

Indexing As An Alternative:

Why Investors Should Consider Index Funds

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The Vanguard Group

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Indexing Should Be Considered For A Part Of Every Investor's Portfolio

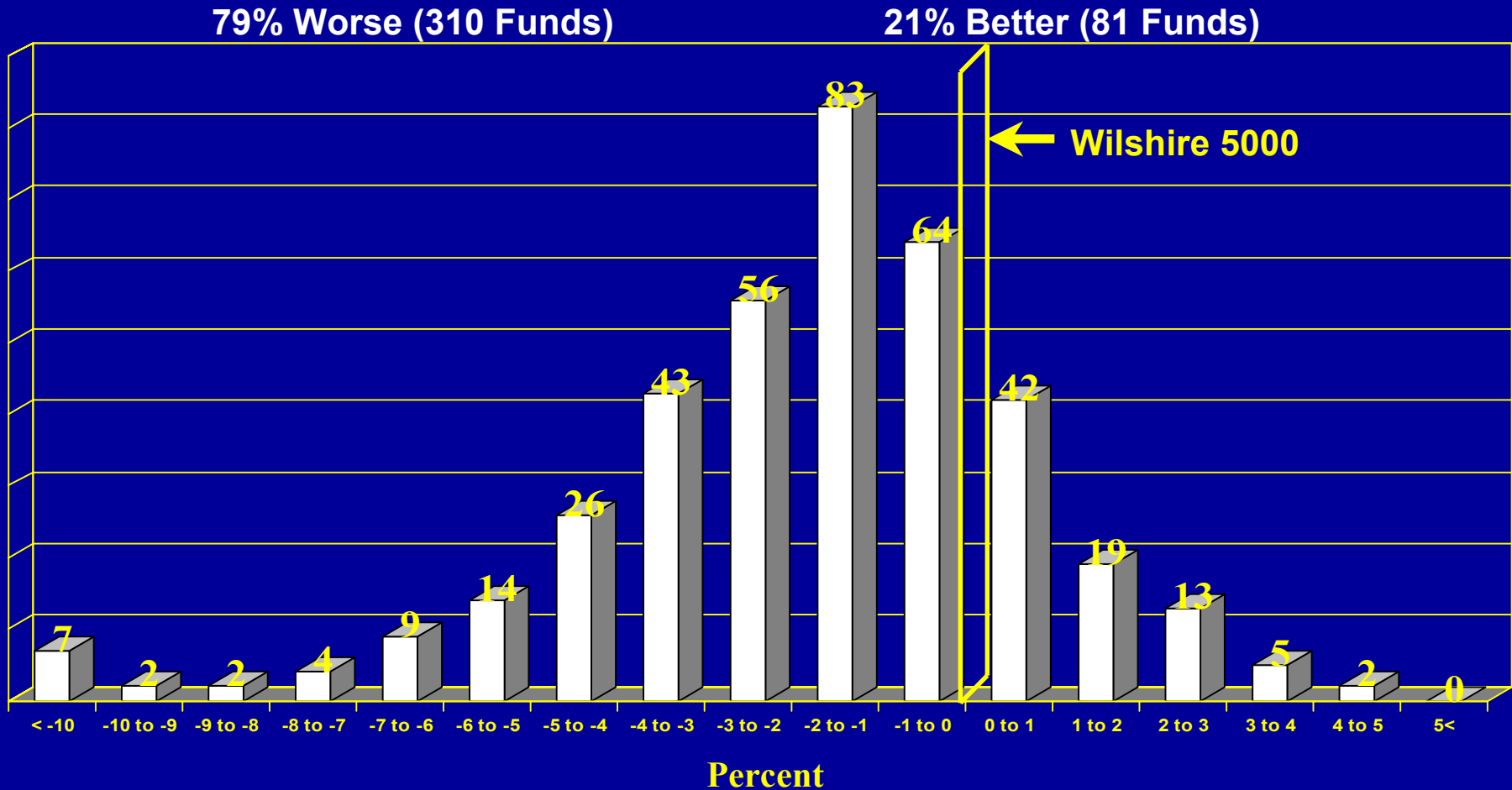
- **Indexing provides several advantages relative to active management**
- **Growth of index mutual funds and exchange-traded funds (ETFs) offer investors access to index based investments**

Advantages of Indexing

- **Relatively Predictable Performance**
 - **Broad Diversification**
 - **No Manager Risk**
- **Long Term Outperformance**
 - **Low Advisory and Administrative Costs**
 - **Low Turnover (Minimal Transaction Costs)**
 - **Fully Invested**
- **Very Tax Efficient**
 - **Low Turnover/Low Realization of Capital Gains**

The Results

US Diversified Equity Funds vs. Wilshire 5000 Index Fifteen Years Ended December 31, 2001



Source: Lipper Analytical Services, Wilshire Associates & The Vanguard Group

Why Does An Index Fund Tend To Outperform Actively Managed Funds?

