

In The Vanguard®

WINTER 2002

Investing Your Money

Rebalance To Keep Plan On Track And Temper Risk

Few investors would dispute that maintaining an appropriate balance of stocks, bonds, and short-term investments makes good financial sense.

Yet, many investors have trouble doing just that. Investors tend to ride their winners and ditch their losers, and inadvertently wind up with portfolios that are unbalanced and far riskier than they intended. Buy-and-hold investors who don't rebalance their portfolios often get into the same predicament.

Rebalancing a portfolio simply means adjusting your investments to match your target mix. For example, if you originally decided to split your investments evenly

between stocks and bonds, you'll need to make periodic adjustments or the assets' differing returns will throw your mix off kilter. Rebalancing sounds simple enough, but having the discipline to actually do it is another matter.

"It goes against human nature," said Francis Kinniry, a principal in Vanguard's Investment Counseling and Research Group. "You're telling people to sell shares from their best-performing asset class and put them into their worst-performing asset class. It's the opposite of chasing returns."

But the importance of periodic rebalancing can't be ignored, as this article emphasizes. We also offer guidance on when and how to rebalance.

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A Momentous Year For Indexing

Although 2001 was a difficult year for stocks, it was a momentous year for Vanguard and the index approach. Vanguard offered its first exchange-traded class of shares—Vanguard® Total Stock Market VIPERS™—and two of our largest index funds celebrated milestones: Vanguard® 500 Index Fund marked its 25th anniversary and Vanguard® Total Bond Market Index Fund reached 15 years. To obtain insight about the year from a leading figure in index management, *In The Vanguard* interviewed Gus Sauter, managing director of Vanguard's Quantitative Equity Group, which oversees \$205 billion invested in 33 index funds tracking 19 different benchmarks.

How would you summarize the performance of indexing in 2001?

It was a "good news/bad news" type of year. The bad news: The broad stock market recorded its second consecutive down year. The good news is that, on a relative basis, indexing held up quite well. During 2001, the average general equity fund posted a loss of -10.9%, compared with a -11.0% decline for the Wilshire 5000 Index. According to Lipper data, the Wilshire 5000 outpaced 55% of general equity funds for the year.

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Vanguard Prospectuses Now Feature After-Tax Returns

Vanguard has begun adding after-tax performance figures to the prospectuses of our equity and balanced mutual funds—well ahead of the Securities and Exchange Commission-mandated deadline of February 15, 2002, for such disclosure. Vanguard has voluntarily published after-tax returns in fund annual reports since 1999 and has been posting such information on Vanguard.com™ for the past 18 months. •

New PlainTalk® Program Available

If you or someone in your family is just starting out in investing, you may be interested in our new PlainTalk guided investment program, *Get a Financial Start*. The 16-page guide discusses how to develop a financial plan, prioritize objectives, and invest for a future goal. Please call one of our associates for a copy. •

Vanguard Fixed Income Group Turns 20

Vanguard Fixed Income Group, the mutual fund industry's largest manager of fixed income portfolios, recently celebrated its 20th anniversary. At the time of its inception in October 1981, the group provided advisory services to six funds with aggregate assets of \$1.7 billion. Today, under the continuing leadership of Managing Director Ian A. MacKinnon, the group of 79 investment professionals oversees \$200 billion in assets invested in 46 bond and money market funds. •

Fund News

New VIPER™ Shares Trading

Vanguard® Extended Market VIPERs™ (Vanguard Index Participation Equity Receipts), which are exchange-traded shares issued by Vanguard® Extended Market Index Fund, are now trading on the American Stock Exchange under the symbol VXF. Unlike Vanguard's conventional index fund shares, VIPER Shares are bought and sold through a broker (such as Vanguard Brokerage Services®) at any time during the trading day. Extended Market VIPERs are the second in a planned series of low-cost, exchange-traded offerings by Vanguard. Our first such offering, Vanguard® Total Stock Market VIPERs, began trading on the AMEX last May under the symbol VTI. •

Vanguard Expands Value Fund Offerings

A new value-oriented fund has joined Vanguard's stable of 20 actively managed stock funds. Vanguard® Capital Value Fund seeks to provide maximum long-term total return by investing in a combination of small-, mid-, and large-capitalization stocks that the adviser deems undervalued or out-of-favor. Wellington Management Company, LLP, serves as the fund's investment adviser. •

Past performance cannot be used to predict future returns. The investment return and principal value of an investment will fluctuate, so an investor's shares, when redeemed, may be worth more or less than their original cost.

The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Vanguard funds and non-Vanguard funds available through our FundAccess® program are offered only by prospectus, a document that contains more complete information on risks, advisory fees, distribution charges, and other expenses. Prospectuses for Vanguard funds can be obtained directly from The Vanguard Group by calling 1-800-662-7447; prospectuses for non-Vanguard funds offered through FundAccess can be obtained from Vanguard Brokerage Services by calling 1-800-992-8327. Vanguard® VIPER™ Shares are available through registered broker-dealers, who have copies of the shares' prospectuses and product descriptions, which should be read carefully before you invest or send money.

External Advisers Bring Diversity Of Thought To Vanguard Investors

Many investors apply the golden rule of diversification by spreading investments across the three primary asset classes: stocks, bonds, and cash. This is only the first layer of the onion, however. A second layer is to diversify within asset classes, selecting a mix of large-, mid-, and small-capitalization stocks. Another layer: You can diversify by style, purchasing growth and value stocks. A fourth layer is to choose an index fund or an actively managed fund. Finally, within actively managed funds, you can diversify among investment management approaches.

Vanguard is well recognized for offering investors a wide variety of both actively and passively managed funds. Equally important, though, are the widely varying underlying investment strategies and portfolio characteristics of our actively managed funds—even among those with similar investment styles.

This is accomplished largely by hiring external advisers to manage 33 of our actively managed funds. In fact, external advisers manage approximately one-third of Vanguard's assets.

A World Of Talent

Vanguard's external advisers are selected for the wealth of experience, distinct investment

approaches, and independent research processes they bring to portfolio management. Our approach allows us to hire recognized boutique firms specializing in a specific investment style, as well as large firms with broad research capabilities. Vanguard's Portfolio Review Group, a specialized team of analysts who oversee our external advisers, has cultivated relationships with investment advisory firms all over the world, from Pasadena to Boston and from London to Bombay.

"We cherish the idea that we have this independence of thought," said Jeffrey Molitor, principal of the Portfolio Review Group. "Our funds' distinctiveness stems from the diverse backgrounds of our external advisers, which means that exposure to similar bets across funds is unlikely."

In contrast, the internal analysts at many fund companies are paid to identify the best securities and to promote their ideas throughout their organizations. This can foster a culture of "group think," where investment ideas—however good—are utilized by many managers of different funds within the same family. The result is often considerable similarity in top holdings and investment themes, as shown by the analysis presented in the chart below. •

This chart compares the top holdings of four of Vanguard's large-capitalization value funds with the holdings of four similar funds from a competing fund company. On the left are the ten largest holdings of the fund family's flagship large-cap value fund, and those of three of its large-cap value siblings. Five of the fund's top ten holdings are duplicated across all of the large-cap value offerings. On the right is Vanguard's large-cap value fund lineup. Note the absence of any "across the board" duplication and the low overall similarity of holdings.

Common Portfolios Versus Diversity Of Thought

Competitor's Funds

Largest Value Fund	Value Fund A	Value Fund B	Value Fund C
ExxonMobil	•	•	•
Citigroup	•	•	•
IBM			
Merck			•
Philip Morris	•	•	•
Johnson & Johnson	•		•
SBC Communications	•	•	•
Royal Dutch Petroleum	•	•	•
Bristol-Myers Squibb			
Verizon Communications	•		

Vanguard Funds

Vanguard® Windsor™ II Fund	Equity Income Fund	U.S. Value Fund
Philip Morris		•
Citigroup	•	
Energy		
Bank of America		•
J.P. Morgan Chase & Co.		
Allstate		
American Electric Power		
Sears, Roebuck		
Occidental Petroleum		
Verizon Communications		•

Source: Morningstar, Inc.

Notes: Data are as of October 31, 2001. Top-ten holdings for all Vanguard funds as a percentage of total net assets can be found on Vanguard.com.

Rebalance To Keep Plan On Track And Temper Risk (continued from page 1)

Why Rebalance?

You decided on your current asset-allocation plan for a reason. (If you don't have a plan, develop one. See Vanguard.com for tips on determining an asset allocation appropriate for your investment goals, time horizon, and risk tolerance.) An important part of that reason was to limit some of the risks that accompany investing. Changes in market returns, such as the recent 40% decline in the broad U.S. stock market between March 2000 and this past September, can bring unwelcome changes in your portfolio's risk characteristics. That's where rebalancing can help.

"The primary purpose of rebalancing is to manage risk, not to maximize returns," said Mr. Kinniry.

As the chart on page 5 shows, a portfolio evenly divided between stocks and bonds that was rebalanced every six months would have generated an average annualized return of 9.4% over four decades—only marginally lower than the 9.6% return of the same initial portfolio that was never rebalanced. However, rebalancing substantially lowers your risk. Over 12-month rolling periods, the rebalanced portfolio had returns of -5% or lower about 6% of the time, compared with more than 10% of the time for the other portfolio.

Over some periods, rebalancing *can* add value to your returns, Mr. Kinniry said. From the end of 1996 through October 2001, a portfolio of half stocks/half bonds that was rebalanced semiannually had a total cumulative return of 38.6%, about 3 percentage points higher than the same initial portfolio that was never rebalanced. Just as important, over the 12 months following March 2000, the rebalanced portfolio declined -6.0%, or about one-third less than the -9.6% decline of the never-rebalanced portfolio.

Rebalancing takes on even more importance as you get older. If historical trends hold true and

you don't rebalance, stocks can become a disproportionate portion of your portfolio. "You're taking on more equity risk as you age, just when you may want to lower risk," Mr. Kinniry said.

