

# Bear Markets

A historical perspective on market downturns

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## Bear Markets

**D**uring the 1990s, the stock market provided investors with a generous average annual return of 18.2%, far outpacing the long-term historical average of 11.0%.\* By the end of the 1990s, the market had not suffered a severe or prolonged period of falling prices in quite some time.

That period of good fortune changed in 2000. The overall U.S. stock market\*\* fell 10.9% in 2000, and some segments of the market fell even more. The Nasdaq Composite, for instance, fell 38.7% during 2000—including a plunge of nearly 50% from its peak in March to the end of the year. The downturn continued into 2001. On March 12, the Standard & Poor's 500 Index closed more than 20% lower than its peak in March 2000.

On Wall Street, a major downturn (such as the one that began in 2000) is known as a “bear market.” Bear markets, which occur in both stocks and bonds, can be trying for even the most seasoned investor. The U.S. stock market, for example, declined a stunning 48% over a nearly two-year period in the early 1970s.

Since no one can predict the timing or magnitude of future market movements, when the 2000–2001 bear market will end is a mystery. Hopefully, you were prepared for the inevitable downturn and positioned to ride it out. This brochure provides some perspective on past bear markets and offers some guidelines on preparing an investment program for a bear market.

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\*Based on Standard & Poor's 500 Index since 1926.

\*\*Based on Wilshire 5000 Total Market Index.

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## BEAR MARKETS DEFINED

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What is a bear market? One generally accepted definition of a bear market in stocks is a price decline of 20% or more over at least a two-month period. By comparison, a “market correction” is usually defined as a sudden, sharp decline in stock prices that lasts only a few days or weeks. A prime example of a market correction occurred in October 1997 when the Standard & Poor’s 500 Index, a widely accepted benchmark of the broad stock market, lost about 10% of its value in a one-week period.

Since 1956, ten downturns are generally regarded to have been bear markets, with declines of 20% or more, as measured by the S&P 500 Index (see Figure 1 on page 2). Thus, bear markets have occurred an average of once every five years. The average duration of the nine bear markets prior to the current one was about one year—with the shortest lasting three months and the longest lasting nearly two years.

Bear markets also strike bonds. The most recent bear market in bonds started in December 1998 and continued into January 2000, when surging interest rates sent bond prices (as measured by the 10-year U.S. Treasury bond) tumbling 14.6%. Bond prices and interest rates are inversely related: As interest rates rise, bond prices fall, and vice versa. Many factors affect interest rates, including Federal Reserve policy, inflation rates, economic growth, and—importantly—investors’ expectations regarding these factors and others. Figure 2 on page 3 shows the periods in which bond market prices have risen or fallen since 1967. As you can see, price fluctuations in the bond market can be every bit as frightening as those in the stock market.

