

Fund Essentials®

index

investing



THE **Vanguard** GROUP®

Vanguard[®] index funds

A tradition of leadership



Contents

| | |
|---|----|
| What Is Indexing? | 2 |
| The Benefits of Indexing | 3 |
| What Are the Risks? | 9 |
| Why Vanguard Index Funds? | 10 |
| Vanguard Index Funds to Meet Your Needs | 11 |
| Key Fund Facts | 14 |

The power and appeal of indexing are undeniable. From its inauspicious debut in 1976, Vanguard 500 Index Fund, the first index fund for individual investors, has attracted **millions of investors** to become one of the largest mutual funds in the world. From the start, Vanguard has been a leader in indexing. Today, we offer more than 30 index funds spanning nearly every sector of the U.S. stock and bond markets, as well as stock markets around the world. This brochure shows you how you can put the **power of Vanguard index funds** to work in your portfolio.

What Is Indexing?

Indexing is an investment approach that seeks to track the performance of a specific stock or bond benchmark, or index.

Index funds do this by holding all (or a representative sample) of the securities in the index being tracked. This “passive” investment strategy emphasizes broad diversification,* low portfolio trading activity, and low costs. No attempt is made to use “active” management strategies or to make “bets” on individual securities.

*Diversification does not ensure a profit or protect against a loss in a declining market.

The Benefits of Indexing

If you're looking for a low-cost way to closely track the performance of particular market benchmarks, index funds may be appropriate for you.

Vanguard advocates using index funds as the “core” of your investment portfolio. For many investors, it may even be possible to construct a soundly balanced portfolio that uses only index funds. In any case, you may want to consider investing at least 50% of your portfolio assets in index funds, with the remainder in a carefully chosen mix of actively managed funds, depending on your investment objectives, time horizon, and risk tolerance. Here's a closer look at some of the benefits of indexing.

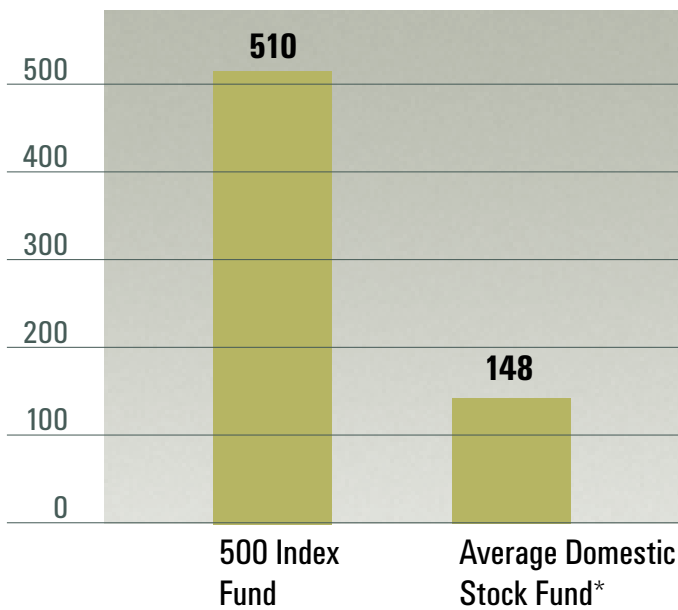
Diversification. When it comes to diversification, it's difficult for actively managed funds to compete with index funds, because index funds generally hold most or all of the securities in their target indexes. In contrast, an actively managed fund typically holds a much smaller selection of securities that the advisor believes are likely to outperform its index. Index funds may hold hundreds or even thousands of securities; actively managed funds typically hold far fewer than that. Although the diversification index funds offer cannot protect investors against broad market declines, it does reduce the risk posed by a dramatic decline in any one security or

economic sector. (Of course, some index funds offer exposure to a broader range of securities than other index funds due to the composition of their benchmarks.)

The chart below shows the magnitude of the difference in the number of securities held by Vanguard 500 Index Fund and comparable actively managed domestic stock funds.