- 1. Low Costs**
- 2. Low Turnover**

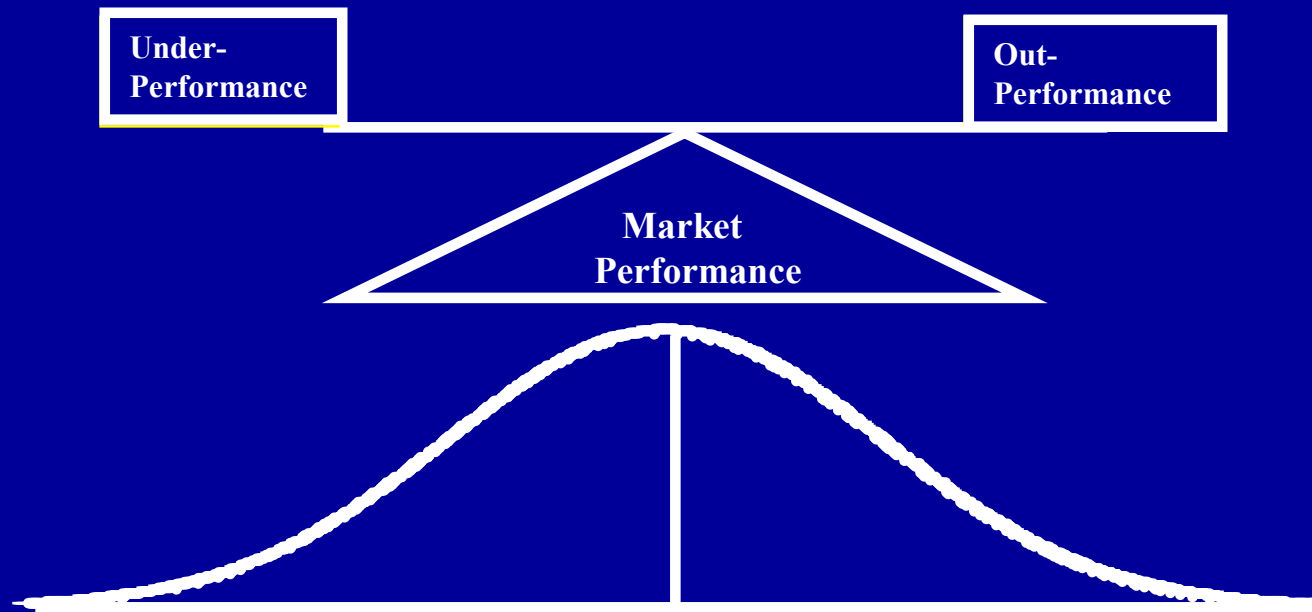
The Cost Advantage

- **Expense Ratio:**
 - **Average Active Equity Fund** = **1.55%**
 - **Index Fund** = **0.20%**
 - **Indexing** + **1.35%**
- **Transaction Costs:**
 - **Active Funds average 85% turnover** = **1.00%**
 - **Index Fund** = **0.10%**
 - **Indexing** + **0.90%**