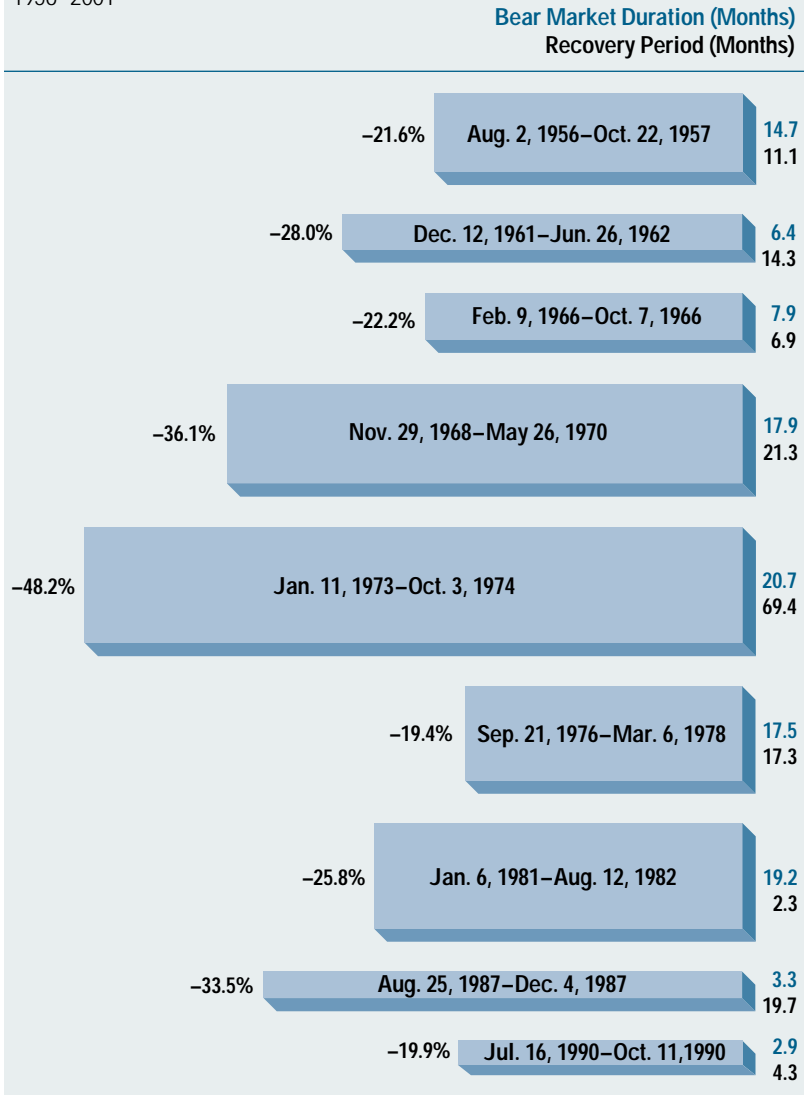
### Market downturns and mutual funds

The diversification offered by stock and bond mutual funds greatly reduces the risk that problems with an individual security will seriously damage the value of your investment. Investing in

Figure 1

## Bear Markets: Stocks

1956–2001



A bear market started in March 2000, beginning with declines in the technology sector, but it didn't become "official" until the S&P 500 fell more than 20% from its peak. That mark was passed on March 12, 2001, when the S&P 500 closed 22.3% down from its all-time high.

The height of each bar illustrates the length of time each downturn lasted. The width of each bar shows the amount the stock market dropped. Past performance does not guarantee future returns.

Source: Standard & Poor's Corporation.

Figure 2

### Market Cycles in Bonds

March 31, 1967–January 31, 2000

<b>Bear Market Duration</b>	<b>Length (in months)</b>	<b>Percent Price Decline (10-year constant maturity)</b>
March 1967–May 1970	38	-23.0%
March 1971–September 1975	54	-18.2
December 1976–March 1980	39	-32.7
June 1980–September 1981	15	-27.9
May 1983–June 1984	13	-17.1
January 1987–October 1987	9	-15.5
October 1993–November 1994	13	-17.9
December 1998–January 2000	13	-14.6
<b>Bull Market Duration</b>	<b>Length (in months)</b>	<b>Percent Price Increase (10-year constant maturity)</b>
May 1970–March 1971	10	16.7%
September 1975–December 1976	15	11.2
March 1980–June 1980	3	18.7
September 1981–May 1983	20	30.3
June 1984–January 1987	31	45.9
October 1987–October 1993	72	32.2
November 1994–December 1998	49	26.3
February 2000–December 2000	11	11.2

Source: Vanguard Fixed Income Group.

mutual funds, however, does not eliminate the volatility associated with investing in financial markets. Shares of mutual funds can be expected to rise and fall along with the markets in which they invest.

The extent to which the value of a stock fund investment will decline during a market downturn is largely determined by its investment objectives and policies. For example, an aggressive growth fund that is fully invested in stocks is likely to suffer a greater decline in price than a more conservative stock fund that has 10% of its assets invested in short-term securities. Figure 3 offers a glimpse of how different types of stock funds and stock market indexes fared during 2000.

Figure 3

**Total Return Performance**

February 29, 2000–December 31, 2000

Stock Market Benchmarks		Stock Funds	
Dow Jones Industrial Average	7.97%	Large-cap	-6.26%
S&P 500 Index	-2.45	Multi-cap	-1.64
Russell 2000	-15.41	Small-cap	-2.44
Wilshire 4500	-26.23	Mid-cap	-5.08
Wilshire 5000	-9.07	General equity	-2.82
Nasdaq Composite	-46.96	Science & Technology	-46.21

Source: Lipper Inc.

In the case of fixed income funds, bond portfolios with longer maturities typically fluctuate more than those with shorter maturities when interest rates change. Figure 4 shows how different types of bond funds and bond market indexes performed during the December 1998 through January 2000 bear market in bonds. While the overall market was down during the period shown, the Dow Jones Industrial Average was up almost 8%. For all of 2000, however, that average lost almost 4.7%.