Your current asset mix may be even farther off target if you are making stock-heavy contributions to a company-sponsored retirement plan, said Bruce J. Berno, a Certified Financial Planner with Berno Financial Management in Cincinnati.

"Some investors mistakenly believe that because their contributions to a 401(k), for example, stayed 70% into stocks and 30% into bonds, then their portfolio mix also remained the same," Mr. Berno said.

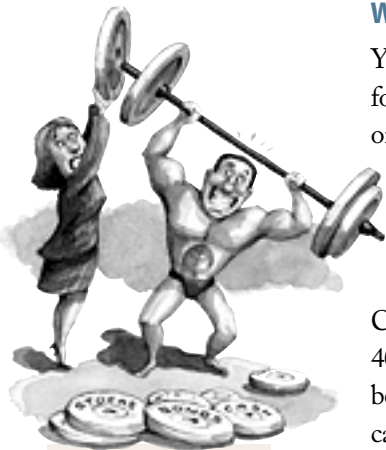
So what's the best strategy for rebalancing?

The "When" Of Rebalancing

The when and how of rebalancing depend on your situation, such as the size and tax sensitivity of your portfolio. But a few rules of thumb apply to everyone.

For simplicity's sake, both Messrs. Kinniry and Berno suggest rebalancing on a regular schedule—quarterly, semiannually, or annually. This approach helps to ensure that external events, short market swings, or emotions of the moment won't sway your decisions, Mr. Kinniry said. Rebalancing once a year on an anniversary date is adequate for most people. And, even then, rebalance only if your asset mix has strayed from its target by more than 5 percentage points, both experts said. Anything less is probably not worth the bother of rebalancing, and may unnecessarily increase your tax burden.

Some investors go to great lengths to fine-tune their portfolios—for example, acquiring specific percentages of market segments, such as between U.S. and international stocks, growth and value stocks, large-cap and small-cap issues, or bonds in varying types and maturities. But Mr. Kinniry urged investors to do this rebalancing of market



Portfolio rebalancing doesn't require heavy lifting. Simply review your portfolio periodically and make adjustments as needed to keep you in balance.

segments only within the greater context of asset classes. In other words, worry about the “micro” issues only after you’ve taken care of the “macro” issues, he said.

The “How” Of Rebalancing

When figuring out your allocation mix, take both taxable and nontaxable accounts into consideration. Generally, try to rebalance within your nontaxable accounts, such as an IRA or 401(k), so you don’t incur any tax burdens.

It’s possible that you will have to rebalance your taxable accounts to get your overall mix on target. Here, rebalancing calls for a slightly different strategy. Because of potential tax consequences—and because it’s psychologically easier to not have to sell “winners”—you may use cash flow to rebalance whenever feasible, rather than exchanging shares between asset classes. In other words, put new cash into the asset class that has fallen in value, or redirect dividend and capital gains distributions—which are taxed anyway—from the asset class that has performed well to the one that has fallen below your target mix.

Cash flow, of course, can also go the other way. A retiree living off savings might, for example, sell individual stocks or shares of stock funds if that asset class has exceeded his or her target allocation. Some investors have the mind-set that only bonds can be used for income, said Mr. Kinniry; yet selling stocks could generate that needed income with potentially lower taxes.

In certain cases, cash flow alone won’t do the job, said Mr. Berno. If you have the fortunate problem of a large portfolio, redirecting cash flow may not be enough to move the overall asset mix. In such instances, bite the bullet, exchange shares to rebalance, and live with the tax consequences.

Mr. Kinniry said that tax consequences should be considered in your rebalancing decisions, but that you should “never allow your taxes to drive your goals.”

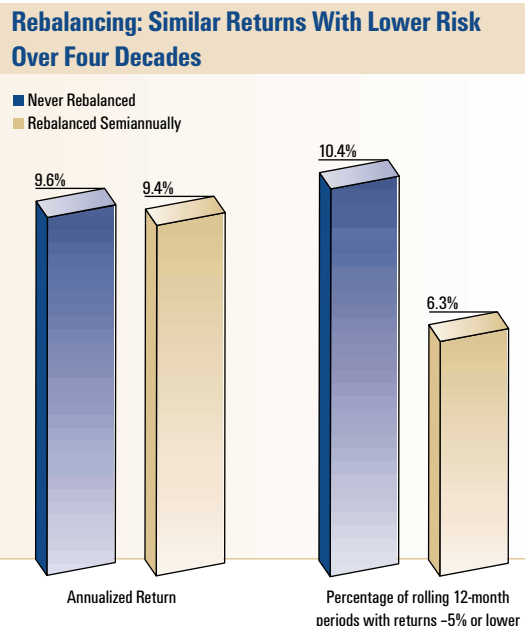
Many people who were overly concerned about taxes held on to large amounts of stock acquired from their employers, only to see its value plummet during the recent market meltdown.

It’s Common Sense

Despite the straightforward nature of rebalancing, Mr. Berno concedes that it’s a hard sell. “It’s hard for people to go back into international stocks now, for instance. Back in 1998–1999, it was tough to get them out of technology funds because they were really going up. They wanted to wait ‘til it got higher.’”

In the end, Messrs. Berno and Kinniry stress, rebalancing is nothing more than investing common sense: Buy low and sell high. •

Note: Data cover January 1960–October 2001. This hypothetical example assumes a portfolio evenly split between stocks and bonds at the start of 1960, with dividends reinvested. Stocks were represented by the S&P 500 Index (1960–1970) and the Wilshire 5000 Index (1971–2001); bonds were represented by the S&P High Grade Corporate Index (1960–1968), the Salomon High Grade Index (1969–1972), the Lehman Government/Credit Index (1973–1975), and the Lehman Aggregate Bond Index (1976–2001).



A Momentous Year For Indexing (continued from page 1)



Gus Sauter

The S&P 500 Index fared even better in 2001 on a relative basis, outperforming 72% of actively managed large-capitalization funds. The index returned -11.9%, nearly five percentage points better than the average large-cap fund, which returned -16.7%. [Source: Lipper Inc.] But I would caution investors about evaluating any investment based on such a short period.

Beyond the good relative performance of broad market index funds, is there a silver lining to an otherwise cloudy year?

There is a silver lining from a tax-efficiency standpoint. Our index team has incurred net losses on the sale of securities in many of our funds. The result is that most of our index funds did not distribute capital gains in 2001. In fact, only three funds distributed capital gains and the amounts were quite modest.

Our flagship index funds—Vanguard® Total Stock Market Index Fund and Vanguard® 500 Index Fund—did not have year-end capital gains distributions, so their shareholders will not have any capital gains taxes to pay. In fact, the 500 Index Fund is marking its second consecutive year free of capital gains distributions. I cannot, of course, give assurances about distributions in future years, but the fund's distributions in past years have been fairly small.

The realized losses that most of the funds incurred can also be carried forward to offset

gains in future years. This can help a fund's tax efficiency by reducing (or eliminating) taxable capital gains distributions in future years.

Has the turn in the market's performance over the past year resulted in cash outflows for index funds?

Actually, the opposite is true. About three out of every five dollars invested in stock funds in 2001 found its way to an index product, according to data from Strategic Insight. Index funds in aggregate represent only about 12% of stock fund assets, so to attract nearly 60% of stock fund cash flow is really quite remarkable. I think this trend offers further evidence that indexing is still gaining converts and that those converts are embracing the broad market index concept. Many investors, perhaps, have realized how risky it can be to hold a few individual stocks or concentrated funds.

You've been encouraging investors to consider the Wilshire 5000 as their core stock holding. Why?

The Wilshire 5000 tracks the entire U.S. stock market of about 6,600 stocks and gives investors exposure to large-, mid-, and small-cap stocks. We don't believe investors—either individuals or institutions—can consistently pick the market segment that will outperform. Therefore, we think most investors are best served by investing in the entire market.

How did indexing fare in different market segments?

Quite well. We look at the performance of index funds relative to active peer funds by using the Morningstar stock fund matrix. This nine-box matrix categorizes stock funds based on market capitalization and style. In seven of the nine boxes, the relevant benchmark outperformed the comparable actively managed fund over the one-year period ended November 30, 2001.

Indexing's relative outperformance over one year is consistent with the longer-term trend. Over the five-year period ended November 30, 2001, the benchmarks prevail in all but two of the nine boxes. (Note: The online version of this story on **Vanguard.com** will feature updated figures for periods ended December 31, 2001.) •

Performance By Style And Size: 12 Months Ended November 30, 2001

	Value	Blend	Growth
Large	-2.51%	-13.20%	-23.87%
	-8.56%	-12.22%	-16.63%
	20%	59%	80%
Medium	9.87%	-2.46%	-19.34%
	11.10%	1.74%	-6.97%
	61%	70%	81%
Small	20.95%	12.02%	-6.91%
	20.38%	12.08%	1.52%
	49%	53%	73%

Fund average
 Index
 Percentage of active funds outperformed by index

Source: Morningstar, Inc.

Market Barometer: Fourth-Quarter 2001

The Investment Environment

- In the United States, the economic recession that began in March 2001 continued during the fourth quarter as a slump in spending by businesses and a slowdown in manufacturing dragged on.
- Optimism that the U.S. economy may recover in 2002 fueled a surge in the stock market and a decline in bond prices during the final three months of 2001.

S&P 500 Price/Earnings Ratio



Last Observation: December 2001. Shaded areas indicate recessions.
Sources: Standard & Poor's Corporation; Crandall, Pierce & Company.