Number of securities held

As of 3/31/2006



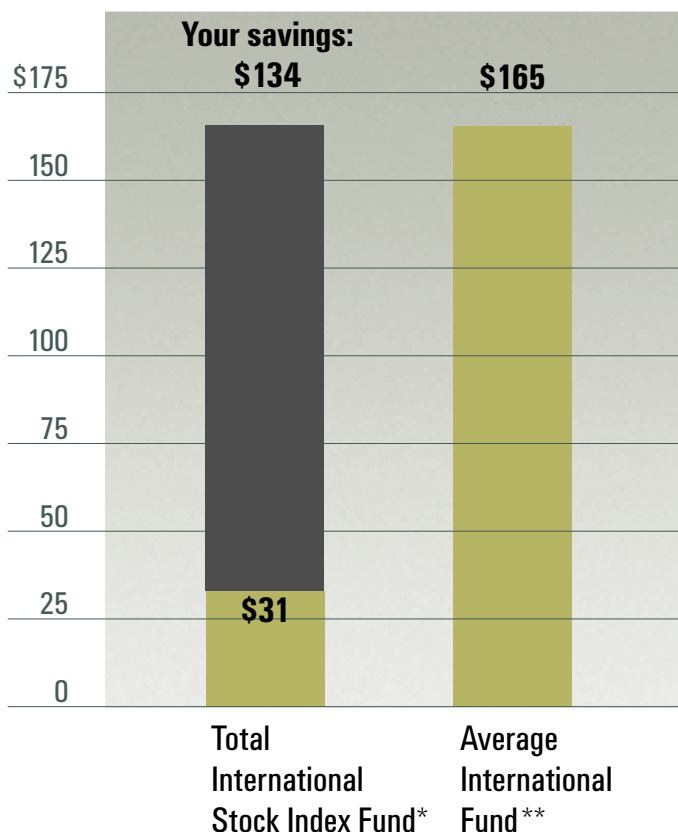
*Source: Morningstar.

Low costs. The expense ratios of index funds are typically much lower than those of their actively managed competitors. These low costs can provide a powerful long-term edge. Because index funds don't have to pay a fund advisor to analyze and select stocks, they can pass on a higher percentage of their investment returns to shareholders. Also, the buy-and-hold approach that index funds employ has historically led to much lower transaction costs and higher tax efficiency.

For example, as the chart below shows, the 0.31% expense ratio of Vanguard® Total International Stock Index Fund is less than *one-fifth* the 1.65% charged by the average international fund. That's a substantial difference that can affect your bottom line.

The cost advantage of index funds

Amount deducted annually from a \$10,000 investment



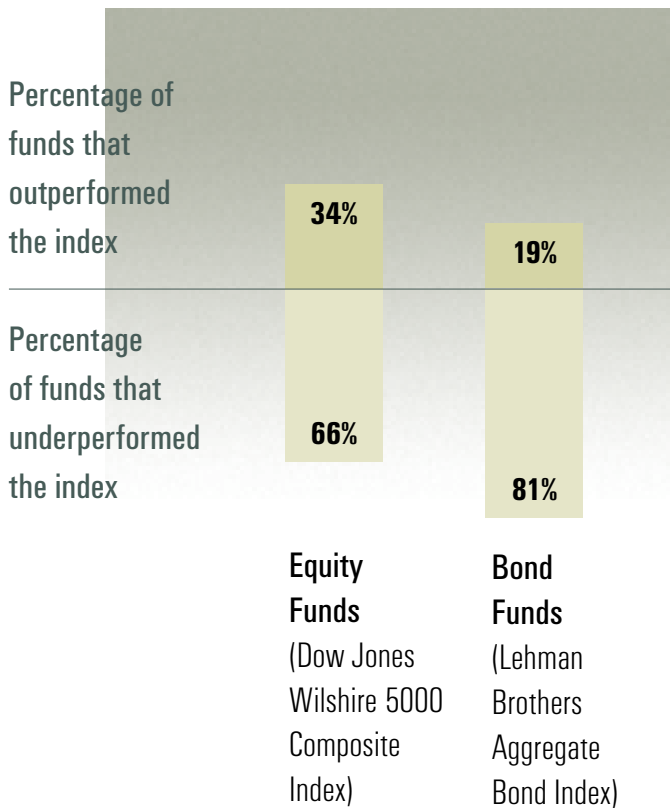
*Amount based on expenses incurred by three underlying funds, as of the fund's latest fiscal year.