Figure 4

**Total Return Performance**

December 1998–January 2000

Bond Market Benchmarks	
Lehman Brothers 1–5 Year Government/Credit Index	1.89%
Lehman Brothers 5–10 Year Government/Credit Index	-2.61
Lehman Brothers Long Government/Credit Index	-6.02
Bond Funds	
Short-term investment-grade debt	2.87%
Intermediate-term investment-grade debt	-1.03
Corporate debt A-rated (long-term)	-2.13
Short-term government	2.67
Intermediate-term government	-1.50
General government (long-term)	-2.70

Source: Lipper Inc.

## PREDICTING BEAR MARKETS

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What causes a bear market? It's difficult—perhaps even impossible—to foresee what will cause a market to plunge. And it's just as hard to predict how investors will react to an initial decline in stock or bond prices and how those reactions will affect the markets. Some investors may view a price drop as an opportunity to “buy on the dip,” while others may see the same decline as the start of a deeper downturn.

Hindsight, however, can reveal some of the causes of past bear markets. Iraq's invasion of Kuwait touched off the 1990 bear market in U.S. stocks. The Persian Gulf crisis led to higher oil prices, renewed fears of inflation, and a rise in interest rates—all of which helped to drive stock prices down. A combination of economic and political factors also accompanied the 1973–1974 stock market collapse. At the time, the United States was mired in “stagflation,” an unusual mixture of slow or stagnant economic growth and high inflation. The Arab oil embargo had pushed energy prices sharply higher, and the downturn was exacerbated by the political upheavals associated with the Watergate scandal and the winding down of the country's involvement in the Vietnam War.

The stock market, however, does not always mirror the state of the economy. The downturn in 1987 occurred during a period of economic prosperity, although a sharp rise in interest rates certainly contributed to the crash of stock prices. Conversely, the bull market of the 1990s started in the midst of a recession.

Nonetheless, the relative strength of the stock market is tied to the general health of the economy as well as to political forces. When the economic or political outlook is bright, investors tend to be optimistic about the prospects for corporate profits and are more willing to invest in stocks. When conditions are expected to sour, investors often stop buying stocks and may even sell

their shares. So the sentiment of investors also exerts tremendous influence on the direction of the stock and bond markets—both up and down. Figure 5 shows some of the positive and negative factors that influence investments in stocks.

The bond market is largely driven by the same factors as stocks. But some developments that are viewed positively by stock investors—such as rising corporate profits and strong economic growth—may be viewed negatively by bond investors who are worried about a possible rise in inflation. Higher inflation may result in an increase in interest rates, which will tend to drive down bond prices. Because stock and bond prices often (but not always) move in opposite directions, there's good reason to diversify your investments by holding both types of securities.

Whatever causes bear markets, you should view them as a regular part of investing. Moreover, the uncertainty surrounding the timing, severity, and duration of market drops provides all the more reason to prepare—in advance—to ride out any declines.

Figure 5

### **Influences on Stock Investments**

#### **Positive Factors**

- An “easy” money policy imposed by the Federal Reserve.
- A low or declining rate of inflation.
- Low or declining interest rates.
- Rising corporate profits.
- Political stability.
- High employment.

#### **Negative Factors**

- A “tight” money policy imposed by the Federal Reserve.
- A high or increasing rate of inflation.
- High or rising interest rates.
- Declining or stagnant corporate profits.
- Political instability or international conflict.
- High unemployment.

## PAST BEAR MARKETS IN PERSPECTIVE

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The worst bear market in stock market history occurred from September 1929 through July 1932, when stock prices fell 86%. Rampant speculation, investments made with borrowed money, and sheer panic ushered in a cataclysm in the financial markets that accompanied the Great Depression. While regulatory changes make the recurrence of such a dramatic decline unlikely, investors should keep in mind that anything is possible in the financial markets.

Since World War II, the worst bear market began in January 1973 and lasted until October 1974—when the market plunged 48% (as measured by the S&P 500 Index). In dollar terms, an investor who had \$10,000 invested in stocks lost \$4,800—nearly half the value of the portfolio. In addition, because inflation jumped significantly at the same time, the loss in terms of purchasing power was even worse.