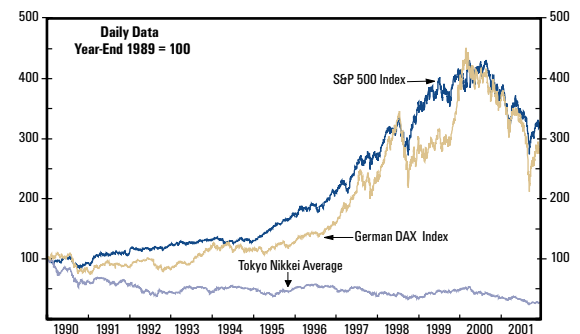
U.S. Stocks

- The U.S. stock market rallied during the fourth quarter—the S&P 500 Index gained 10.7%—but stocks posted their second consecutive down year for the first time since 1973–1974.
- The all-market Wilshire 5000 Index returned 12.4% during the quarter and –11.0% for the year.
- Despite the general decline in stock prices during the year, valuations were still at relatively high levels at the end of 2001. (See the price/earnings ratio chart at left.)

Global Equity Markets

- International markets—though reeling from the impact of recessions in the United States and in many other nations—showed signs of life in the fourth quarter.
- The MSCI® Europe, Australasia, Far East (EAFE®) Index, a measure of developed international stock markets, returned a solid 6.2% in U.S. dollars during the period. However, for all of 2001, the index returned –22.0%.
- The U.S. dollar strengthened versus most major currencies—including the euro and the yen—during the quarter, diminishing the returns for U.S. investors.

Global Market Indexes



Last Observations: December 31, 2001. Sources: Standard & Poor's Corporation; Dow Jones and Company; Crandall, Pierce & Company.

U.S. Treasury Issue Yields

Maturity	Dec. 29, 2000	Sept. 28, 2001	Dec. 31, 2001	2001 Change (percentage points)
3 Months	5.89%	2.37%	1.72%	-4.17
2 Years	5.10	2.85	3.02	-2.07
5 Years	4.97	3.80	4.30	-0.67
10 Years	5.11	4.59	5.05	-0.06
30 Years	5.46	5.42	5.47	0.01

Source: The Vanguard Group.

Bonds

- The Federal Reserve Board continued its attempt to revive the economy by reducing interest rates. The Fed cut short-term rates three times during the fourth quarter, by a total of 1.25 percentage points.
- As signs of economic strength emerged late in 2001, bond prices declined. The U.S. bond market, as measured by the Lehman Aggregate Bond Index, eked out a tiny gain for the quarter, but returned 8.4% for the year.

Market Risk Isn't The *Real* Risk

In the tumultuous final months of 2001, some investors lost their appetite for stocks. From September to November, investors withdrew a net \$14 billion from wildly fluctuating stock funds and piled into lower-risk assets, according to the Investment Company Institute, an industry association.

Taking steps to reduce risk might seem sensible, if not for this unhappy paradox: A less-risky portfolio could jeopardize your long-term financial health.

"People think of risk as their ability to withstand short-term volatility, but the real risk is not being able to meet the financial goals you're saving for," said Jack Brod, principal of Vanguard Asset Management and Trust Services.

Shortfall Risk

The likelihood that you won't meet your goals is known as "shortfall risk." It's based on a number of factors, which *don't* include the daily ups and downs of the stock market. Shortfall risk depends on your saving and spending patterns, future rates of inflation, your life expectancy, your estate plans, your asset allocation, long-term returns in the stock and bond markets, and your investment costs.

Most investors need a significant stake in stocks to help them meet their long-term goals. In the past, stocks have been subject to the biggest short-term losses, but they have also given investors the best chance of meeting their future spending needs. There are no guarantees, of course, but Vanguard expects this pattern to persist over the long haul.

Safer Assets, Higher Risk

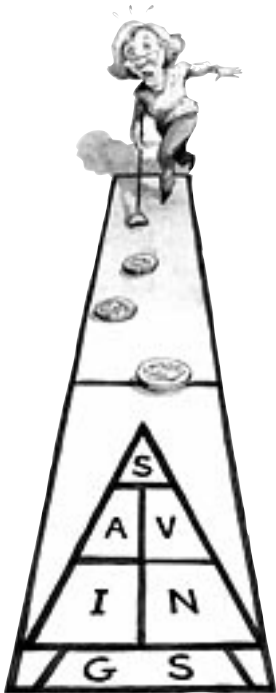
Vanguard analysts examined the shortfall risk for hypothetical investors with a \$1 million portfolio using three distinct asset allocations: (1) 100% bonds; (2) 50% stocks/50% bonds; and (3) 100% stocks. The analysis assumed an investment time horizon of 40 years, and spending of \$40,000

per year, with annual adjustments for inflation. The simulations used actual investment returns (see the footnote that accompanies the table on page 9 for more details) and inflation rates from 1960 to the present, and then placed them in every conceivable pattern to "stress-test" investment plans for worst-case scenarios.

The chart below shows the change in value of an all-bond portfolio using three different patterns of return—the worst case, the best case, and the average case, which is simply an average of all the possible paths from 1960 through 2000.

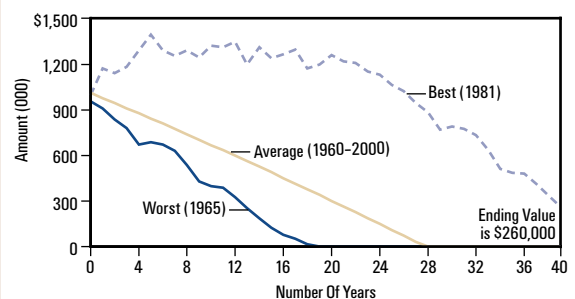
In the worst case, the portfolio experiences the pattern of returns provided by the bond market from 1965 onward—a period marked by bouts of high inflation and poor bond returns. The portfolio's assets are depleted in only 19 years, leaving the investor with a 40-year horizon in a tight spot. In the best case, returns mirror those generated by bonds starting in 1981, when bond yields were extremely high. At the end of a simulated 40 years, this portfolio would still be worth about \$260,000.

Although the all-bond portfolio faced the lowest risk of short-term loss, on average, it carried the highest level of shortfall risk: The investor met his goals only 12% of the time. By contrast, a portfolio split evenly between stocks and bonds sustained greater short-term losses, but the investor had enough money to finance his goals 56% of the time. An all-stock portfolio carried the least shortfall risk, meeting the investor's



Falling short of your savings goals is a risk that faces many investors. Supercharging your savings and limiting your spending is a good way to mitigate shortfall risk.

Three Possible Paths For A 100% Bond Portfolio



Source: The Vanguard Group.

In this table—and in the table on page 8—stocks are represented by the S&P 500 Index from 1960 through 1970 and by the Wilshire 5000 Index thereafter. Bonds are represented by a combination of the Lehman Brothers Long-Term Corporate Index (70%) and the Salomon Smith Barney T-Bill Index (30%) from 1960 through 1972 and by the Lehman Government/Credit Index thereafter. Inflation is represented by the Consumer Price Index.

Three Portfolios In Three Return Environments

Asset Allocation (Stocks/Bonds)	Ending Value In Worst-Case Scenario	Ending Value In Best-Case Scenario	Ending Value In Average-Case Scenario	Success Rate
0%/100%	Depleted in 19 years	\$259,835	Depleted in 28 years	12%
50%/50%	Depleted in 21 years	\$1,713,617	\$385,727	56%
100%/0%	Depleted in 21 years	\$6,432,885	\$2,538,698	68%

Source: The Vanguard Group.

needs 68% of the time. The trouble is, few investors have the emotional fortitude to withstand the gyrations of an all-stock portfolio. Also, despite our expectations, stocks may not offer the best returns in the future. The bottom line: Balance and diversification must be the cornerstones of any long-term plan.

The table above summarizes the values of the three portfolios in the worst, best, and average cases. It also displays each portfolio's ending values after 40 years, along with the rate of success in helping the investor meet his goal.

Control What You Can

Rather than fiddle with your long-term asset allocation in response to market volatility, you should consider the other factors that determine your shortfall risk. "You can't control market risk, but you can control your spending and saving," said Mr. Brod.

Again, consider the \$1 million portfolio split between stocks and bonds. The investor could significantly improve the odds of meeting her goals by reducing her spending. If she cut spending to \$35,000 per year (a figure that would go up each year to account for inflation), she'd meet her goals 85% of the time, up from 56% at a \$40,000 spending rate. And if she cut spending to just \$30,000, the chances of success reach 100%.

Low costs also help. We assumed that the \$1 million investor paid an annual fee of 0.40% of assets. But if that fee were 1.40%, a level more typical of the mutual fund industry, a \$1 million portfolio split between stocks and bonds would be depleted, on average, two years before the lower-cost portfolio.

Keep Your Goal In Sight

In Peter Bernstein's book on risk, *Against the Gods*, investment manager Robert Jeffrey explains that "volatility per se . . . is simply a benign statistical probability factor that tells us nothing about risk. . . . The real risk in holding a portfolio is that it might not provide its owner . . . with the cash he requires to make essential outlays."

Amid the stock market's zigs and zags, there's a powerful tendency to ignore Mr. Jeffrey's insight. But if you can forget the market's daily gyrations and focus on your long-term plan, you stand a better chance of making decisions that will get you where you want to go.

Vanguard Can Help

Vanguard can offer a customized assessment of your shortfall risk. For a one-time fee, Personal Financial Planning creates an investment plan that will help you meet your goals. For a modest asset-based fee, Asset Management and Trust Services provides ongoing investment management and advice to investors with assets of at least \$500,000.

For more information, visit us on the web at **Vanguard.com**. Or call us at 1-800-205-6099. •

Making Your Nest Egg Last

- Invest in a combination of stocks for long-term growth and bonds for stability and income.
- Have realistic expectations for financial market returns.
- Save aggressively, spend conservatively.
- Keep your investment costs low.

Easy Ways To Invest

- Open an IRA—or any mutual fund account—electronically, using our e-signature option on **Vanguard.com™**.
- Choose our Automatic Investment Plan to transfer money from your bank account to your Vanguard accounts on a regular schedule.
- Use our RMD Service to calculate your withdrawals and to have the money transferred to another Vanguard fund.

