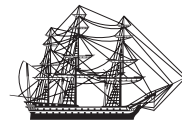


Vanguard's Investment Philosophy

We Believe #1

Investing is for meeting long-term goals; saving is for meeting short-term goals.



Vanguard[®]

Successful investment management companies base their business on a core investment philosophy, and Vanguard is no different. Although we offer many strategies with both internally and externally managed funds, common themes run through the investment advice we provide our clients. Indeed, these tenets have been a part of the company since our inception and are embedded in Vanguard's culture. We've distilled our philosophy into nine statements, the first of which is presented here. For Vanguard, these nine statements represent both the past and the future—enduring principles that guide the investment decisions we help our clients make.

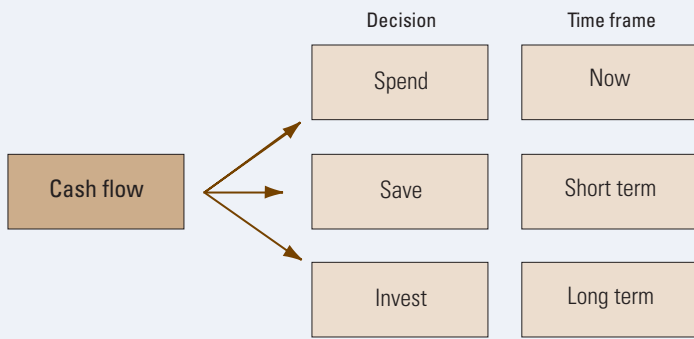
Vanguard believes that . . .

1. Investing is for meeting long-term goals; saving is for meeting short-term goals.

Differentiating between short- and long-term financial goals, and the strategies appropriate for each, is the first step in productive portfolio management. Current cash flow that will be used to finance future goals can be either saved or invested (see Figure 1, page 2). The terms *saving* and *investing*, although commonly used interchangeably, represent two distinct ways of managing money.

The goal of saving is to preserve an asset's value. Savings are typically used to fund near-term, relatively certain, spending requirements; thus, stability of principal is imperative. The cost of principal stability is that savings vehicles generally offer low returns relative to other investment vehicles. Money market funds, U.S. Treasury bills, certificates of deposit, and bank savings accounts are appropriate savings vehicles.

Figure 1. Options for cash-flow management

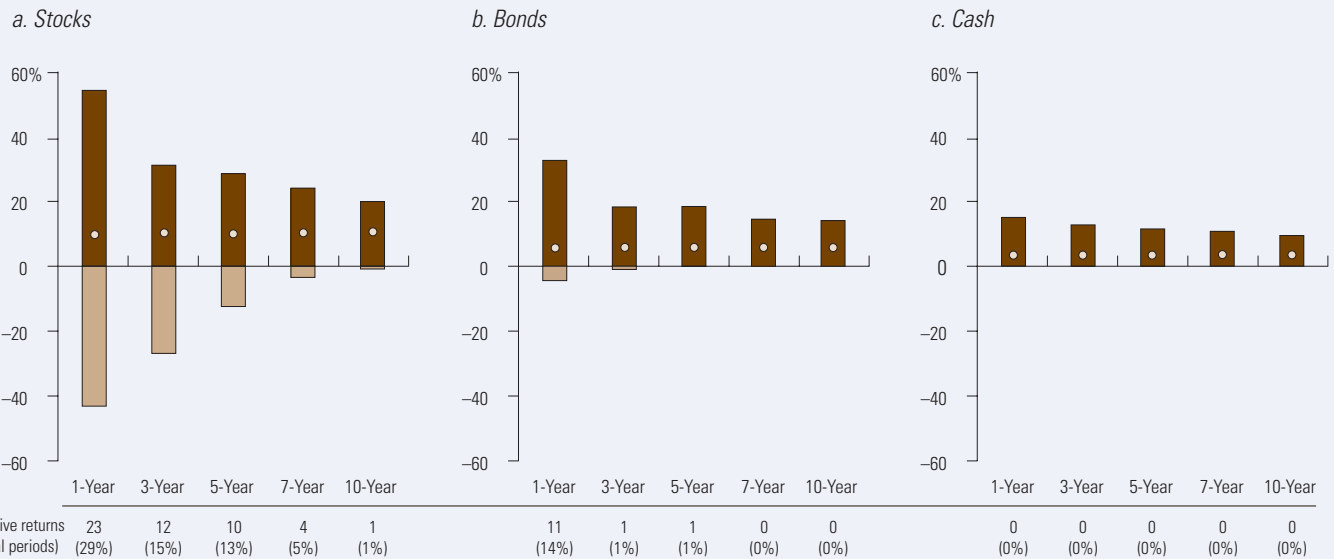


The goal of investing, on the other hand, is to enhance an asset's real (inflation-adjusted) value. Investments are typically used to fund longer-term, less-certain spending needs, perhaps arising decades in the future. The long-term orientation of investing strategies implies that short-term fluctuations in value are less important than long-term growth. Stocks and bonds are appropriate vehicles for investing.

Match your goal and the time horizon

The point in time at which an investing strategy may be more appropriate than a savings strategy is not marked by a bright line. The first factor to consider is spending requirements. Investors' near-term liabilities are often more certain than their future liabilities. For example, it is frequently more difficult for investors to predict what their spending needs will be in ten years than what they will be in the next 12 months. As lack of certainty in spending needs increases, an investing strategy often becomes more critical to successfully meet the liability. The second factor to consider is asset allocation. Historical data suggest that the risk/return balance of both stocks and bonds becomes attractive over periods of three to five years. Over shorter time frames, the risk/return balance may be very unfavorable.