Holding a balanced portfolio of stocks, bonds, and cash investments can cushion the decline of any one market. A portfolio of stocks and bonds fared much better during the 1973–1974 bear market, as an investor holding 60% in stocks and 40% in bonds lost “only” \$2,900. This example demonstrates the benefits of allocating investments across asset classes—a topic we’ll explore in greater detail in the next section.

The heartening news for long-term investors is that in the past, the market has eventually recovered from its declines. However, in most cases it took some time. For example, the market took nearly eight years to recover to its precollapse peak after the 1973–1974 bear market.

Unfortunately, one of the more common mistakes made by investors during bear markets is to lose patience and sell at or near the bottom of the downturn. Many investors did just that in the 1973–1974 market decline. Those who got out of stocks missed an extraordinary rebound in stock market performance. After declining to its low in October 1974, the market (as measured by the S&P 500 Index) provided generous returns in the ensuing periods. Indeed, annual returns averaged 14.8% over the 10 years from 1975–1984, 16.6% over 15 years from 1975–1989, 14.6% over 20 years from 1975–1994, and 16.1% over 25 years from 1975–2000.

Along with maintaining patience in the midst of bear markets, investors would be wise to guard against being fooled by false rallies. A bear market is not typically characterized by a “straight line” decline in stock prices. Rather, the market’s downward trend is likely to show intermittent bursts of stock price increases, which some investors mistakenly take as the return of a bull market. The 1973–1974 bear market in stocks was replete with these so-called sucker’s rallies.

Finally, it is important to note that the bulk of major market movements—both up and down—often occur over brief periods. Over the past 73 years, the S&P 500 Index has dropped more than 7% in a single day on 14 different occasions, with the biggest one-day fall coming on October 19, 1987, when the S&P 500 Index closed down 20%. When stocks recover, it is common for the gains to be concentrated in a few days or weeks of extraordinary activity. Consequently, trying to time the markets by temporarily abandoning stocks requires a perfectly executed exit from the market, as well as an equally deft return—a nearly impossible feat. Be wary of self-proclaimed market seers promoting claims to the contrary.

## WERE YOU PREPARED FOR THE BEAR MARKET?

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Prudent investors were already prepared for the 2000–2001 bear market—holding a balanced portfolio that reflects their investment goal, investment time horizon, risk tolerance, and financial condition. We recommend that you take the time now to review these four factors to ensure that your current asset allocation—or mix of stocks, bonds, and cash investments—suits your personal needs.


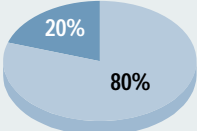
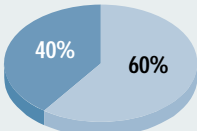
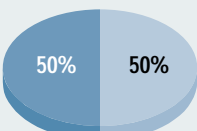
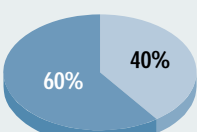
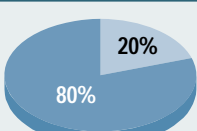
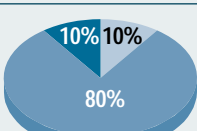
- ***Your goal.*** This is simply a purchase or series of expenditures you want to make at some time in the future. For instance, one goal might be to make a down payment on a house, while another might be to ensure financial security in retirement.
- ***Your time horizon.*** This is the number of years you have to invest before reaching your goal, including the period during which you are spending your investment. The time horizon for making a down payment on a house might be 2 or 3 years, while the time horizon for retirement might be 40 years, including your years in retirement.
- ***Your risk tolerance.*** This is the ability to endure the inevitable fluctuations that come with investing. Knowing that you have many years to reach a goal may make you more comfortable with investments, such as stocks, that are likely to provide higher long-term returns but also have higher risks. Keep in mind that you can't avoid all investment risks. And if you select only very stable investments, you run the risk of losing purchasing power to inflation.
- ***Your financial condition.*** This is the stability of your job and the state of your personal finances. A person with a steady job and well-established investment programs can afford to take on more investment risk than someone with an unstable job and few assets.

To help guide you, Vanguard has developed seven model portfolios with varying asset allocations (see Figure 6). To give you a sense of each portfolio's risk level, this chart shows the average annual returns since 1926 for each portfolio, the loss of each portfolio during the 1973–1974 bear market, and the loss each portfolio would have suffered in 1931 (the worst year during the period, with one portfolio exception in 1969). Also shown for each portfolio is the average loss in “down” years over the full period and the number of years with a loss.