To Reduce Tax-Time Stress, Know Tax Deadlines And Forms

The year 2001 may have come to an end, but that doesn't mean you can put it behind you just yet. Over the next several months, you'll need to keep an eye on your calendar and your mailbox to make sure you're aware of the deadlines and retirement-related tax forms that may affect you.

Here's a review of several important dates in 2002, along with information about tax forms that you will receive from Vanguard and some that you'll need to file on your own.

January 31: Your employer must mail to you IRS Form W-2, which summarizes earnings and income taxes you paid, by the end of January. For information on tax forms for your nonretirement accounts, see page 14.

April 1: If you turned 70½ during 2001, April 1, 2002, is the deadline for taking your first mandatory withdrawal—known as a required minimum distribution, or RMD—from your retirement plans. [These plans include traditional IRAs, as well as SIMPLE and SEP-IRAs, 401(k)

and 403(b) plans, and Keoghs. Roth IRAs are exempt from RMDs during the account owner's lifetime.] Also, if you delayed your first withdrawal until 2002, you must make a second withdrawal by the end of 2002. In subsequent years, you must take your RMD by December 31.

April 15: This is the day by which you must file your 2001 federal tax return, but it is also the deadline for making a traditional or Roth IRA contribution for 2001. Here's an idea: Make a contribution of \$5,000 before April 15 and designate \$2,000 as your 2001 contribution and \$3,000 (the new higher maximum) for 2002.

Two other reasons to circle April 15 on your calendar: It's generally the deadline for removing "excess contributions" to an IRA in order to avoid a penalty, and it's generally the last day that investors may "recharacterize" tax-year 2001 contributions to a traditional or Roth IRA, or conversions made in 2001 from a traditional, SIMPLE, or SEP-IRA to a Roth IRA. (In both cases, the deadline is later if you receive a filing extension.) For recharacterization requests, it's important to contact Vanguard at least a week before April 15. •

Retirement Tax Forms

Form	Title	Purpose	How To Use
1099-R	<i>Distributions from Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc.</i>	To report distributions from IRAs and other retirement plans; shows recharacterized amounts distributed from an IRA; sent to investors by Vanguard in January.	A copy of this form is furnished to the IRS. On your Form 1040, report IRA distributions on lines 15a and 15b. If the 1099-R shows federal income tax withheld, attach a copy to your 1040.
4972	<i>Tax on Lump-Sum Distributions</i>	To calculate special tax treatment on lump-sum distributions from qualified retirement plans.	If your distribution qualifies for special tax treatment, use this form to determine the tax and attach it to Form 1040.
5329	<i>Additional Taxes on Qualified Plans and Other Tax Favored Accounts</i>	To report penalty taxes due to premature distributions, excess contributions, or excess accumulations, as well as distributions from Education Savings Accounts (ESAs, formerly Education IRAs) that are not used for education expenses.	If you owe a penalty tax, use this form to calculate the tax. Then attach the form to Form 1040. <i>Exception:</i> If you owe a 10% premature withdrawal penalty and your 1099-R is coded "01" (premature distribution), you need not file this form. Instead, report the penalty on line 55 of Form 1040.
5498	<i>IRA Contribution Information</i>	To report your year-end IRA value and any contributions (including rollovers and Roth conversions); shows recharacterized amounts received by an IRA; sent to investors by Vanguard in May. Also, if you made a contribution to an ESA, the deadline for tax-year 2001 was December 31, not the tax filing date—you'll receive this form in January.	A copy of this form is furnished to the IRS.
8606	<i>Nondeductible IRAs and Coverdell ESAs</i>	To track the nondeductible balance in your IRA, to determine the taxable amount of a withdrawal from any IRA or ESA and to report a Roth IRA conversion or the reversal of a conversion or contribution.	Complete this form and attach it to Form 1040. You may use the worksheets found in the instructions for Form 8606 to track the cost basis—the total value of nondeductible contributions—of your Roth IRA or ESA.

Cash Out, Stay Put, Or Roll Over? How To Protect Your Financial Future

Since touching a 30-year low of 3.9% in the fall of 2000, the nation's unemployment rate has surged, reaching 5.8% in December 2001. That means that hundreds of thousands more Americans are looking for work. At a time when they may be under considerable stress, many of these job seekers also have to decide what to do with the assets in their employer-sponsored retirement plans.

Unfortunately, if past statistics prove prologue, the choice made by a large number of the newly unemployed could threaten their future financial security.

The Perils Of 'Cashing Out'

A 1998 survey published in the *National Tax Journal* found that more than 70% of those who took distributions from employer-sponsored plans did so in cash, as a lump sum. Two out of every five of those who "cashed out" used the proceeds to cover current spending. Others typically repaid debts, put the money in the bank, or paid for education-, housing-, and health-related bills. Other studies, summarized in *How America Saves*, a report issued in 2000 by Vanguard's Center for Retirement Research, have found similar results.

"Absent a true emergency, people should definitely keep their retirement assets tax-deferred," said William McNabb, managing director of Vanguard's Institutional Investor Group. "When you cash out, you incur current income taxes and, if you are under age 59½, an early withdrawal penalty. You also raise significantly the amount you must save during the remainder of your working life."

Consider Your Options

When you change jobs—or lose one—you have several options besides cashing out your retirement assets: You can shift the money into a qualified annuity plan; or, in some cases, you may be able to leave the money where it is or transfer it to a new employer plan.

While all of these choices let you continue to defer taxes, each has its own drawbacks. Annuity providers typically charge relatively high expenses because of insurance features. And employer-sponsored plans offer limited investment choices.

Fortunately, there's another option: You can roll the proceeds of an employer-sponsored plan into an IRA, which offers continued tax-deferral and the freedom to select your investments. You can invest IRA money in bank deposits, individual stocks and bonds, or mutual funds, to name just a few options.

Mr. Termine's Plan

Richard Termine, manager of benefits for Block Drug Company, knows he is one of the unlucky ones who will lose his job in 2002. His company was acquired in January 2001, and there have already been a number of layoffs.

Mr. Termine figures there are two key reasons why he and many of his coworkers have decided to roll their 401(k) money into a Vanguard IRA.®

First, Vanguard makes rollovers easy. Second, Vanguard's costs are low. "You know that you're not going to find a mutual fund company with much lower costs than Vanguard," said Mr. Termine. Costs "add up and reduce returns over the long haul."

Convenience—And Cost—Matter

Mutual funds are a popular choice for rollovers, primarily because they offer broad diversification and professional investment management.

More than 60 Vanguard funds are suitable for IRAs, and we also offer access to hundreds of non-Vanguard funds, plus individual stocks and bonds, through Vanguard Brokerage Services®. Associates in our Retirement Resource Center (1-800-523-7708) can simplify the rollover process by filling out the necessary Vanguard paperwork—you'll just need to review and sign it. •



It's easy to move your 401(k) plan proceeds to a Vanguard IRA. Our associates in Vanguard's Retirement Resource Center (1-800-523-7708) can simplify the rollover process by completing the necessary Vanguard paperwork—you'll just need to review and sign it.

Two Retiring Directors Discuss Vanguard, Its Board, And Investing



James O. Welch, Jr.

In 1971, James O. Welch, Jr., was running the Cambridge, Mass.-based candy business his father had started, when he got an intriguing proposal from a friend, W. Nicholas Thorndike, and one of Thorndike's business partners, John C. Bogle, the chief executive of Wellington Management Company. They invited him to become a director of the Wellington funds, which later became the Vanguard funds. "To have an inside view of the investment world, and mutual funds in particular, was an ideal opportunity," Mr. Welch recalled.



Bruce K. MacLaury

In 1990, Bruce K. MacLaury was president of The Brookings Institution. Previously the president of the Federal Reserve Bank of Minneapolis, Dr. MacLaury was invited to join Vanguard's board to succeed David P. Eastburn, former president of the Federal Reserve Bank of Philadelphia. "The opportunity to get an eye on the world of investing from Vanguard's perspective, given its operating principles, was far too intriguing to pass up," said Dr. MacLaury.

On December 31, Dr. MacLaury and Mr. Welch—the last founding member of Vanguard's board—retired as directors. *In The Vanguard* spoke with them recently about the board, the company, and investing.

What should shareholders know about the role of the board at Vanguard?

Dr. MacLaury: The board has a very important oversight role in the management of the corporation. I am on a number of other boards, and it is unusual to have as many opportunities to give input to management's thinking as Vanguard's strategic-planning sessions provide. In comparison with many boards, we outside directors are small in number, and the emphasis is clearly on independence.

Mr. Welch: I think shareholders should know that the board has substantial breadth of experience. The mix is really perfect.

We have financially sophisticated members of the board, and we have several members who have had extensive general management experience and who bring a perspective to Vanguard's senior management team in terms of their personnel policies, strategic thinking, and management selection.

How has Vanguard changed over the years?

Dr. MacLaury: There has been an explosion of electronic and computer-based services—the Internet being the most obvious case in point—and those services are now absolutely essential.

Mr. Welch: I think the most amazing change has been in the level of absolute growth, not only in assets managed but in the company's ability to serve shareholders. I don't think the basic philosophy of Vanguard has changed, and that in and of itself is remarkable. To maintain that image and that personal touch with so much enthusiasm for every task is one of Vanguard's greatest strengths.

How do you think Vanguard could improve its service to clients?

Mr. Welch: Performance has always been number one with me, and so any way that Vanguard can continue to monitor the performance of its managers and challenge them is probably the best service to shareholders that Vanguard can provide.

Dr. MacLaury: I think the continuing challenge for Vanguard, as one of the last—if not the last—purely direct-marketing firms in the industry, is to find new ways to give advice and personalized service. Given the plethora of investment vehicles that are out there, advice is increasingly a necessity.

What are the most important things you've learned about investing over the years?

Dr. MacLaury: It sounds very trite, but I've learned that diversification and low costs are critical to succeeding as an investor. It's also important to invest for the long term. Get started early, invest regularly, and stay with it.