**As of 12/31/2005.

History of competitive performance. Thanks to their broad diversification and low costs, index funds have proved to be an effective way to achieve competitive returns over the long run (although past performance is no guarantee of future returns). In fact, the low costs associated with indexing can provide a powerful long-term edge for both stock and bond investments, as indicated below. The chart below shows the percentage of stock and bond funds that outperformed and underperformed their respective broad-market indexes from 1986 through 2005.

Equity and bond fund performance versus their indexes

1986-2005



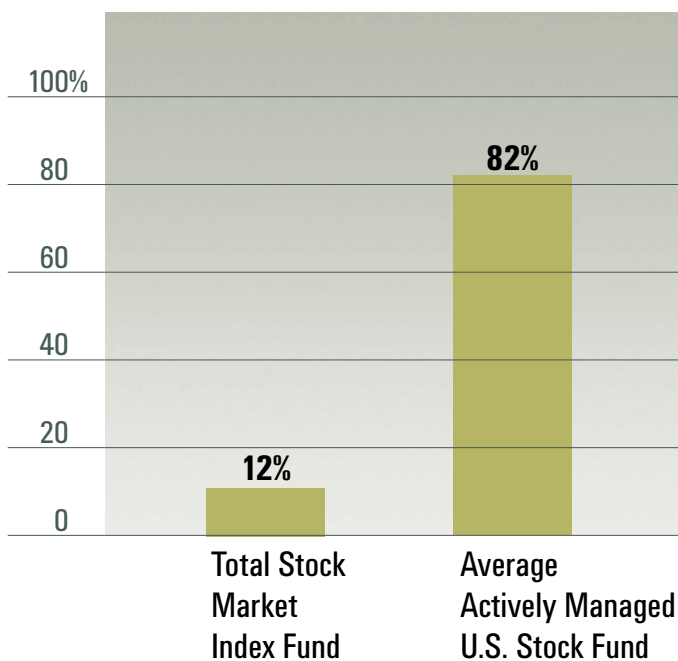
Simplicity. There's nothing complicated about how index funds are designed to operate. They have a precise, easily understood objective—to track the performance of a specific stock or bond market index whose composition is always known. With index funds, you'll always know how your money is being invested.

Relative consistency. Any investment—including an index fund—carries uncertainty. However, since index funds can be expected to closely follow the ups and downs of their respective indexes, they are more likely to provide returns consistent with those of their benchmarks than actively managed funds, whose returns are less predictable.

Tax advantages. Because index funds typically engage in much lower portfolio turnover than actively managed funds, most index funds tend to realize—and thus distribute—only modest capital gains to shareholders. This is particularly important for shareholders who hold index funds in taxable accounts. However, keep in mind that some index funds (such as small-capitalization index funds or index funds that focus on a narrow industry segment) may be less tax-efficient because the holdings of the indexes they track change more frequently. As a result, the funds may have to buy and sell securities more frequently and may possibly incur capital gains distributions.

The advantage of low turnover in index funds

Annual turnover rates, 2005



Actively managed mutual funds typically buy and sell securities frequently, which can ultimately lead to increased portfolio costs that are passed along to shareholders.

What Are the Risks?

As with any bond or stock fund investment, index funds carry risks. Here is a closer look at a few of the risks involved.

Prices can fall. Prices of bond, balanced, and stock index funds can decline for short or long periods due to investor pessimism, poor corporate profits, or other reasons, so it's possible to lose money if you sell shares when prices have fallen. If you're considering a small-cap or sector index fund, note that prices of small-company stocks or stocks in a single-sector fund often fluctuate more significantly than those of large-company stocks. And if you're interested in international funds, keep in mind that international stock funds may fluctuate more than U.S. funds because of currency and political volatility.

Investors lose the opportunity to outperform the market. Index funds attempt simply to track the performance of their respective benchmarks as closely as possible, not outperform them. So it isn't possible to beat the market by investing in index funds, but remember that relatively few actively managed funds have been able to outperform index funds over long periods of time.