These model portfolios may serve as a starting point for your asset allocation decision; your actual investment program should reflect your own personal needs. We also suggest a separate cash investment, such as a savings or money market account, for financial emergencies and short-term goals. For more information on personal portfolio planning, please refer to another brochure in the Plain Talk Library, *The Vanguard Investment Planner*.

Figure 6

**Model Portfolios: 1926–2000**

Your Asset Allocation	Average Annual Return	Number of Years With a Loss	Average Loss	Two-Year Loss in 1973–1974	Worst Annual Loss (1931)
	11.0%	21 of 75	-12.3%	-37.1%	-43.1%
	10.3%	20 of 75	-9.6%	-31.2%	-34.9%
	9.3%	18 of 75	-7.3%	-25.0%	-26.6%
	8.8%	16 of 75	-7.0%	-21.8%	-22.5%
	8.2%	16 of 75	-5.2%	-18.5%	-18.4%
	7.0%	13 of 75	-3.7%	-11.8%	-10.1%
	6.2%	10 of 75	-3.2%	-6.4%	-6.7%*

■ Stocks (S&P 500 Index) 
 ■ Bonds (Long-Term U.S. Corp.) 
 ■ Cash Investments (U.S. T-bills)

\*Worst annual loss, 1969.

Source: The Vanguard Group.

## BEAR MARKETS: TWO HYPOTHETICAL CASE STUDIES

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Simply put, a severe bear market has the potential to damage even a seemingly well-crafted investment program. The danger looms even larger for investors near or in retirement. Suppose an individual invested consistently and prudently for more than 30 years, amassing a sizable nest egg for retirement. But once in retirement, this investor's portfolio could easily be ravaged by a sharp market downturn, and the wealth that took decades to accumulate could be wiped out in a matter of days or weeks.

Such circumstances could have a profound impact on the retiree's future standard of living. What's more, the retiree does not have the luxury of time to enable his or her portfolio to adequately recover, nor the income from employment to help meet expenses and rebuild the portfolio.

On the other hand, younger individuals saving for retirement have time on their side and can afford to ride out market declines. Moreover, younger investors may ultimately benefit from market drops since they can then buy securities or fund shares at lower prices that eventually rise over time.

We've created hypothetical case studies to help demonstrate the impact of a bear market on two investors in different stages of the investment life cycle. Note that these case studies, which are oversimplified for illustration purposes, are intended to illuminate the risks of market declines and offer a "reality check" for investors.

## Stay on course

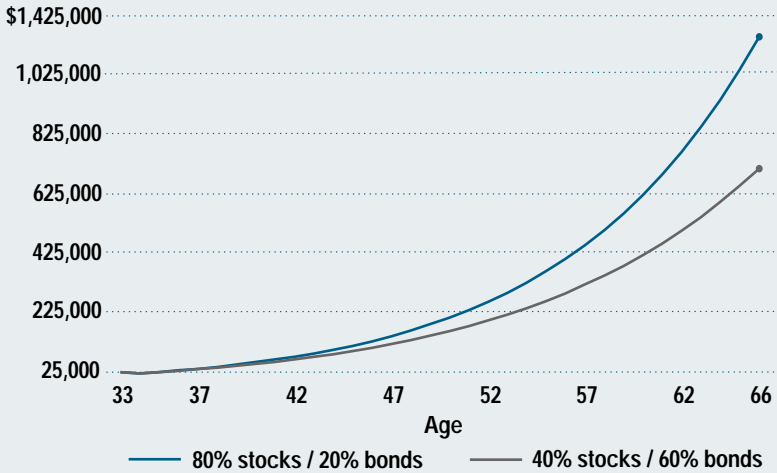
Allison is 30 years old with a promising career as a graphics designer. She is earning \$42,600 a year and receives regular raises of about 4% a year. With \$14,700 in her retirement portfolio, Allison hopes to amass enough assets to retire at age 62 when she can begin collecting some Social Security benefits. To reach this goal, she sets aside 5% of her salary each year in retirement accounts and invests 80% of her assets in stocks and 20% of her assets in bonds—an allocation that has provided average long-term annual returns of almost 10% a year after expenses.

