trailing the market significantly because it was already priced in, so it's best not to try it at all.

Now, I said that you can take advantage of a down market; and the way you do this, and hopefully a lot of our clients did it, I mentioned it in the opening, was tax-loss harvesting. And Massy, you know this. It's a simple thing to do. When you have a down market, you know you have losses in your portfolio. And if you've been investing for let's say a decade, you've been investing for a while, you actually still have a lot of gains. And what you simply do is look at those lots, at those times you purchased things and say, "Do I have ones with a great long-term gain, or do I have an investment with a long-term gain? And I've got ones I made last year with, you know, that was a year and three months ago, and they've got a nice loss to them."

And what you simply do is you sell them, and they cross out. And so you eliminate that gain and match it up with a loss. And then you take those proceeds and invest them in a similar but not identical exposure. And that's a simple tax-loss harvesting, and you can improve your after-tax return. So investors should consider that in a down market.

Now, but before jumping into that, do a little bit more research. We're happy to talk to them. And look, if they're an Advise client at Vanguard, we've already been doing it for you. So those are the options for people. The best way to take, I think, a great way to take advantage of a down market is tax-loss harvesting.

Massy Williams: So thank you for those valuable insights. I'm sure all of our investors appreciate it.

I want to stay on the topic of time-tested strategies, right. Like you talked about tax-loss harvesting just now. We have a few questions around the role of bond as a ballast in a diversified portfolio, especially in the type of years that we just had where both stock and bond concurrently actually declined.

So we have a lot of people questioning the validity of that strategy, and Rosemarie from Michigan wrote, "Many commentators on TV say that a 60/40 portfolio does not work in turbulent market and should be reexamined." And she is questioning whether Vanguard saying "stay the course" is still the right course. So what is your view on that?

Tim Buckley: Stay the course. Yes, you know, that's my view.

Look, I just find it fun. People come out, and they'll judge a strategy based off of one year. You should never judge a strategy based off of one year. And that 60/40 portfolio, the return prospects for it just got better. In fact, they're probably the best that, I've been doing this webcast for a decade now, and the returns are probably second best that we've seen in that time. So if you look forward and say expected return on a 60/40 portfolio, now is the time, and you don't want to sell it now.

And so let me go into why. People think about what happened. Stocks and bonds, as you know, Massy, they don't love rising rate environments for the most part. And they have to reprice. Rates go up. You have to reprice kind of forward earnings for a stock; and they go up, and the coupon you're getting is like, "Hey, that's not as worth as much as the future ones." So the price has to come down to equalize it. And so you knew that was going to happen. It was the speed with which it happened that surprised everyone and shocked the markets and why everything tumbled.

This time last year, early January last year, we were at a market high. Expectations, I don't know if you remember this. Expectations for where the Fed would end with short-term rates, 75 basis points. Well, yes, they went up 75, and they did that another three times. You had four 75s, you had two 50s, and a 25 in there. So you end up at a level that's six times what the market expected, so that was shocking to both stocks and bonds; and that's where you felt that pain.

But 60/40's been through rising rates before. It's been through declining rates.

So now is the time you'll look at your portfolio and say, "60/40, hey, it's proven, the return prospects of it." When you look out ten years, you could expect about a 6 to 7% return from that portfolio. 6 to 7% return. So at a 7%, you're doubling your assets in about ten years.

So, no, bonds aren't dead. And you'll be happy to have them in your portfolio, especially in a recession. Right, they tend to zig when stocks zag there. That's post-rising rates, and 60/40 is time tested and it's prospects are great.

Massy Williams: Thank you, Tim.

Tim Buckley: You can tell I've got some passion about diversification.

Massy Williams: Yes, I could feel the passion. I could totally feel the passion

Tim Buckley: Yes, and our team here does a really nice job of, Joe Davis's team and the research team of thinking about what are those forward-looking returns? They do a really nice job of projecting them, and we were looking really good you mentioned.

Massy Williams: Yes.

Tim Buckley: Remember, and people asked, "How have you done?" When we looked back, what did we say ten years ago and what happened? We actually tracked that, and we were actually doing really well into last year. And last year, it was just like we had, it looked like we had way underestimated what returns would be. But as you mentioned, they fell right back, exactly back to what we had said. So a decent track record when you look at 60/40 global portfolio.

Massy Williams: Thank you, Tim. And so Rosemary, I think you have your answer.

We believe that staying the course is still the right course. And a portfolio diversified across asset classes and region remain an effective tool for all of us to manage risk tolerance across a long-term horizon.

