The New York Times

Vanguard Is Growing Faster Than Everybody Else Combined

By LANDON THOMAS Jr.APRIL 14, 2017

A statue of the Vanguard founder, John C. Bogle, at the Vanguard headquarters in Malvern, Pa. Credit Mark Makela for The New York Times

MALVERN, Pa. — The Vanguard trading floor is the epicenter of one of the great financial revolutions of modern times, yet it is a surprisingly relaxed place.

A few men and women gaze at Bloomberg terminals. There is a muted television or two and a view of verdant suburban Philadelphia. No one is barking orders to buy or sell stock. For a $4.2 trillion mutual fund giant that is still growing rapidly, it occupies a small fraction of the space of a typical Wall Street trading hub.

You can barely hear the quiet hum of money being invested — money in scarcely imaginable quantities, pouring into low-cost index mutual funds and exchange-traded funds (E.T.F.s) that track financial markets.

In the last three calendar years, investors sank $823 billion into Vanguard funds, the company says. The scale of that inflow becomes clear when it is compared with the rest of the mutual fund industry — more than 4,000 firms in total. All of them combined took in just a net $97 billion during that period, Morningstar data shows. Vanguard, in other words, scooped up about 8.5 times as much money as all of its competitors.

"Flows of this magnitude into one company are unprecedented," said Alina Lamy, an expert on fund flows at Morningstar. "Since the crisis, investors have been saying, 'I may not be able to control the market, but I can control how much I pay in mutual fund expenses.' And when they look for quality funds with low fees, the first answer is Vanguard."

The triumph of index fund investing means Vanguard's traders funnel as much as $2 billion a day into stocks like Apple, Microsoft and Amazon, as well as thousands of smaller companies that the firm's fleet of funds track. That is 20 times the amount that Vanguard was investing on a daily basis in 2009. It is manageable, in large part, because no stock-picking is involved: The money simply flows into index funds and E.T.F.s, and through February of this year, nine out of every 10 dollars invested in a United States mutual fund or E.T.F. was absorbed by Vanguard.

By any measure, these are staggering figures. Vanguard's assets under management have skyrocketed to $4.2 trillion from $1 trillion seven years ago, according to the company. About $3 trillion of this is invested in passive index-based strategies, with the rest in funds that rely on an active approach to picking stocks and bonds.

More broadly, this deluge of money abandoning higher-price actively managed funds for Vanguard's plain vanilla cut-rate vehicles has come as an existential shock to a mutual industry that has long been resistant to change.

What is being called the Vanguard effect was felt last month when the indexing giant's rival, BlackRock, announced that it would revamp its stock-picking operations, promoting instead a process that relies more on computer-driven methodologies.

The effect within Vanguard has been no less profound. For decades, the firm has made the case that cheaper index funds will, over time, outperform more-expensive mutual funds that rely on brainy portfolio managers to pick stocks.

The main advocate of this doctrine was the founder, John C. Bogle, who retired in 1999 but runs a research operation on the Vanguard campus. For years, the firm has relied more on his simple message and the passion of his devotees than on fancy advertising campaigns to spread the word.

"Mr. Bogle used to say, 'This is not our money,' and I agree," said F. William McNabb III, Vanguard's chief executive. Credit Mark Makela for The New York Times

Unlike its peers, Vanguard is owned by its funds — and ultimately its investors — so as money rushes in, expenses are persistently reduced, resulting in perpetual savings for the legions of Vanguard clients. They number well over 20 million and include New York Times employees: Vanguard runs the company's 401(k) retirement plans.

The model has been a powerful one: Since 1976, fees on Vanguard funds have fallen to about 0.12 percent from about 0.70 percent. By comparison, Lipper calculates that the average fee for all mutual funds is currently 1 percent, although it has been coming down rapidly.

"Mr. Bogle used to say, 'This is not our money,' and I agree," said F. William McNabb III, Vanguard's chief executive, referring to the extraordinary inflows. "For many years, there has been a real move to our way of investing. And it's more than active versus passive — it's high cost versus low cost."

This no-frills approach has come under some strain as cash flowing into Vanguard funds reaches new highs year after year, some people who follow Vanguard closely say. There have been reports of operational snarls, including website outages, longer-than-usual wait times on the phone and misdirected fund transfers.