Mr. Welch: There are no magic bullets in investing. And as Dr. MacLaury has said, we need to consider our investment activities as a long-term effort, which requires, at times, great patience.

Dr. MacLaury: Implicit in all of this is that market-timing is a fool's chase.

Mr. Welch: Absolutely. The great temptation is to try to outguess the market. The problem is no one, not even the best experts, seems to be able to predict where the market is headed. You'll recall that Mr. Greenspan referred to "irrational exuberance" when the Dow was around 6,400. He watched it go a lot higher.

What should investors expect from a mutual fund company and its board of directors?

Dr. MacLaury: The board of directors has only one goal, and that is to safeguard the assets of the shareholder. That means keeping costs down, so that as much return as possible gets through to the shareholder. It also means making sure that the educational materials that are sent out are straightforward and understandable.

Mr. Welch: In addition to low costs, performance is fundamental. I think that's an area that's become more important to the present Vanguard management. Since we have managed funds, monitoring their performance and insisting on careful research and investing by our advisers is the board's fundamental responsibility.

You've witnessed the national movement toward 401(k)s and other defined contribution plans. How has that changed investing?

Mr. Welch: Investors are going to be increasingly responsible for their own well-being and personal wealth. And I think it's incumbent upon companies like Vanguard to keep it simple and make it easy for investors to understand and participate in employer-sponsored retirement plans.

Dr. MacLaury: Investors must become more sophisticated about their investments, because, like it or not, Big Daddy—meaning the corporation—is not going to be there with defined benefits in the future. The risks of investing have been devolved to the individual participant, and the responsibility that goes with that is to know what one's portfolio is invested in.

What's been enjoyable about being a Vanguard director?

Mr. Welch: To have the opportunity to provide input into the management of the firm and to have it reflected upon—and often acted upon—has been very rewarding. And there was the camaraderie. It sort of emanates from the whole company and carries through to the board. It's something that those of us who are retiring will probably miss the most.

Dr. MacLaury: Well, I can't improve on that. There is a sense of mission at Vanguard that the directors share, and that is to provide fiduciary services to investors in the most cost-effective way possible. It has been very rewarding. •

The People Who Govern Vanguard

The board of directors of The Vanguard Group works with Vanguard officers to establish the policies and oversee the activities of the Vanguard funds. A majority of the directors are independent—they have no affiliation with Vanguard or the funds, apart from serving on the board and being investors in the funds. The year in which the director joined the board is noted in parentheses.

John J. Brennan (1987)—Chairman of the board, chief executive officer, and director/trustee of The Vanguard Group, Inc., and of each of the investment companies in The Vanguard Group.

Charles D. Ellis (2001)—Senior adviser to Greenwich Associates; successor trustee of Yale University; overseer of the Stern School of Business at New York University; trustee of the Whitehead Institute for Biomedical Research.

JoAnn Heffernan Heisen (1998)—Vice president, chief information officer, and a member of the executive committee of Johnson & Johnson; director of The Medical Center at Princeton and Women's Research and Education Institute.

Burton G. Malkiel (1977)—Chemical Bank Chairman's Professor of Economics, Princeton University; director of Prudential Insurance Co. of America, BKF Capital, The Jeffrey Co., and NeuVis, Inc.

Alfred M. Rankin, Jr. (1993)—Chairman, president, chief executive officer, and director of NACCO Industries, Inc.; director of Goodrich Corp.

J. Lawrence Wilson (1985)—Retired chairman and chief executive officer of Rohm and Haas Co.; director of AmerisourceBergen Corp., Cummins Inc., and The Mead Corp.; trustee of Vanderbilt University.

Vanguard Adopts New Exchange Privilege For Index And International Funds

Vanguard is pleased to announce a new exchange privilege for our index and international funds that gives shareholders convenience and flexibility to manage their investments along with protection from the negative effects of market-timing activity.

The new exchange privilege, which is expected to take effect in mid-March, will permit telephone and online exchanges on index funds and international funds, except between 2:30 p.m. and 4 p.m. (Eastern time) on business days. Shareholders will be limited to two telephone or online exchanges out of a fund within any rolling 12-month period. There will be no limit on the number of exchanges into a fund. Exchanges requested in writing will continue to be honored.

The telephone and online exchange privilege will apply to nonretirement accounts and to most retirement accounts (including traditional and Roth IRAs) in Vanguard's stock and balanced index funds, Vanguard® Growth and Income Fund, and most international funds.

The policy permitting telephone and online exchanges for Vanguard's other funds will not change. •

Vanguard.com Introduces New Online Services

Forbes.com recently cited **Vanguard.com** as its fund family favorite for the fourth consecutive year—lauding our site's robust investment information and ease of navigation. But as good as Vanguard.com is today, it promises to be even better tomorrow.

Vanguard.com is set to introduce a redesigned Personal Investors homepage, along with a new suite of services that will make managing your Vanguard investments easier and more convenient. We've made it simpler to conduct your day-to-day business online—whether you are reviewing your account balances, tracking

transactions, or researching investments. In addition, the new site will offer **Consolidated View™**, which will enable you to view all of the Vanguard fund and brokerage assets in your entire household through a single log-on. Plus, professional-grade analytic tools can help you monitor your asset allocation, analyze your holdings, and check your personal rates of return.

If you don't have online access to your Vanguard accounts, you should register today. We think you'll like the new features that are being rolled out on Vanguard.com. •

A Guide To Year-End Tax Forms

Vanguard's year-end tax forms will be mailed to you shortly. Here's a preview:

- **Form 1099-DIV** lists taxable dividends and capital gains distributions for nonretirement accounts.
- **Form 1099-B** reports proceeds from share redemptions, including the total amount sold in dollars and shares and the share price for each account with a fluctuating share price from which you redeemed or exchanged shares.
- **Vanguard Average Cost Summary Statement** summarizes, by fund, gains and losses for the year if you sold fund shares.

These forms and statements are available online to registered users of Vanguard.com. •

Online Tax Preparation Available

Registered users of Vanguard.com will be offered online tax preparation and filing services again this year through Quicken® TurboTax® for the Websm. Taxpayers who file their federal tax returns before April 1, 2002, will receive a 50% savings over the regular price. Note that additional charges apply if you use TurboTax to file your state tax return. •

Note: Our website is best viewed using a browser that supports the capabilities of Netscape Communicator® version 4.7.3 or higher or Microsoft® Internet Explorer® version 4.0 or higher. For the upcoming enhancements described on this page, we recommend Netscape 6.1 or Internet Explorer 5.0.

How To Open An Account

For more information about Vanguard Brokerage, please call 1-877-817-7304. You may also open a brokerage account on **Vanguard.com** with an e-signature.

Vanguard Brokerage: A Focus On Cost, Convenience

Which company tops the list when it comes to the very best in brokerage firms? It's Vanguard Brokerage Services®, according to *Worth*® Magazine's third annual Readers' Choice Awards, appearing in the July/August 2001 edition. Vanguard Brokerage was cited for matching "good value and excellent service."

The award is based on a survey sent to *Worth* readers, who rated 18 products and services on a 1-to-10 scale. The highest median score achieved in each category determined the winners. Vanguard received a rating of 7.9 in the "Broker" category, topping Charles Schwab & Co. and Fidelity Investments.

Low Commissions, Simple Schedules

Since 1983, Vanguard Brokerage has been serving Vanguard clients who wish to complement their mutual fund holdings with individual stocks, bonds, and options. What attracts many to VBS are commission schedules that are simple, competitive, and free of nuisance fees. For example, trading 1,000 equity shares via **Vanguard.com** costs a flat commission of \$20. And that rate applies whether you conduct a market or limit order. The commission schedule below offers rates for online, automated telephone, and broker-assisted trades.

Such competitive commissions have led many clients to execute their orders online, but Vanguard Brokerage is easy to use in other ways as well. Clients have 24-hour access to AutoBroker®, a toll-free, automated service that provides touch-tone telephone access to real-time quotes, account balances, and trade requests. For those who prefer more personalized

assistance, associates are available every business day from 8 a.m. to 8 p.m., Eastern time.

Convenience Counts

Many investors enjoy the convenience of having their mutual fund assets under one roof. Vanguard Brokerage makes it easy to do so with its FundAccess® program, which offers some 2,600 no-load mutual funds from many leading fund families. Shares in about 1,650 of these funds may be purchased for a transaction fee of \$35. An additional 950 funds are available with no transaction fee (NTF). The minimum initial investment for each NTF fund is \$5,000 (\$1,000 for an IRA), and a 1% redemption fee (\$50 minimum) is assessed on shares that are redeemed within a year.

"FundAccess is particularly attractive to investors seeking to simplify their financial affairs by managing all of their fund holdings through Vanguard," said Richard Luzzi, principal, Vanguard Brokerage, who noted that investors can transfer their non-Vanguard fund holdings to Vanguard Brokerage on a tax-free basis.

Another popular service is the Bond Desk, which offers U.S. Treasury bills, notes, and bonds; government agency bonds; corporate bonds; zero-coupon bonds; municipal bonds; and certificates of deposit. Brokerage clients who are registered users of Vanguard.com also have access to the Bond Desk Online, which they can use to research a variety of bonds and certificates of deposit and to employ search criteria to find the securities that best match their goals.

Enhancements On The Way

Vanguard Brokerage is moving forward to revamp and expand its services, particularly online. Trading securities online will soon be easier, thanks to redesigned, user-friendly trading screens. "We responded to client feedback and plan to add a new site tour, trading tutorials, and educational materials," said Mr. Luzzi. "In short, we will make it as simple to trade a stock online as a fund."

Other planned enhancements include U.S. Treasury bond trading and a host of new online tools for researching stocks and evaluating holdings. •

Vanguard Brokerage Commission Schedule

Transaction Method	Commission*
Access VBS® (online trading)	\$20 or \$0.02 per share, whichever is greater
AutoBroker (automated telephone trading)	\$40 or \$0.02 per share, whichever is greater
Orders Desk (through a VBS associate)	\$45 + \$0.03 per share

*For stocks priced less than \$1, a commission of \$30 plus 3% of principal applies. For foreign securities, a \$75 processing fee is added to the commission rates listed in the table.