Allison, however, is not accustomed to market declines since she has not experienced one in her brief career as an investor. When she is age 34, the stock market is rocked by a 29% decline, which wipes out more than \$7,500 of the value of her stock investments. Her total retirement portfolio drops from almost \$30,000 to a little more than \$25,000. Stung by her losses, she sells some of her stock holdings and buys bonds to create a more conservative portfolio: 40% stocks and 60% bonds. That allocation has provided long-term average annual returns of 7.8%.

Allison's decision to change her investment direction is a costly one. As shown in the hypothetical examples in Figure 7 on page 14, the change in her asset allocation costs her more than half a million dollars by the time she reaches age 66. Instead of accumulating \$1.34 million, she has only \$827,000.

Figure 7

### One-Year Bear Market: -29%



This represents the value of Allison's retirement portfolio in tax-deferred accounts at the end of each year from age 33 on. The chart shows how she would have fared if she had kept her allocation of 80% stocks and 20% bonds as well as how she would have fared after changing to an allocation of 40% stocks and 60% bonds at age 35. The information shown is hypothetical and does not represent the returns from any particular investment.

This hypothetical example illustrates the merits of staying on course. Once you've decided on a long-term asset allocation, it's best to stick with it. If you feel you must change your mix of assets, make only small changes and make them gradually. What's more, recent changes in the markets—whether up or down—should not dictate your investment mix. Letting emotional reactions to recent gains or losses guide your investment decisions can lead you to a disastrous cycle of buying high and selling low.

### Make conservative assumptions

Stan is a recent retiree who has \$300,000 invested in tax-deferred retirement accounts—half in stock funds and half in bond funds. He figures that his stock funds will return about 10% or 11% a year

and his bond funds will yield 6% or so a year, so Stan believes his portfolio is healthy when he needs to withdraw \$18,000 (6% of his savings) in his first year of retirement.

Unfortunately, inflation starts rising and the stock market is devastated by a horrible bear market, plunging almost 40% in two years. The \$18,000 needed in Stan's first year of retirement becomes \$19,500 in the second year because of inflation—and it continues to climb after that. Even when the market begins to recover, Stan is withdrawing far more than 6% a year. In just over a dozen years, Stan runs completely out of money, as shown in Figure 8. With only Social Security to rely on, Stan is forced to sell his home and move in with his daughter's family to make ends meet.

Figure 8



This represents the value of Stan's \$300,000 retirement portfolio in tax-deferred accounts at the end of each year. The initial withdrawal is \$18,000 (6% of portfolio); subsequent withdrawals are adjusted for inflation. Assets are split 50–50 between stocks and bonds. The information shown is hypothetical and does not represent the returns from any particular investment.

The point of this example is that retirees and people who are about to retire need to make conservative assumptions in planning their personal finances. Stan's assumptions about how his mutual funds would perform were not unreasonable given the long-term average returns of stocks (11%) and bonds (5.6%),\* but he failed to recognize that short-term returns can be quite different from averages.

In planning for retirement, investors can increase their odds of surviving a bear market by making conservative assumptions about their finances. This means planning on stocks and bonds earning less than their historic averages, and counting on inflation running higher than its long-term average (3.1%). Vanguard recommends that newly retired investors withdraw no more than 4% of their assets in a year to meet expenses.

Stan, of course, could have fared better if he'd taken action to offset the bear market's impact. He could have slashed expenses earlier or returned to work to help rebuild his savings.

### Riding out a bear market

You can actually make a bear market—or any market downturn—work to your long-term benefit by using the strategy of dollar-cost averaging. Dollar-cost averaging means that you invest a fixed amount in your mutual fund at regular intervals, regardless of whether the market is up or down. This disciplined approach helps you to buy shares when they're cheapest (at the bottom of a bear market).

By dollar-cost averaging, you'll get more shares for your money when the price is low and fewer shares when the price is high. As a result, the average price you pay per share is always lower than the average market price during the time you are investing. The hypothetical example on the next page shows how dollar-cost averaging might work for you during a temporary market drop.

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\*Source: The Vanguard Group.

Monthly Investment	Share Price	Shares Acquired
\$ 400	\$ 10	40
\$ 400	\$ 8	50
\$ 400	\$ 5	80
\$ 400	\$ 8	50
\$ 400	\$ 10	40
<b>\$2,000 (total)</b>	<b>\$7.69 (average)</b>	<b>260 (total)</b>

In this example, you would have paid \$7.69 a share\*—less than the average market price during this period of \$8.20 a share. ( $\$10 + \$8 + \$5 + \$8 + \$10 = \$41$ ;  $\$41$  divided by 5 months =  $\$8.20$ .) The value of your \$2,000 investment would be \$2,600 at the end of the period, compared with \$2,000 if you'd invested the entire \$2,000 at the start of the period.