"All this growth has come at the same time that the company has been cutting costs," said Daniel P. Wiener, the editor of the Independent Adviser, a newsletter for Vanguard investors, who says he has received many complaints about the current state of customer service at Vanguard. "Most companies when they are growing spend more. Vanguard is trying to spend less. At some point, cutting costs will bite you."

There is no doubt about Vanguard's commitment to pinching pennies. In touring the 287-acre campus of pathways, low-slung buildings and a commanding statue of Mr. Bogle, the sensibility is decidedly puritan.

Vanguard employees on the equity trading floor, a relatively relaxed place. Credit Mark Makela for The New York Times

There are few flashy cars to be found in the parking lots. The walls are largely devoid of eye-catching art — with the exception of some musty paintings of the HMS Vanguard, a Napoleonic-era British warship that inspired the company's name.

In sum, the look is slightly drab, certainly by Wall Street standards: rows of uniform cubicles, colorless carpets and an executive boardroom that seems more appropriate for a community college than one of the largest financial institutions in the land.

Vanguard executives say they are disciplined in terms of plowing money back into people and technology, but not overly so. "Our true investment spending has doubled in the past five years," Mr. McNabb said.

This tension between breakneck growth and spending restraint is most acutely felt in the firm's retail division — or the front lines, as they are referred to here — where 6,000 customer service representatives attend to the wishes, demands and whims of the close to eight million clients who purchase their mutual funds directly from Vanguard. In 2015 and 2016, this division added 350,000 new accounts each year, numbers never before seen at the firm.

"The spotlight is on us, given the growth, and there have been operational challenges," said Karin A. Risi, who oversees Vanguard's retail investor group and is in the midst of an aggressive hiring push. "But it is not fair to say we are not investing. Bringing in 2,000 crew on a base of 6,000 is not insignificant."

As with many executives at Vanguard, Ms. Risi gets a glint in her eye when she talks of the virtues of investing in low-cost index funds. Like the majority of her peers, she has spent the bulk of her career at the firm and, as a certified culture carrier, it is clear that she is taking the current growing pains to heart.

"My parents were Vanguard investors, and I was investing in Vanguard funds in high school," said Karin A. Risi, who oversees Vanguard's retail investor group. Credit Mark Makela for The New York Times

"My parents were Vanguard investors, and I was investing in Vanguard funds in high school," she said. "So I feel the burden of this responsibility. We are serving a mission here."

Beyond their devotion to indexing, Vanguard employees talk as if they are working on a frigate, a nod to the nautical images and themes embraced by Mr. Bogle at the company's founding.

Employees are called crew, one eats at the galley (not the cafeteria) and works out in the “ship shape” room, and new workers come onboard as opposed to being hired.

“You absorb the culture and you join the cause,” said Joseph Brennan, who, as head of global equity indexing, has had a front-row seat as the firm has expanded. His division embodies Vanguard’s credo of do more with less: The 45 people he oversees globally look after $2 trillion in assets.

“Our assets per head are incredible,” he said. At $44 billion per person, that certainly qualifies as an understatement.

Up and down Wall Street, where the sum of a firm’s assets under management has become a badge of power and sway, Vanguard’s ability to attract and run so much money with so few people has been a cause for envy and disbelief. Some have even warned that index funds will distort the broader market, especially if active stock pickers are pushed farther to the sidelines.

Already, six out of the 10 largest mutual funds by asset size belong to Vanguard, with the largest, Vanguard Total Stock Market Index, now weighing in at $465 billion, according to Morningstar. Only two — American Funds’ Growth Fund of America and its EuroPacific Growth Fund, both belonging to the Capital Group — are actively managed, promising higher returns for a steeper fee.

“There is this existential crisis in the soul of every professional asset manager,” said Josh Brown, a financial adviser and blogger at Ritholtz Wealth Management. “Vanguard has become synonymous with the idea that people should pay less — not more — for stock market exposure.”

Correction: April 23, 2017

An article in the Mutual Fund Quarterly last Sunday about the growth in inflows to the index fund giant Vanguard misspelled the given name of the executive who oversees its retail investor group. She is Karin A. Risi, not Karen. (The error was repeated in a picture caption.)