So, Tim, we have a few questions here about the global equity outlook. You mentioned in your opening that we have seen an incredible selloff. Most indexes actually posted losses like more than 20% last year.

Tim Buckley: Yes.

Massy Williams: So what is our prospect as we're thinking about like the next few years?

Tim Buckley: You think let's talk equities here. A tale of two valuations. You've got U.S. and non-U.S. The U.S., go again to the past year, had a huge run up in equity prices. And a lot of it wasn't earnings based. It was valuation expansion, people willing to pay more for forward earnings. So the PE of a stock went up.

You had this huge valuation expansion, and it didn't happen in Europe. People love the forward earnings in the U.S., but they didn't love in Europe or non-U.S. stocks. And so what you saw happen this past year is both came down dramatically. And so now we had U.S. equities last year as overvalued, and now they've come down into just into the fair value range when we look at U.S. equities.

International equities present a little bit more value from a valuation standpoint, plus they suffered last year from a strong dollar. So if you get that dollar weakening a little bit, it comes to more of an equilibrium, you will actually get some benefit from that.

So the outlook, think about we mentioned bonds. Think about bonds as giving you U.S. and gold bond giving you 4 to 5, U.S. equities maybe giving you 6 to 7 over the next ten years, and then 8 to 9 more from the international side. So if you just ladder it that, you think about it that way, you get a little bit more being international; and you get a little bit, a tiny bit from the dollar as well in there. So that's a ten-year outlook. What happens next year, you know, could be anybody's guess.

Massy Williams: Yes, and I think actually listening to some of the return numbers that you shared, specially if you think about the U.S. and international, it actually makes the case for global diversification again.

Tim Buckley: Oh, for sure.

Massy Williams: All right, so we have a question coming up for you, Tim, on actually many different investors. So we have Christina in New York who is a newer investor, Randy in Pennsylvania who is nearing retirement, and Clay who is an 85-year-old retiree. All of them are wondering what advice do we have for investors that are feeling still anxious about the portfolio, especially given the content that you just shared with us.

Tim Buckley: So you're talking about investors that are saving for retirement, in retirement, and they've got different goals in there, so it's tough to give them one strategy. But I think they can have one approach. Okay, control what you can control. In a time of volatility, markets are down, control what you can control.

And I'll tell you, say if somebody's saving for retirement, they're 35 years old, 40 years old, that means like the markets are down. What should you do? Ideally, if you're here at Vanguard, you already controlled one thing, which is the expenses in your funds. Right, the cost of your funds.

So the next thing you could do is save more. People are, "Oh, the markets down." Well that's an ideal time to start putting more in. That will improve your long-term outlook. If you want to improve your long-term outlook, save more because as the market comes back, you'll have more principal to ride that market up to expand. So if you want to control that part for the person saving for retirement, it's save more.

How about if I'm in retirement? I'm done. Like I don't have that income coming in. I was living off my investment. That is still control what you control. Now you control your expenses. And it's the drawdown on your principal. If you're newly retired, if you just retired, it's the worst time to retire; and you can't know this is right before a market downturn.

And you may retire and you say, "Okay, well I know that I can pull \$100,000 a year from my portfolio. Right, and I'll grow it for inflation." That's when you're going into your retirement, and the market tanks. Well, if you just continue to pull that, and maybe it's a 4 or 5% rate, you're pulling that from your portfolio. If you pull that rate from your portfolio, you actually, and you don't change your behavior, our studies have shown looking over eight bear markets, that you've increased your depletion risk to about 30% chance, a 30% chance that you will outlive your assets, and nobody wants that.

So how do you control for that? Well, quite simply, you lower expenses. Does it have to be a lot? Surprisingly, no. If you just take that \$100,000 and you drop it down to 98 or ideally 95, just spend a little less. Right, don't take that trip. You don't have to drop it down to 50. You just drop it down to 98, 95, 90. The more you can drop it the better in those tight times. But then when the market comes back, well, reward yourself. You increase your payout 5%. Take it up to 105, right? And then you can reward yourself. If you're dynamic in your spending as a retiree, you take that risk I mentioned, that depletion risk back down to, if you set it the right way going in, and if we went through those past scenarios, your depletion rate goes back down close to zero and gets you back on the path that you wanted. So those are the two strategies of control what you can control. Save more, spend less.

Massy Williams: Right, and I feel like we can get a hashtag out of it. As you were talking, I was thinking about spend time in the market. Don't try to time the market, right?

Tim Buckley: 100%.

Massy Williams: Thinking about the conversation we have had so far.