Of course, dollar-cost averaging isn't a magic formula for investment success. If the share price hadn't recovered, you might have lost money on your investment. And if you'd invested the entire \$2,000 when the share price was \$5, your investment would have been worth much more (\$4,000) at the end of the period. Some investors might have lost their nerve when the share price fell to \$5 and stopped investing—missing out on the best time to invest during the period.

Even so, dollar-cost averaging does have certain benefits regardless of market conditions. Many people find this systematic, disciplined approach to investing is a convenient way to build a significant investment portfolio—even if they don't have a large sum to invest at one time. Because the amounts you invest remain constant, you can easily budget for them.

Before you begin dollar-cost averaging, you should ask yourself whether or not you'd have the stomach to keep investing if market prices plunge. You should also remind yourself that investing always involves taking risks, and you can lose money no matter how you go about buying shares.

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\*Your average share cost:  $\$2,000 \div 260 \text{ shares} = \$7.69$ .

## BEAR MARKET SURVIVAL TIPS

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Bear markets are undoubtedly trying times for investors, so we've assembled the following guidelines to help you manage your investments during a market downturn.

- ***Maintain your balance.*** Hold a mix of stocks, bonds, and cash investments tailored to your objectives, time horizon, tolerance for risk, and overall financial situation. Cash investments provide stability as well as liquidity for financial emergencies, while bonds offer steady income and can help dampen the swings in stock prices. Stocks have historically provided the highest long-term returns and the best long-term protection against inflation at the cost of greater price volatility. Periodically revisit your investment portfolio and make adjustments as necessary to keep your mix of assets in line with your goals.
- ***Continue investing regularly.*** If you invest regularly through an automatic investment plan or a 401(k) plan, continue making contributions.
- ***Keep an even keel.*** It's human nature, at the first sign of trouble, to become nervous and want to revise your investment mix. Indeed, market downswings can cause even the heartiest of investors to have second thoughts. It pays, however, to remain focused on the long term. Take solace in the wise words of Abraham Lincoln: "This, too, shall pass away." While Mr. Lincoln wasn't talking about the financial markets, his observation is nonetheless telling. The markets run in irregular cycles in which good and bad markets come and go. Remember, too, that you're most likely investing to achieve a long-term goal, not to avoid a short-term loss.

- ***Make gradual shifts (if necessary).*** Resist the temptation to fundamentally alter your investment strategy simply because one component of your program heads south. Most experts will tell you that moving your money from stocks and bonds to more conservative investments in hopes of avoiding a loss or finding a gain is seldom successful. Note, too, that while investment vehicles such as bank deposit accounts and certificates of deposit (CDs) safeguard you against day-to-day fluctuations, they do little to preserve the spending power of your assets over time.\* If you are anxious about the proportion of your program invested in stocks, consider gradually and modestly reducing your stock holdings in small increments.
- ***Consider the tax consequences of selling.*** Many investors swore off stocks after the 1973–1974 debacle—selling out their entire equity holdings. Not only did these investors miss out on the market’s eventual rally, but they most likely incurred a tax liability in doing so. While it should not be your sole consideration, evaluate the tax consequences of your investment decisions. Given the tremendous advance in stock and bond prices in the 1990s, you may realize a significant capital gain when you sell or exchange shares of a fund at a higher price than you purchased them. Capital gains realized on shares held one year or less (that is, short-term capital gains) are taxed at the same rate as ordinary income—from 15% to 39.6%. Capital gains realized on shares held for more than one year (that is, long-term capital gains) are subject to taxes at lower rates—no more than 20%. Abandoning your stock or bond position in response to a market downturn could result in a nasty tax surprise.

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\*Bank deposit accounts and CDs are guaranteed (within limits) as to principal and interest by an agency of the federal government.

- ***Set realistic expectations*** Each of the three major financial asset classes provided handsome average annual returns in the past 10 years—17.5% for stocks, 9.0% for bonds, and 4.9% for cash investments.\* The past two years (1999 and 2000), however, were a somewhat different story. Bonds lost 6.5% in 1999, but rebounded to return 12.7% in 2000. Stocks surged 21.0% in 1999, but limped to a loss of 9.1% in 2000.\*\* Some investors were probably surprised by the recent market setbacks, but hopefully now have more down-to-earth expectations.

