

Five Reasons to Favor a Passive, Index Approach to Investing

1. Lower Fees and Expenses

Expense Ratio	
Average U.S. Equity Mutual Fund	1.44%
Vanguard S&P 500 Index Fund	0.18%

Source: Morningstar, 2005

Trading Costs	
Average Large Cap Equity Fund	0.50%
Vanguard S&P 500 Index Fund	0.05%

Source: Wermers, Journal of Finance, 2000

2. Lower “Cash Drag”

Cost of Holding Cash	
Average U.S. Equity Mutual Fund	0.70%
Average Equity Index Fund	0.10%

Source: www.efmoody.com; Wermers, Journal of Finance, 2000

3. More Tax Efficient

Tax Costs	
Average U.S. Equity Mutual Fund	0.95%
Vanguard S&P 500 Index Fund	0.38%

Source: Carhart, Journal of Finance, 1997; Morningstar, 2005

In aggregate, these costs amount to a 2.9% after-tax return hurdle that active managers must overcome to simply match the index fund’s return. **The vast majority do not succeed.**

4. Superior Long-Term Performance

- Through August 2002, the Vanguard S&P 500 Index Fund outperformed 81% of all U.S. diversified stock funds over 20 years.¹
- Through year-end 2003, 102 intermediate-term investment-grade bond funds had been in existence ten years; 87% of those funds returned less than the Lehman Aggregate Bond Index.²
- Over the period 1987-1999, a passive 60% stock / 40% bond portfolio outperformed 90% of the nation’s largest corporate pension plans, despite those plans’ resources and ability to hire the “best” managers.³

5. Picking “Winners” is a Loser’s Game

- While some funds will always outperform the broad markets, it is nearly impossible to predict in advance which ones will. Of the twenty best-performing equity mutual funds from 1983 to 1993, sixteen (80%) failed to match the market return in the subsequent decade.⁴
- In attempting to select the best funds, investors end up just chasing returns. For the 19 years ending July 2003, the average U.S. equity investor earned 2.6% per year, compared to the 12.2% annual return of the S&P 500.⁵

Sources: 1 – The Vanguard Group, Inc.; 2 – Lipper Inc. and The Vanguard Group, Inc.; 3 – Dimensional Fund Advisors; 4 – Lipper Inc.; 5 – Dalbar Inc.