All right, so let's pick up the beat and cover a few questions on investment strategies, starting with the question we received from John in Pennsylvania who is asking, "What are your thoughts on actively managed funds in the client portfolio?"

Tim Buckley: So this is John. The first thing I would say to John would be, you know, what's your stomach for risk or your appetite for risk? Because look, active's going to be, you know, let's say active equity's going to be kind of a more volatile ride than, index equity still's going to be a volatile ride, but that has the market risk in it. What you're putting on top is manager risk.

Now, can it work for you? Well, it can if you find a manager with edge and you keep expenses low, it can work. You look at Vanguard's experience, if you look at our active managers, and you look over ten years, straight up, 68% of our managers have outperformed their indexes over ten years.

Look, if you get it right, it is worth it. But you've got to know that you've found someone with edge, and you've got to keep those expenses low. And you've got to hold on for a volatile ride, because it tends to, returns from the active world tend to be punchy.

Massy Williams: Thank you, and I think the numbers, I want to go back to a number you shared because I think it's very significant on how we have been able to create value for the investor, 68%, and that's net of fees.

Tim Buckley: That's net of fees, yeah.

Massy Williams: Yes, that's incredible.

Tim Buckley: Yes, it's much higher on the fixed income side. So, you know, we have a distinctive edge in the fixed income world; and we've talked about it with clients before. Our ability, our low expense ratio means in the fixed income world, and think about what's going on now. We've got really talented PMs and analysts, and with the low expense ratio, they don't have to take risk when they're not getting rewarded.

So spreads are still tight, so they don't have to take risk when a recession may be on the horizon so they can keep dry powder. And then when something hits and there's a dislocation and people have to sell things for cheaper prices, they can be there. And they can take advantage of that and get that further outperformance.

So when it's not worth taking the risk, like that low expense ratio means they don't have to; and they can still give you a great return. And when the risk is cheap relatively, they can take that risk and really punch up that return. So that's that fixed income edge we like to talk about, and that's why if you look over a decade, they've done so well.

Massy Williams: That makes sense. We received a few more questions on a product we decided to actually launch or not launch. Can you talk a little bit on our philosophy on that. Why did we decide, for example, that we're not going to have crypto.

Tim Buckley: Crypto, every year we hear, "Hey, where's your crypto fund?" I guess no one's asking that one this year.

Well, Massy, we have some simple rules. One, the asset class has to have intrinsic value, and I'll come back to crypto or gold on that. It needs to belong in a long-term portfolio, that it's a true diversifier in a long-term portfolio. Third, it needs to be feasible. Like not everything can be in a 40 act in a mutual fund or an ETF. Like, it's just not feasible to put it in there. Historically private equity was that, and we've figured some things out around that.

And then, finally, we actually have to be like thinking we can be the best at it. Like, we don't want to be an also-ran in it. So, hey look, if it's got intrinsic value, it's feasible, it belongs in a long-term portfolio, and we can be the best at it, we'll put it out there. Now like crypto funds and all, it's easy to talk about them now; but we were talking about them before. People would ask for them and say, "Look, we don't offer them because they didn't pass the test of our intrinsic value. They don't have cash flows to them. They're just based off of that demand will exceed supply and set a price, and that has to keep increasing over time."

And it's tough to think about that in a long-term portfolio as a diversifier, so we just said, "We can't figure it out." So when we can't figure it out, we just say, "We stay out." At the same time, we don't put gold in there either, and we find that there are other diversifiers if you want to diversify for inflation or the such. We have other funds we think are better to do that in a portfolio.

Massy Williams: Good. So if we don't see investment merit, so we're not going to go into fad. That's what I think I heard. And we don't see that there is a client need actually that we can feed and that we cannot competitively drive success for those clients, we will not launch it.

Tim Buckley: Yes, we're not going to do it. Yes.

Massy Williams: That feels like a great discipline to us.

Tim Buckley: It doesn't mean we always get it right. I mean things go out in the marketplace, and, you know, on occasion we'll find out that for clients that it hasn't had the acceptance. But we put a ton of work into it ahead of time.

Massy Williams: And that's a discipline but also distinctive approach that I feel Vanguard has. So given that we're almost at time, believe it or not, the time actually flown by, we have this question from Kevin in Pennsylvania that seems very fitting for me to ask you right now. "Vanguard built a reputation as a low cost mutual fund provider, but it is no longer the only player in that space. What will distinguish Vanguard when you think about the low cost option in the coming years?"

I think Kevin is really asking us why Vanguard? Why should people come here?

Tim Buckley: Well, we need a lot of time for- No.

Massy Williams: I knew that was your favorite question.