Vanguard prepared this brochure to raise a cautionary flag to mutual fund investors—not to predict anything about the markets. It is only sensible to periodically assess the risk and reward aspects of your investment program to make sure they are compatible with your investment objectives and tolerance for investment losses. The markets may or may not be in for more rough sailing in the immediate future, but a prudent investor is always prepared.

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\*Stocks are represented by the S&P 500 Index, bonds by long-term U.S. corporate bonds, and cash investments by U.S. Treasury bills.

\*\*Source: The Vanguard Group.

## HOW VANGUARD CAN HELP

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For information about Vanguard® funds and services, to learn more about investing, or to open an account online, visit our website at [www.vanguard.com](http://www.vanguard.com). There you'll find our complete Plain Talk® Library, Retirement Center, and our popular Education Center. Register for immediate secure access to our online investment-management center, and you can monitor your accounts, conduct transactions, trade securities, and invest in both Vanguard and non-Vanguard funds—24 hours a day.

Or you can speak with a Vanguard associate by calling us at **1-800-662-7447** on business days from 8 a.m. to 10 p.m. and on Saturdays from 9 a.m. to 4 p.m., Eastern time. Our associates are always pleased to answer your questions or provide information about our funds and services.

Vanguard also invites you to take advantage of the broad selection of programs and services we offer that can teach you more about investing and help you stay on track toward reaching your financial goals.

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At an affordable fee, this service offers customized one-time analysis and advice on investment, retirement, and estate planning.

**Vanguard® Asset Management and Trust Services** 1-800-567-5163  
Individuals who have a minimum of \$500,000 in investable assets can receive comprehensive, ongoing wealth management services at a very reasonable fee.

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Through Vanguard Brokerage, you can invest in individual stocks, bonds, options, and more than 2,600 non-Vanguard mutual funds. You can open an account and trade on our website as well.

Our experienced retirement specialists can provide a wealth of information to help you plan or manage your retirement investments.

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1-800-337-8476

Vanguard offers special services for clients with substantial assets.

- **Voyager Service**®, for clients investing more than \$250,000 in Vanguard mutual funds, offers the expert assistance of a special service team.
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Eligible clients are invited to call Vanguard for more information.

The Dow Jones Industrial Average follows the combined price movements of 30 blue chip U.S. stocks. These stocks primarily represent industrial companies but also include some service-oriented firms.

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The S&P 500 Index consists of stocks of the 500 largest publicly traded U.S. companies. The Index encompasses approximately 70% of the total value of the U.S. stock market.

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The Wilshire 4500 Equity Index, which consists of all U.S. stocks not included in the S&P 500 Index, is a barometer of small- and medium-size companies. The Wilshire 5000 Equity Index tracks all regularly traded U.S. stocks and consequently includes stocks in the Wilshire 4500 as well as those in the S&P 500 Index.

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## Invest with a leader

The Vanguard Group traces its roots to the opening of its first mutual fund, Wellington™ Fund, in 1929. The nation's oldest balanced fund, Wellington Fund emphasized conservatism and diversification in an era of rampant market speculation. Despite its creation just before the worst years in U.S. financial history, Wellington Fund prospered and within a generation was one of the largest mutual funds in the nation.

The Vanguard Group was launched in 1975 solely to serve the Vanguard mutual funds and their shareholders. From its start as a single fund in an infant industry, Vanguard has become one of the largest investment management firms in the world. Today, some \$550 billion is invested with us in more than 100 investment portfolios. And some 11,000 crew members now serve millions of shareholders who have entrusted their investment assets—indeed, their financial future—to a company that they believe offers the best combination of investment performance, service, and value in the industry.



**THE Vanguard GROUP.**

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Vanguard funds and non-Vanguard funds offered through our FundAccess<sup>®</sup> program are offered by prospectus only. Prospectuses contain more complete information on risks, advisory fees, distribution charges, and other expenses and should be read carefully before you invest or send money. Prospectuses for Vanguard funds can be obtained directly from The Vanguard Group; prospectuses for non-Vanguard funds offered through FundAccess can be obtained from Vanguard Brokerage Services<sup>®</sup>, 1-800-992-8327.

**World Wide Web**

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