Investments in bond funds are subject to interest rate, credit, and inflation risk. Stocks of companies in emerging markets are generally more risky than stocks of companies in developed countries.

Why Vanguard Index Funds?

Not all index funds are the same. There are several reasons why you should consider Vanguard if you're looking for index funds.

Indexing pioneer. Vanguard was the first fund company to offer index funds for individual investors. We have been in the indexing business since 1976 and, with more than \$425 billion in index fund assets (as of 3/31/2006), we are one of the world's largest managers of index funds for individual investors.

Largest selection of index funds. Since introducing Vanguard 500 Index Fund in 1976, we've grown to offer a roster of more than 30 low-cost stock, bond, and balanced index funds.

Experience and tracking ability. The thorough knowledge of indexing that our Quantitative Equity Group and Fixed Income Group have achieved over 30 years has enabled us to develop strategies and proprietary methods that are more likely to deliver consistent and reliable results. Our sophisticated portfolio management tools help us keep costs low and seek to ensure that our index funds track their indexes more closely over both short- and long-term time periods than competitive index funds.

Vanguard Index

Funds to Meet Your Needs

We're confident that Vanguard has one or more index funds to suit your investment objectives. The following pages describe some of the more than 30 Vanguard index funds you might consider for the core of your portfolio.



Total Stock Market Index Fund seeks to track the investment returns of the MSCI® US Broad Market Index, which includes virtually all regularly traded U.S. stocks. This fund offers a convenient way to match the performance of the entire domestic stock market.

500 Index Fund seeks to track the Standard & Poor's 500 Index, a widely used barometer of the performance of large-capitalization U.S. stocks. It enables investors to match the performance of a substantial portion of the largest domestic stocks.



Large-Cap Index Fund seeks to track the investment performance of the MSCI US Prime Market 750 Index, which represents some 85% of the total value of the U.S. stock market. This fund offers investors a convenient way to track the performance of a benchmark that includes a larger portion of the U.S. stock market than the S&P 500 Index.



Mid-Cap Index Fund seeks to track the investment results of the MSCI US Mid Cap 450 Index, which measures the performance of stocks of midsize companies. The fund is a convenient way to match the performance of companies that have market capitalizations of roughly \$1.8 to \$14 billion.



Small-Cap Index Fund seeks to track the investment performance of the MSCI US Small Cap 1750 Index, a barometer of the small-company segment of the stock market. It is ideal for investors who want to target U.S. companies that have an average market value of less than \$1.8 billion.

Total International Stock Index Fund seeks to track the Total International Composite Index, which measures the performance of nearly all markets outside the United States and Canada. This “fund of funds” invests in three Vanguard index funds—European Stock Index Fund, Pacific Stock Index Fund, and Emerging Markets Stock Index Fund—to gain broad exposure to stocks from 39 countries.



Developed Markets Index Fund seeks to track the MSCI Europe, Australasia, Far East (EAFE®) Index. This “fund of funds” invests in the European Stock Index Fund and Pacific Stock Index Fund to gain wide-ranging exposure to stocks from 21 countries.

Total Bond Market Index Fund seeks to track the Lehman Brothers Aggregate Bond Index, a mix of corporate, government, and mortgage-backed bonds that represents the total universe of domestic, publicly traded, investment-grade bonds that have maturities of more than one year. It is suitable for investors who want to participate in the U.S. bond market as a whole.



Balanced Index Fund invests 60% of its assets in stocks that seek to track the MSCI US Broad Market Index (which represents the entire U.S. stock market) and 40% in bonds that seek to track the Lehman Brothers Aggregate Bond Index. The fund offers broad diversification across the two asset classes.

Key

Fund Facts

| | Inception Date | Investment Focus |
|--|----------------|----------------------------|
| Total Stock Market Index Fund [†] | 4/27/1992 | Large-capitalization blend |
| 500 Index Fund [†] | 8/31/1976 | Large-capitalization blend |
| Large-Cap Index Fund [†] | 1/30/2004 | Large-capitalization blend |
| Mid-Cap Index Fund [†] | 5/21/1998 | Mid-capitalization blend |
| Small-Cap Index Fund [†] | 10/3/1960 | Small-capitalization blend |
| Total International Stock Index Fund | 4/29/1996 | International |
| Developed Markets Index Fund | 5/8/2000 | International |
| Total Bond Market Index Fund [†] | 12/11/1986 | Bonds |
| Balanced Index Fund [†] | 11/9/1992 | Balanced |

Note: The minimum initial investment for all account types is \$3,000 for each fund. Each fund assesses a \$10 annual maintenance fee for accounts having balances of less than \$10,000. This fee, which is paid directly to the respective fund, more fairly allocates the cost of administering these accounts.