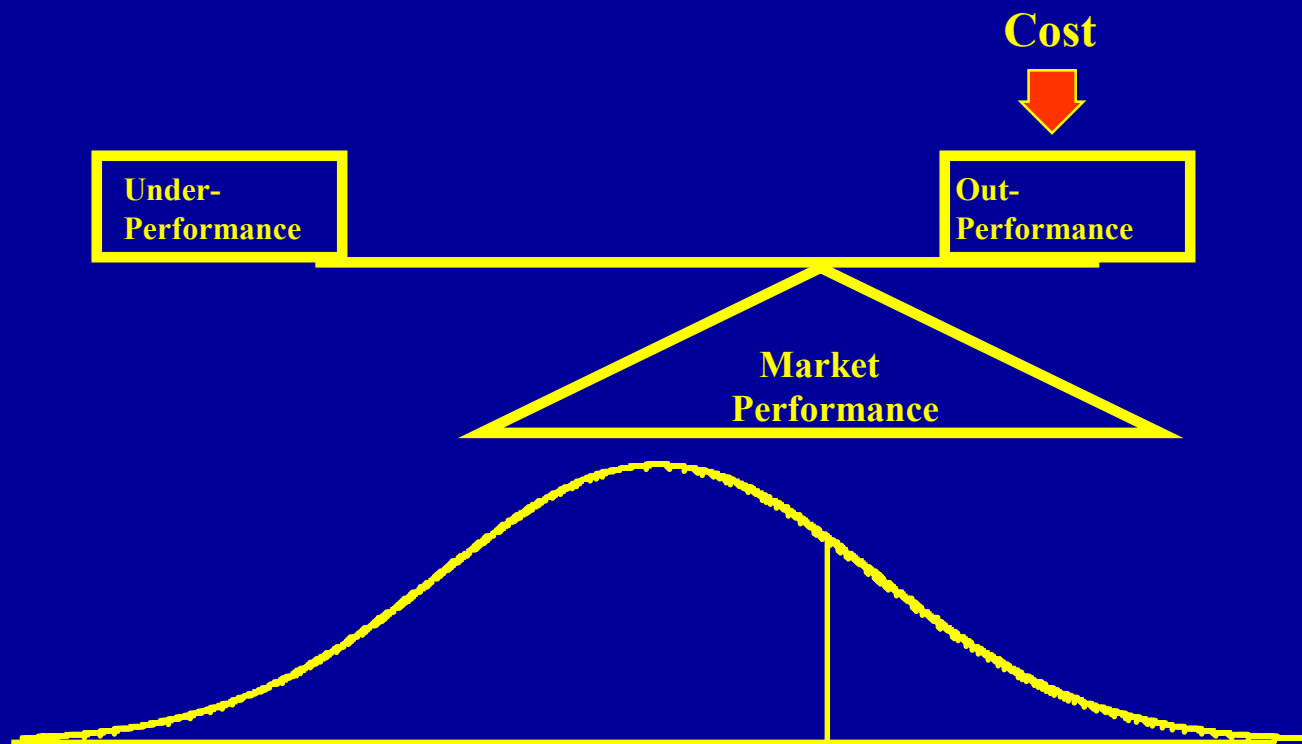
TOTAL YEARLY ADVANTAGE = +2.00%

The Impact of Costs:

Relative Investment Performance Before Costs is a Zero Sum Game



However, Costs Reduce Active Performance to Less Than Market Performance



Percentage of Managers Outperformed by Benchmark (15 Years Ended 12/31/01)