Big Gains Are The Wrong Reason To Buy Bonds Now

After years offstage, bonds recaptured the spotlight in 2001, delivering solid returns as stock prices tumbled. Through November, fund shareholders invested a net \$3 in bond funds for every \$1 invested in stock funds, according to the Investment Company Institute, an industry association.

We hope that investors are simply making modest adjustments to their stock and bond allocations within the context of sensible long-term investment plans. But we fear that these cash-flow figures reflect investors' counterproductive tendency to chase performance.

Bond Returns Past

Investors who chase performance could be in for a rude surprise. That's because the conditions that led to strong fixed income returns in 2001 are unlikely to persist. Indeed, as 2001 ended, bonds were giving back their earlier gains.

Consider the sources of a bond's (or a bond fund's) return: the income from interest payments plus the change in the bond's (or the fund's) market price.

At the end of October, as cash flows into bond funds crested, the 12-month return of the 10-year Treasury note, a benchmark for fixed income investments, stood at a remarkable 15.7%—5.3% from interest payments and the rest from a price increase produced by falling interest rates. (Bond prices move in the opposite direction from interest rates; the prices of existing bonds rise or fall until their yields equal those of comparable newly issued bonds.) Since then, interest rates have risen sharply, producing a decline in bond prices.

Bond Returns Future

Despite their recent tumble, bonds are unlikely to record big price increases in 2002. That's not a forecast, simply an acknowledgment that interest rates don't have much farther to fall. On December 31, 2001, the 10-year Treasury note was yielding 5.02%. To match the double-digit returns recorded earlier in 2001, for example, the note would need to increase in price by about 5%. Such a rise would require a sharp decline in interest rates.

But interest rates are already near 40-year lows. And as we saw just a few years ago, very low interest rates can mean weak future returns on bonds. In September 1998, when Russia defaulted on its debt and investors sought the safety of U.S. government securities, the price of the 10-year Treasury note rose, and its yield dipped to 4.4%—about where it was in October 2001. The result was big profits in 1998, but big losses over the next 12 months as rates rose and bond prices tumbled. From September 30, 1998, to September 30, 1999, the 10-year Treasury note returned -7.0%.

Follow Your Plan, Not Performance

Vanguard is a strong advocate of balanced investing. Bond funds provide current income and moderate the volatility of an all-stock portfolio, so they have a place in just about all investors' portfolios. But if the recent enthusiasm for bonds is based solely on their double-digit returns in 2001, investors are likely to be disappointed. Our financial markets are just too cyclical for trends to continue indefinitely.

We advise you to develop a long-term investment plan with stocks, bonds, and short-term reserves in proportions suited to your goals, circumstances, and tolerance for risk. Once you have designed such a plan, stick with it. Follow this simple counsel, and you'll remain focused on your goals, not fixated on the top performers of the past. •



It's easy to obtain information about Vanguard funds or your account.

For automated fund and account information 24 hours a day, 7 days a week, visit our website or call Vanguard Tele-Account®.

World Wide Web:
www.vanguard.com

Vanguard Tele-Account:
1-800-662-6273

To speak with a Vanguard associate about fund information or your account, call us toll-free Monday through Friday from 8 a.m. to 10 p.m. or Saturday from 9 a.m. to 4 p.m., Eastern time.

Vanguard Fund Information:
1-800-205-6099

Vanguard Client Services:
1-800-662-2739

Text Telephone:
1-800-749-7273

Vanguard Brokerage Services®

To speak with a Vanguard Brokerage Associate, call toll-free Monday through Friday from 8 a.m. to 8 p.m., Eastern time:
1-877-817-7304.

Send your written comments to:

The Vanguard Group
P.O. Box 2600
Valley Forge, PA 19482-2600

Overnight Mailing Address

The Vanguard Group
455 Devon Park Drive
Wayne, PA 19087-1815

We welcome your feedback via e-mail:

itveditor@vanguard.com

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Vanguard Performance Profile

WINTER 2002

Fund No.	Vanguard® Fund Name (Inception Date)	Ticker Symbol	Average Annual Total Returns For Periods Ended December 31, 2001				Next Report/ Prospectus Online††
			1 Year	5 Years	10 Years	Since Inception ¹	
Growth and Income Funds							
40	500 Index Investor Shares (8/31/1976)	VFINX	-12.02%	10.66%	12.84%	13.49%	2/2002 A
540	500 Index Admiral Shares (11/13/2000)	VFIAX	-11.98	—	—	-12.33	2/2002 A
328	Capital Value (12/17/2001)	VCVLX	—	—	—	2.60	12/2001 P
82	Convertible Securities (6/17/1986)	VCVSX	-3.09	9.03	10.22	9.13	1/2002 A
65	Equity Income Investor Shares (3/21/1988)	VEIPX	-2.34	11.25	12.96	12.79	1/2002 P
565	Equity Income Admiral Shares (8/13/2001)	VEIRX	—	—	—	-0.98	1/2002 P
93	Growth and Income Investor Shares (12/10/1986)	VQNPX	-11.13	11.37	13.25	13.64	1/2002 P
593	Growth and Income Admiral Shares (5/14/2001)	VGIAX	—	—	—	-6.87	1/2002 P
123	REIT Index Investor Shares (5/13/1996)	VGSIX	12.35	6.25	—	10.57	3/2002 A
5123	REIT Index Admiral Shares (11/12/2001)	VGSIX	—	—	—	6.04	3/2002 A
934	Selected Value (2/15/1996)	VASVX	14.99	6.36	—	7.24	2/2002 P
101	Tax-Managed Growth and Income Investor Shares (9/6/1994)	VTGIX	-11.93	10.73	—	14.93	2/2002 A
5101	Tax-Managed Growth and Income Admiral Shares (11/12/2001)	VTGLX	—	—	—	2.87	2/2002 A
85	Total Stock Market Index Investor Shares (4/27/1992)	VTSMX	-10.97	9.74	—	12.73	2/2002 A
585	Total Stock Market Index Admiral Shares (11/13/2000)	VTSAX	-10.89	—	—	-11.73	2/2002 A
124	U.S. Value (6/29/2000)	VUVLX	2.94	—	—	10.55	12/2001 P
57	Utilities Income (5/15/1992)	VGSUX	-19.45	7.19	—	9.31	3/2002 A
6	Value Index Investor Shares (11/2/1992)	VIVAX	-11.88	9.38	—	13.47	2/2002 A
506	Value Index Admiral Shares (11/13/2000)	VVIAX	-11.83	—	—	-8.07	2/2002 A
22	Windsor™ Investor Shares (10/23/1958)	VWNDX	5.72	10.95	14.40	13.07	2/2002 P
522	Windsor™ Admiral Shares (11/12/2001)	VWNEK	—	—	—	8.39	2/2002 P
73	Windsor™ II Investor Shares (6/24/1985)	VWAFX	-3.40	10.37	13.51	13.96	2/2002 P
573	Windsor™ II Admiral Shares (5/14/2001)	VWAFX	—	—	—	-6.68	2/2002 P
Growth Funds							
213	Calvert Social Index™ (5/31/2000)	VCSIX	-14.08%	—	—	-14.37%	12/2001 P
98	Extended Market Index Investor Shares (12/21/1987)	VEXMX	-9.13	7.49%	11.07%	12.43	2/2002 A
598	Extended Market Index Admiral Shares (11/13/2000)	VEXAX	-9.09	—	—	-11.59	2/2002 A
9	Growth Index Investor Shares (11/2/1992)	VIGRX	-12.93	11.08	—	13.20	2/2002 A
509	Growth Index Admiral Shares (11/13/2000)	VIGAX	-12.88	—	—	-17.44	2/2002 A
859	Mid-Cap Index Investor Shares (5/21/1998)	VIMSX	-0.50	—	—	11.27	2/2002 A
5859	Mid-Cap Index Admiral Shares (11/12/2001)	VIMAX	—	—	—	8.06	2/2002 A
26	Morgan™ Growth Investor Shares (12/31/1968)	VMRGX	-13.60	10.14	12.13	11.66	1/2002 P
526	Morgan™ Growth Admiral Shares (5/14/2001)	VMRAX	—	—	—	-8.75	1/2002 P
59	PRIMECAP Investor Shares (11/1/1984)	VPMCX	-13.35	17.03	17.56	17.38	11/2001 P
559	PRIMECAP Admiral Shares (11/12/2001)	VPMAX	—	—	—	7.69	11/2001 P
114	Strategic Equity (8/14/1995)	VSEQX	5.42	11.40	—	14.03	2/2002 P
102	Tax-Managed Capital Appreciation Investor Shares (9/6/1994)	VMCAX	-15.34	10.59	—	14.39	2/2002 A
5102	Tax-Managed Capital Appreciation Admiral Shares (11/12/2001)	VTCLX	—	—	—	4.26	2/2002 A
23	U.S. Growth Investor Shares (1/6/1959)	VWUSX	-31.70	3.28	7.99	12.12	12/2001 P
523	U.S. Growth Admiral Shares (8/13/2001)	VWUAX	—	—	—	-2.20	12/2001 P
Aggressive Growth Funds							
111	Capital Opportunity Investor Shares (8/14/1995)	VHCOX	-9.68%	20.70%	—	17.86%	2/2002 P
5111	Capital Opportunity Admiral Shares (11/12/2001)	VHCAX	—	—	—	9.41	2/2002 P
51	Energy Investor Shares (5/23/1984)	VGENX	-2.55	7.99	12.53%	11.84	3/2002 A
551	Energy Admiral Shares (11/12/2001)	VGELX	—	—	—	2.71	3/2002 A
24	Explorer™ Investor Shares (12/11/1967)	VEXPX	0.56	12.32	12.97	9.81	2/2002 P
524	Explorer™ Admiral Shares (11/12/2001)	VEXRX	—	—	—	12.20	2/2002 P
544	Growth Equity (3/11/1992)	VGEQX	-27.41	9.23	—	11.61	1/2002 P
52	Health Care Investor Shares (5/23/1984)	VGHGX	-6.87	23.71	19.93	22.11	3/2002 A
552	Health Care Admiral Shares (11/12/2001)	VGHAX	—	—	—	2.84	3/2002 A
53	Precious Metals (5/23/1984)	VGPMX	18.33	-3.68	1.48	2.10	3/2002 A
861	Small-Cap Growth Index (5/21/1998)	VISGX	-0.78	—	—	3.94	2/2002 A
48	Small-Cap Index Investor Shares (10/3/1960)	NAESX	3.10	8.44	12.27	11.17	2/2002 A
548	Small-Cap Index Admiral Shares (11/13/2000)	VSMAX	3.17	—	—	4.39	2/2002 A
860	Small-Cap Value Index (5/21/1998)	VISVX	13.70	—	—	6.45	2/2002 A
116	Tax-Managed Small-Cap (3/25/1999)	VTMSX	5.44	—	—	16.06	2/2002 A
Comparative Indexes							
	Wilshire 5000®		-10.96%	9.69%	12.27%		
	S&P 500®		-11.89	10.70	12.94		
	Wilshire 4500™		-9.32	7.16	10.67		
	Russell 2000®		2.49	7.52	11.51		
	MSCI® EAFE® *		-22.01	0.75	4.39		