*As of 3/31/2006.

**For the fund's latest fiscal year.

***As of 12/31/2005.

†Also offers Admiral™ Shares, a separate share class that offers lower expenses. The minimum initial investment for this share class is \$100,000.

††Consists of the MSCI EAFE Index plus the Select Emerging Markets Index. The Select Emerging Markets Index is administered exclusively for Vanguard by MSCI.

†††Average weighted expense ratio based on expenses incurred by the underlying funds.

Vanguard—A Smart Choice for Index Funds

In addition to the nine funds already described, to the right are several other Vanguard index funds. You can get more details about all of our funds by visiting our website at www.vanguard.com, calling us at **800-662-7447**, or returning the enclosed postage-paid reply card.



Once you've selected the funds that best meet your needs, you can open your account online using secure e-signature technology. Visit our website at www.vanguard.com to get started.

Other Vanguard Index Funds

In addition to the funds on pages 11 through 13, we offer several other stock and bond index funds, which are listed below. If you've decided that index funds may be right for you, Vanguard is the place to come, with the broadest offering of index funds.

Stock Funds (domestic)

Dividend Appreciation Index Fund
Extended Market Index Fund
FTSE Social Index Fund
Growth Index Fund
REIT Index Fund
Small-Cap Growth Index Fund
Small-Cap Value Index Fund
Value Index Fund

Sector Index Funds

(Note: These funds offer Admiral Shares only.)

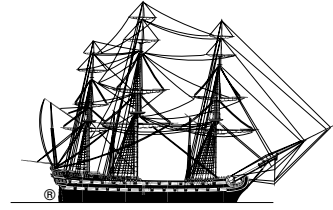
Consumer Discretionary Index Fund
Consumer Staples Index Fund
Energy Index Fund
Financials Index Fund
Health Care Index Fund
Industrials Index Fund
Information Technology Index Fund
Materials Index Fund
Telecommunication Services Index Fund
Utilities Index Fund

Stock Funds (international)

Emerging Markets Stock Index Fund
European Stock Index Fund
Pacific Stock Index Fund

Bond Funds

Intermediate-Term Bond Index Fund
Long-Term Bond Index Fund
Short-Term Bond Index Fund



THE **Vanguard** GROUP®

Post Office Box 2600
Valley Forge, PA 19482-2600

Admiral, Fund Essentials, The Vanguard Group, Vanguard, and the ship logo are trademarks of The Vanguard Group, Inc. *S&P 500®* and *Standard & Poor's 500* are trademarks of The McGraw-Hill Companies, Inc., and have been licensed for use by The Vanguard Group, Inc. Vanguard mutual funds are not sponsored, endorsed, sold, or promoted by Standard & Poor's, and Standard & Poor's makes no representation regarding the advisability of investing in the funds. *FTSE®* and *FTSE4Good™* are trademarks jointly owned by the London Stock Exchange plc and The Financial Times Limited and are used by FTSE International Limited under license. The FTSE4Good US Select Index is calculated by FTSE International

Limited. FTSE International Limited does not sponsor, endorse, or promote the fund; is not in any way connected to it; and does not accept any liability in relation to its issue, operation, and trading.

The funds or securities referred to herein that are offered by The Vanguard Group and track an MSCI index are not sponsored, endorsed, or promoted by MSCI, and MSCI bears no liability with respect to any such funds or securities. For such funds or securities, the prospectus or the Statement of Additional Information contains a more detailed description of the limited relationship MSCI has with The Vanguard Group. All other marks are the exclusive property of their respective owners.

World Wide Web

www.vanguard.com

Toll-Free Information

800-662-7447

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.