	Value	Blend	Growth
Large*	80%	74%	66%
Medium**	56%	67%	62%
Small***	79%	56%	29%

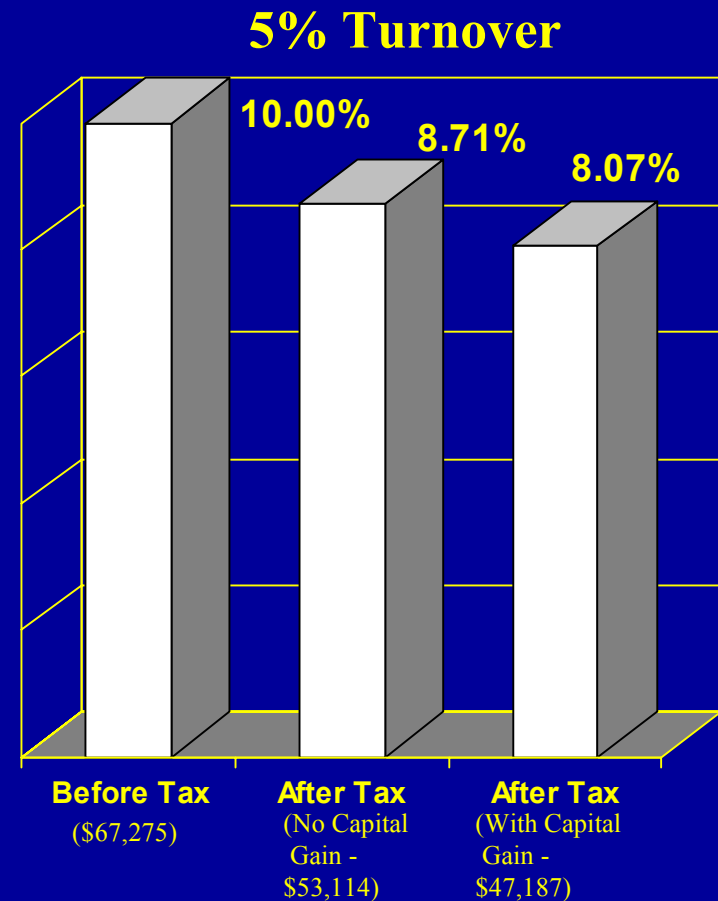
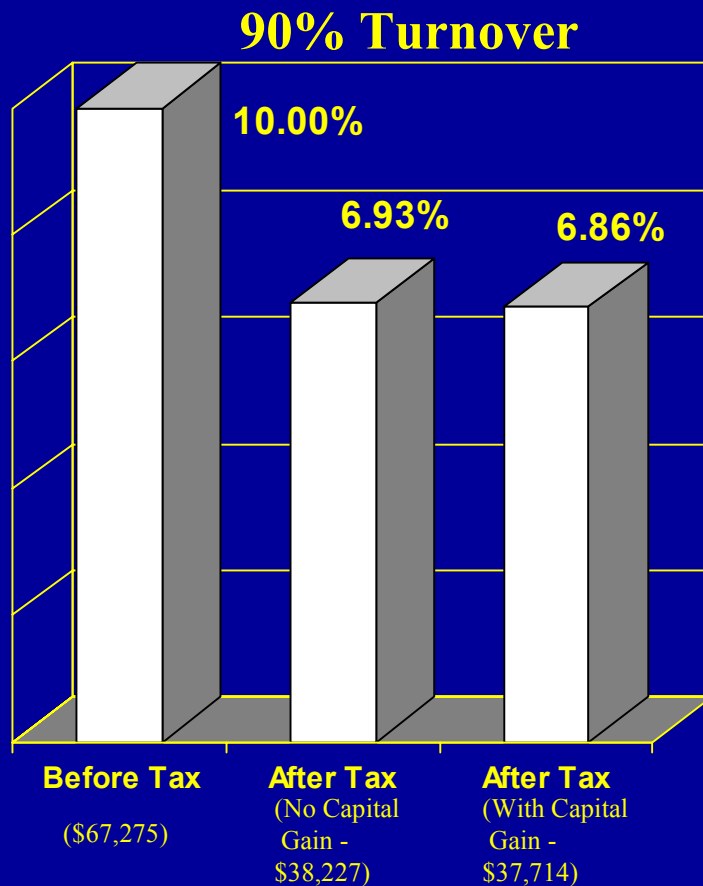
* versus Russell 1000 Value, Russell 1000, and Russell 1000 Growth.

** versus Russell Midcap Value, Russell Midcap, and Russell Midcap Growth.

*** versus Russell 2500 Value, Russell 2500, and Russell 2500 Growth.

Impact of Turnover

Before and After Tax Total Returns of Similar Funds with Different Turnover Ratios



Assumptions: 20-year Holding Period

39.6% Ordinary Income Tax Bracket

Capital Gains on Individual Sales: 20% Years 2-5, 18% Years >5

50% Capital Gains at 39.6% and 50% Capital Gains at 20%

Return=7% Capital Appreciation, 3% Yield

It's now easier than ever to incorporate indexing...

- **A large number of conventional index mutual funds and exchange-traded funds (ETFs) are now available**
 - **Conventional index mutual funds: realize the benefits of indexing over the long term**
 - **ETFs: a faster and more flexible way to index**

Vanguard Offers Both Conventional and Exchange-Traded Index Funds

- **23 Equity Index Portfolios covering various market segments and styles**
- **Two funds offer an exchange-traded share class called VIPERs™**
 - **Total Stock Market VIPERs (VTI)**
 - **Extended Market VIPERs (VXF)**

**INVEST IN A VANGUARD
INDEX FUND IN THE
TIME IT TAKES...**

TO TURN THE PAGE

Vanguard VIPER Shares

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