Fund No.	Vanguard® Fund Name (Inception Date)	Ticker Symbol	Average Annual Total Returns For Periods Ended December 31, 2001				Next Report/ Prospectus Online††
			1 Year	5 Years	10 Years	Since Inception ¹	
Exchange-Traded Shares							
970	Total Stock Market VIPERs™ (5/24/2001)	VTI					2/2002 A
	Return based on net asset value		–	–	–	–9.82%	
	Return based on market price		–	–	–	–10.16	
International Funds							
227	Developed Markets Index (5/8/2000)	VDMIX	–22.04%	–	–	–18.16%	2/2002 P
533	Emerging Markets Stock Index (5/4/1994)	VEIEX	–2.88	–4.99%	–	–0.13	2/2002 P
79	European Stock Index Investor Shares (6/18/1990)	VEURX	–20.30	6.44	9.93%	8.94	2/2002 P
579	European Stock Index Admiral Shares (8/13/2001)	VEUSX	–	–	–	–2.84	2/2002 P
129	Global Equity (8/14/1995)	VHGEX	–3.73	7.20	–	8.97	2/2002 P
81	International Growth Investor Shares (9/30/1981)	VWIGX	–18.92	2.65	7.51	13.02	12/2001 P
581	International Growth Admiral Shares (8/13/2001)	VWILX	–	–	–	–2.64	12/2001 P
46	International Value (5/16/1983)	VTRIX	–14.02	2.01	5.28	10.70	2/2002 P
72	Pacific Stock Index Investor Shares (6/18/1990)	VPACX	–26.34	–8.14	–2.50	–2.59	2/2002 P
572	Pacific Stock Index Admiral Shares (8/13/2001)	VPADX	–	–	–	–13.78	2/2002 P
127	Tax-Managed International (8/17/1999)	VTMGX	–21.94	–	–	–8.83	2/2002 A
113	Total International Stock Index (4/29/1996)	VGTSX	–20.15	0.08	–	0.17	2/2002 P
Balanced Funds							
78	Asset Allocation Investor Shares (11/3/1988)	VAAPX	–5.34%	10.79%	12.04%	13.08%	12/2001 P
578	Asset Allocation Admiral Shares (8/13/2001)	VAARX	–	–	–	–0.70	12/2001 P
2	Balanced Index Investor Shares (11/9/1992)	VBINX	–3.02	9.23	–	10.83	2/2002 A
502	Balanced Index Admiral Shares (11/13/2000)	VBIAX	–2.96	–	–	–2.79	2/2002 A
724	LifeStrategy™ Conservative Growth (9/30/1994)	VSCGX	–0.08	8.51	–	10.52	2/2002 P
122	LifeStrategy™ Growth (9/30/1994)	VASGX	–8.86	8.46	–	11.74	2/2002 P
723	LifeStrategy™ Income (9/30/1994)	VASIX	4.06	8.37	–	9.90	2/2002 P
914	LifeStrategy™ Moderate Growth (9/30/1994)	VSMGX	–4.48	8.62	–	11.24	2/2002 P
56	STAR™ (3/29/1985)	VGSTX	0.50	10.22	11.50	12.02	2/2002 P
103	Tax-Managed Balanced (9/6/1994)	VTMFV	–3.54	8.60	–	10.53	2/2002 A
27	Wellesley® Income Investor Shares (7/1/1970)	VWINX	7.39	9.96	10.44	11.30	1/2002 P
527	Wellesley® Income Admiral Shares (5/14/2001)	VWIAV	–	–	–	3.81	1/2002 P
21	Wellington™ Investor Shares (7/1/1929)	VWELX	4.19	10.65	12.06	8.39	1/2002 A
521	Wellington™ Admiral Shares (5/14/2001)	VWENV	–	–	–	0.73	1/2002 A

	Fund No.	Vanguard® Fund Name (Inception Date)	Ticker Symbol	Average Annual Total Returns For Periods Ended December 31, 2001				Current Yield†	
				1 Year	5 Years	10 Years	Since Inception ¹		
Bond Funds									
	36	GNMA Investor Shares* (6/27/1980)	VFIIX	7.94%	7.25%	6.96%	9.46%	5.83%	3/2002 A
	536	GNMA Admiral Shares* (2/12/2001)	VFIJX	–	–	–	6.32	5.88	3/2002 A
	29	High-Yield Corporate Investor Shares (12/27/1978)	VWEHX	2.90	4.33	7.92	9.65	8.96	3/2002 A
	529	High-Yield Corporate Admiral Shares (11/12/2001)	VWEAX	–	–	–	0.56	9.01	3/2002 A
	119	Inflation-Protected Securities (6/29/2000)	VIPSX	7.61	–	–	9.15	3.26 ¹¹¹	3/2002 A
	314	Intermediate-Term Bond Index Investor Shares (3/1/1994)	VBIX	9.28	7.56	–	7.30	6.00	2/2002 A
	5314	Intermediate-Term Bond Index Admiral Shares (11/12/2001)	VBILX	–	–	–	–2.68	6.05	2/2002 A
	71	Intermediate-Term Corporate Investor Shares (11/1/1993)	VFICX	9.42	7.07	–	6.60	6.32	3/2002 A
	571	Intermediate-Term Corporate Admiral Shares (2/12/2001)	VFIDX	–	–	–	7.37	6.40	3/2002 A
	35	Intermediate-Term Treasury Investor Shares* (10/28/1991)	VFITX	7.55	7.35	7.24	7.71	4.57	3/2002 A
	535	Intermediate-Term Treasury Admiral Shares* (2/12/2001)	VFIUX	–	–	–	6.07	4.71	3/2002 A
	522	Long-Term Bond Index (3/1/1994)	VBLTX	8.17	8.27	–	8.08	6.41	2/2002 A
	28	Long-Term Corporate Investor Shares (7/9/1973)	VWESX	9.57	7.37	8.07	9.12	6.72	3/2002 A
	568	Long-Term Corporate Admiral Shares (2/12/2001)	VWETX	–	–	–	6.91	6.80	3/2002 A
	83	Long-Term Treasury Investor Shares* (5/19/1986)	VUSTX	4.31	7.99	8.21	8.67	5.42	3/2002 A
	583	Long-Term Treasury Admiral Shares* (2/12/2001)	VUSUX	–	–	–	3.67	5.56	3/2002 A
	132	Short-Term Bond Index Investor Shares (3/1/1994)	VBISX	8.88	6.86	–	6.51	4.29	2/2002 A
	5132	Short-Term Bond Index Admiral Shares (11/12/2001)	VBIRX	–	–	–	–1.08	4.34	2/2002 A
	39	Short-Term Corporate Investor Shares (10/29/1982)	VFSTX	8.14	6.61	6.44	8.37	5.13	3/2002 A
	539	Short-Term Corporate Admiral Shares (2/12/2001)	VFSUX	–	–	–	6.54	5.18	3/2002 A
	49	Short-Term Federal Investor Shares* (12/31/1987)	VSGBX	8.61	6.68	6.23	7.19	4.00	3/2002 A
	549	Short-Term Federal Admiral Shares* (2/12/2001)	VSGDX	–	–	–	6.79	4.06	3/2002 A
	32	Short-Term Treasury Investor Shares* (10/28/1991)	VFISX	7.80	6.42	6.08	6.28	3.42	3/2002 A
	532	Short-Term Treasury Admiral Shares* (2/13/2001)	VFIRX	–	–	–	6.49	3.56	3/2002 A
	84	Total Bond Market Index Investor Shares (12/11/1986)	VBMPX	8.43	7.33	7.15	7.75	5.63	2/2002 A
	584	Total Bond Market Index Admiral Shares (11/12/2001)	VBTLX	–	–	–	–2.00	5.68	2/2002 A
Comparative Indexes									
		Wilshire 5000®		–10.96%	9.69%	12.27%			
		S&P 500®		–11.89	10.70	12.94			
		Lehman Aggregate Bond		8.44	7.43	7.23			
		Lehman Municipal Bond		5.13	5.98	6.63			
		Salomon 3-Month Treasury Bill		4.09	5.02	4.69			
		MSCI® EAFE® *		–22.01	0.75	4.39			