Tim Buckley: I think for Kevin, yes. For Kevin, the most important thing is to understand what we were founded on, right, the idea of giving clients a fair shake. Right, putting their interest first and letting them keep more of their return. That's what defines us, not simply low-cost index funds. So don't define yourself about what you do, but define yourself about why you do it.

And so we'll continue to have those low-cost funds, and there really only can be one low-cost provider, and you look at our ETF assets, 86% of our assets are in the lowest cost fund. So our offer is the lowest cost.

I talked to you about the outperformance of our active funds and our index funds likewise. So we want to keep that performance topnotch. That's a high priority for us, but we're not going to limit it to that. We'll look at the success of a client. The success of a client is determined by the funds they have and the advice they get in those funds.

Well this, their funds, we've been hard at work at that one; and dare I say the generations of Vanguard crew that have helped really change investing and really lower the cost of investing let people keep more of their returns and increased the quality there. The past teams at Vanguard have done a great job with that.

So in the future, can we get after advice? Because it's still, well, it's still expensive; and the quality's inconsistent. So, Massy, you know this. It's a big part of your world. We've invested hundreds of millions of dollars in advice engines, improving our advice offer. So people can have full financial planning, no give-up, full financial planning to do things like, well, healthcare estimation, tax-optimized retirement income, tax-loss harvesting, optimizing around multiple goals. All of that for less than the cost of an active fund, and it's consistently ministered, and you can do it on pure digital or talk to, we have more than 1,000 certified financial planners if you want to work with a certified financial planner. So that is a huge part of what we can do in the future to continue to add value.

Now there will be a lot of people listening, like, "Ah, advice isn't for me." I love it; they're do-it-yourselfers. They've seen a website that's changed dramatically this year. We'll continue to improve that site. What you can expect from Vanguard in our digital experience versus someplace else is our clients own us. Right, we are aligned with them. So when we do things online, we want to make them better investors. So we will nudge them towards a better outcome.

Think about our participants in our 401(k) plans. We continually nudge them to do simple things like, hey, are you taking advantage of your company match? It might be something simple like that. Sixty percent of them actually took us up on those nudges and became better investors.

We'll roll that out more and more to our clients. But the difference with Vanguard is we will be nudging people to do things to make them better investors, to improve their outcome, not to cross-sell. Not to improve a bottom line, because our bottom line is our client's bottom line, and it's their end result; and that defines Vanguard.

Massy Williams: Absolutely. I think we talk a lot about that with crew when it comes to advice where it's surely about changing lives. And I think the crew takes a lot of pride in helping our clients get to that goal.

Tim Buckley: Yes, for sure.

Massy Williams: And the other thing I would be remiss if I don't say that is it's not empty rhetoric when we talk about putting client first. It's really part of our DNA because we are structurally built to actually do that. It is part of our strategy.

Tim Buckley: I always tell people we have no one else to serve. I mean like our clients own us, so that's who we serve. And look, we'll always put their interests first. Our intentions will always be pure. We may not get it right, but our intentions will always be pure, and we'll get after it. If something's dropped, we will fix it.

Massy Williams: Yes, and we do, when I hear from the feedback, because you make us better when you share with us where we can improve; but we are here to serve you for sure.

Tim, we are at the close, believe it or not, so I want to go back to you. What would you like of the investors who are with us today to actually walk away with?

Tim Buckley: I think, first and foremost, is tell all of you thank you. Thank you for investing with Vanguard, in trusting Vanguard with your hard earned savings, and we'll never take that trust lightly.

And the coming year could be volatile, but your experience, you've been through volatility like this before; and you get the message. You know to stay disciplined, to make sure you're rebalancing, and keep that long view. You keep that long view and you'll get those great outcomes. And should you have questions, should you have concerns, that's exactly what we're here for.

So thank you for spending the evening with us. Have a great 2023, and I look forward to seeing you online again soon.

Massy Williams: Well, that's all the time we have, Tim. Sound advice and thank you for sharing so many valuable insights with our viewers. And to you, members of the Vanguard community, thank you for joining us tonight, and thank you for your trust. We are grateful for your time, and we hope you benefitted from the discussion. As always, we are here to serve you and to help you, so please don't hesitate to reach out.

One more thing before we let you go. Please select the right Survey button on your screen to share your feedback with us so that we can continue to enhance future events. In a few weeks you will receive an email with a link to a replay of this webcast. We hope you enjoy it.

On behalf of team and all of us here at Vanguard, thank you. Have a great 2023 and, of course, stay the course. Be well.

END OF WEBCAST

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