Figure 2. Range of returns of asset classes: Rolling periods, 1926 through 2005



Source: Vanguard Investment Counseling & Research.

Notes: Stocks represented by S&P 500 Index; bonds represented by Ibbotson Associates corporate bonds and U.S. Treasury data from 1926 through 1975, and Lehman Aggregate Bond Index from 1976 through 2005; cash represented by Citigroup 3-Month U.S. Treasury Bill Index.

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Figure 2a displays the one-year return of the Standard & Poor's 500 Index, a barometer of the U.S. stock market, from 1926 through 2005. Returns ranged as high as 54% and as low as -43%. Stocks have also produced a negative return in about one-third of all one-year observations. The relatively high potential for short-term loss, as well as the extreme unpredictability of near-term returns, explains why stocks are generally not recommended for short-term investment goals.

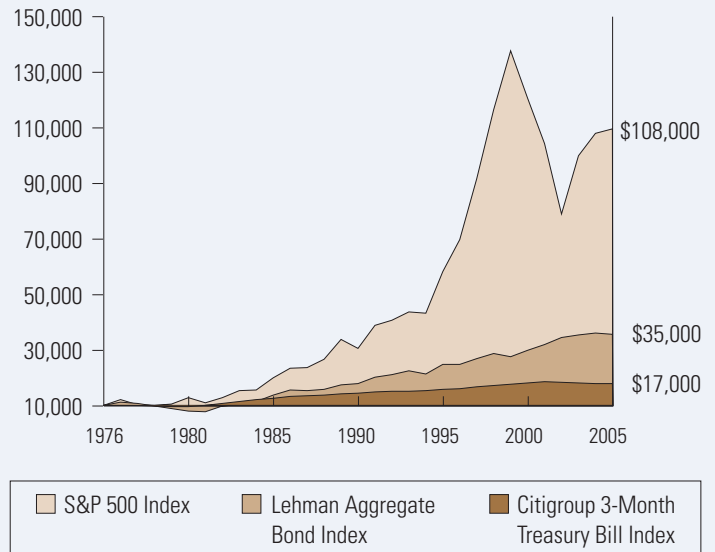
Over longer time horizons, the probability of loss for stocks and bonds diminishes, and the range of returns narrows (see Figure 2a and b), even as average returns remain high relative to savings assets such as U.S. Treasury bills. These patterns suggest that stocks and bonds are a good match for long-term financial goals.

Contrast the patterns of investment assets with those of U.S. Treasury bills (Figure 2c). From 1926 through 2005, the range of Treasury bill returns has been relatively narrow, and Treasury bills have never generated a negative return, making them suitable for short-term financing needs that require stability of principal.

Saving, investing, and opportunity cost

Why not simply minimize all possibility of loss and finance all goals, short- and long-term, through savings? Because the opportunity cost of investing in stable, but low-returning, assets such as Treasury bills can expose a portfolio to other, longer-term, risks, including the risk that an asset will fail to deliver the returns necessary to finance ambitious goals over the long term (or even, potentially, to maintain its purchasing power). The opportunity cost can ultimately manifest itself in one of two ways: an inability to meet a future spending need or the need to save more current cash flow for future spending goals.

Figure 3. Cumulative growth of real (inflation-adjusted) returns: 1976 through 2005



Source: Vanguard Investment Counseling & Research.

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Figure 3 depicts a dollars-and-cents example of the opportunity costs. The figure displays real returns from 1976 through December 2005 of U.S. Treasury bills, bonds, and stocks, as well as the growth of a hypothetical \$10,000 invested in each. One interpretation of this data is that over 30 years the opportunity cost of using a savings strategy (represented by U.S. Treasury bills) versus an investing strategy was \$18,000 compared with an all-bond portfolio (represented by the Lehman Brothers Aggregate Bond Index) and \$91,000 compared with an all-stock portfolio (represented by the S&P 500 Index).

Conclusion

Differentiating between short- and long-term financial goals is the crucial first step in building a framework for productive portfolio management.



Vanguard Investment
Counseling & Research

P.O. Box 2600
Valley Forge, PA 19482-2600

Connect with Vanguard™ > www.vanguard.com > 800-523-1036

Vanguard Investment Counseling & Research

Ellen Rinaldi, J.D., LL.M./Principal/Department Head

Joseph H. Davis, Ph.D./Principal

Francis M. Kinniry Jr., CFA/Principal

Daniel W. Wallick/Principal

Nelson W. Wicas, Ph.D./Principal

Frank J. Ambrosio, CFA

John Ameriks, Ph.D.

Donald G. Bennyhoff

Maria Bruno, CFP®

Scott J. Donaldson, CFA, CFP

Michael Hess

Julian Jackson

Colleen M. Jaconetti, CFP, CPA

Kushal Kshirsagar, Ph.D.

Christopher B. Philips

Glenn Sheay, CFA

Kimberly A. Stockton

Yesim Tokat, Ph.D.

David J. Walker, CFA

For more information about Vanguard funds, visit www.vanguard.com, or call 800-662-7447, to obtain a prospectus. Investment objectives, risks, charges, expenses, and other important information about a fund are contained in the prospectus; read and consider it carefully before investing.

An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of your investment at \$1 per share, it is possible to lose money by investing in such a fund.

Mutual funds are subject to risk. Investments in bond funds are subject to interest rate, credit, and inflation risk.

Bank deposit accounts and CDs are guaranteed (within limits) as to principal and interest by the Federal Deposit Insurance Corporation, which is an agency of the federal government.

Connect with Vanguard, Vanguard, and the ship logo are trademarks of The Vanguard Group, Inc. All other marks are the exclusive property of their respective owners.