Fund No.	Vanguard® Fund Name (Inception Date)	Ticker Symbol	Average Annual Total Returns For Periods Ended December 31, 2001				Current Yield†	Next Report/ Prospectus Online††
			1 Year	5 Years	10 Years	Since Inception¹		
Tax-Exempt Income and Money Market Funds								
100	CA Insured Intermediate-Term Tax-Exempt Investor Shares (3/4/1994)	VCAIX	4.43%	5.63%	—	6.08%	3.90%	1/2002 A
5100	CA Insured Intermediate-Term Tax-Exempt Admiral Shares (11/12/2001)	VCADX	—	—	—	-2.77	3.95	1/2002 A
75	CA Insured Long-Term Tax-Exempt Investor Shares (4/7/1986)	VCITX	3.36	6.02	6.86%	7.29	4.43	1/2002 A
575	CA Insured Long-Term Tax-Exempt Admiral Shares (11/12/2001)	VCLAX	—	—	—	-3.45	4.48	1/2002 A
62	CA Tax-Exempt Money Market (6/1/1987)	VCTXX	2.38	3.03	3.01	3.69	1.53	1/2002 A
18	FL Insured Long-Term Tax-Exempt Investor Shares (9/1/1992)	VFLTXX	4.55	5.99	—	6.79	4.40	1/2002 A
518	FL Insured Long-Term Tax-Exempt Admiral Shares (11/12/2001)	VFLRX	—	—	—	-3.01	4.45	1/2002 A
44	High-Yield Tax-Exempt Investor Shares (12/27/1978)	VWAHX	5.34	5.56	6.63	7.67	5.16	2/2002 P
544	High-Yield Tax-Exempt Admiral Shares (11/12/2001)	VWALX	—	—	—	-2.07	5.21	2/2002 P
58	Insured Long-Term Tax-Exempt Investor Shares (9/30/1984)	VILPX	4.30	5.81	6.67	8.60	4.40	2/2002 P
558	Insured Long-Term Tax-Exempt Admiral Shares (2/12/2001)	VILOX	—	—	—	2.91	4.45	2/2002 P
42	Intermediate-Term Tax-Exempt Investor Shares (9/1/1977)	VWITX	5.05	5.28	6.17	6.26	4.08	2/2002 P
542	Intermediate-Term Tax-Exempt Admiral Shares (2/12/2001)	VWIUX	—	—	—	3.18	4.13	2/2002 P
31	Limited-Term Tax-Exempt Investor Shares (8/31/1987)	VMLTX	5.58	4.71	4.88	5.75	3.44	2/2002 P
531	Limited-Term Tax-Exempt Admiral Shares (2/12/2001)	VMLUX	—	—	—	3.72	3.49	2/2002 P
43	Long-Term Tax-Exempt Investor Shares (9/1/1977)	VWLTX	4.54	5.78	6.73	6.62	4.67	2/2002 P
543	Long-Term Tax-Exempt Admiral Shares (2/12/2001)	VWLUX	—	—	—	2.94	4.72	2/2002 P
168	MA Tax-Exempt (12/9/1998)	VMATX	4.34	—	—	4.28	4.68	1/2002 A
14	NJ Insured Long-Term Tax-Exempt Investor Shares (2/3/1988)	VNJTX	4.58	5.80	6.55	7.37	4.30	1/2002 A
514	NJ Insured Long-Term Tax-Exempt Admiral Shares (5/14/2001)	VNJUX	—	—	—	3.16	4.34	1/2002 A
95	NJ Tax-Exempt Money Market (2/3/1988)	VNJXX	2.59	3.14	3.03	3.70	1.58	1/2002 A
76	NY Insured Long-Term Tax-Exempt Investor Shares (4/7/1986)	VNYTX	4.13	5.76	6.62	6.85	4.35	1/2002 A
576	NY Insured Long-Term Tax-Exempt Admiral Shares (5/14/2001)	VNYUX	—	—	—	2.88	4.39	1/2002 A
163	NY Tax-Exempt Money Market (9/3/1997)	VYFXX	2.57	—	—	3.22	1.60	1/2002 A
97	OH Long-Term Tax-Exempt (6/18/1990)	VOHIX	4.64	5.72	6.54	7.26	4.47	1/2002 A
96	OH Tax-Exempt Money Market (6/18/1990)	VOHXX	2.79	3.34	3.18	3.42	1.67	1/2002 A
77	PA Insured Long-Term Tax-Exempt Investor Shares (4/7/1986)	VPAIX	4.76	5.74	6.65	7.24	4.43	1/2002 A
577	PA Insured Long-Term Tax-Exempt Admiral Shares (5/14/2001)	VPALX	—	—	—	3.49	4.47	1/2002 A
63	PA Tax-Exempt Money Market (6/13/1988)	VPTXX	2.66	3.30	3.14	3.77	1.60	1/2002 A
41	Short-Term Tax-Exempt Investor Shares (9/1/1977)	VWSTX	4.75	4.12	4.04	5.27	2.38	2/2002 P
541	Short-Term Tax-Exempt Admiral Shares (2/12/2001)	VWSUX	—	—	—	3.61	2.43	2/2002 P
45	Tax-Exempt Money Market (6/10/1980)	VMSXX	2.72	3.35	3.21	4.41	1.67	2/2002 P
Money Market Funds								
11	Admiral™ Treasury Money Market* (12/14/1992)	VUSXX	4.16%	5.07%	—	4.80%	2.14%	12/2001 P
33	Federal Money Market* (7/13/1981)	VMFXX	4.22	5.20	4.77%	6.64	2.20	12/2001 P
30	Prime Money Market (6/4/1975)	VMMXX	4.17	5.25	4.82	7.31	2.12	12/2001 P
50	Treasury Money Market* (3/9/1983)	VMPXX	3.99	4.89	4.52	5.90	2.01	12/2001 P

		Standardized Average Annual Total Returns As Of December 31, 2001				Current Yield†
		1 Year	5 Years	10 Years	Since Inception¹	
Vanguard Variable Annuity Plan**						
69	Balanced (5/23/1991)	4.05%	10.22%	11.36%	11.48%	—
145	Diversified Value (2/8/1999)	0.36	—	—	3.08	—
8	Equity Income (6/7/1993)	-3.88	10.18	—	12.43	—
68	Equity Index (4/29/1991)	-12.34	10.24	12.28	12.71	—
10	Growth (6/7/1993)	-32.09	3.13	—	9.76	—
146	High Yield Bond (6/3/1996)	2.88	3.54	—	4.72	8.44%
67	High-Grade Bond (4/29/1991)	7.88	6.87	6.50	7.05	5.20
86	International (6/3/1994)	-18.92	2.76	—	5.73	—
143	Mid-Cap Index (2/9/1999)	-0.89	—	—	13.74	—
64	Money Market (5/2/1991)	3.96	5.01	4.43	4.45	1.91
147	REIT Index (2/9/1999)	11.74	—	—	11.47	—
144	Short-Term Corporate (2/8/1999)	7.44	—	—	5.85	4.40
160	Small Company Growth (6/3/1996)	5.21	18.79	—	16.11	—
Comparative Indexes						
	Wilshire 5000®	-10.96%	9.69%	12.27%		
	S&P 500®	-11.89	10.70	12.94		
	Lehman Aggregate Bond	8.44	7.43	7.23		
	Salomon 3-Month Treasury Bill	4.09	5.02	4.69		

All Vanguard funds and the Vanguard Variable Annuity Plan 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. You can obtain Vanguard fund and annuity prospectuses by writing to us at P.O. Box 2600, Valley Forge, PA 19482-2600. The Vanguard fund and annuity total return data provided represent past performance, and the investment return and principal value of an investment will fluctuate so that investors' shares, when redeemed, may be worth more or less than their original cost. Returns include the reinvestment of dividends and capital gains distributions. Vanguard® VIPER™ Shares are available through registered broker/dealers, who have copies of the shares' prospectuses and product descriptions, which should be read carefully before you invest or send money. An investment in a money market 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 the fund. All figures are unaudited.

The online version of Vanguard Performance Profile at www.vanguard.com/?profile contains more complete information on fund distribution history, high/low share prices, and risk measures.

After-Tax Returns. The after-tax returns are shown in two ways: (1) assuming that an investor owned the fund during the entire period and paid taxes on the fund's distributions, and (2) assuming that an investor paid taxes on the fund's distributions and sold all shares at the end of each period.

Fund No.	Vanguard® Fund Name (Inception Date)	Average Annual Total Returns After Taxes on Distributions For Periods Ended December 31, 2001				Average Annual Total Returns After Taxes on Distributions and Sale of Fund Shares For Periods Ended December 31, 2001			
		1 Year	5 Years	10 Years	Since Inception ¹	1 Year	5 Years	10 Years	Since Inception ¹
Vanguard Tax-Managed Funds									
103	Balanced (9/6/1994)	-4.58%	8.49%	—	10.39%	-1.84%	7.50%	—	9.25%
102	Capital Appreciation Investor Shares (9/6/1994)	-16.40	10.37	—	14.13	-9.86	8.67	—	12.16
5102	Capital Appreciation Admiral Shares (11/12/2001)	—	—	—	4.00	—	—	—	1.92
101	Growth & Income Investor Shares (9/6/1994)	-13.23	10.21	—	14.26	-7.81	8.62	—	12.38
5101	Growth & Income Admiral Shares (11/12/2001)	—	—	—	2.72	—	—	—	0.66
127	International (8/17/1999)	-23.39	—	—	-9.34	-13.95	—	—	-7.50
116	Small-Cap (3/25/1999)	3.64	—	—	15.59	2.35	—	—	12.50

Fee-Adjusted Returns. In accordance with SEC regulations, the returns presented below take into account certain fees that may apply to Vanguard funds. For some funds, fees are levied on purchases or redemptions to offset the costs of buying and selling portfolio securities. For others, fees are assessed on redemptions made within certain time periods after a purchase to discourage short-term trading. All purchase or redemption fees are paid directly to the fund to compensate long-term shareholders for the costs of trading activity. In addition, Vanguard index funds apply a \$10 annual maintenance fee, which is not reflected in the figures, to accounts with balances below \$10,000.

Fund No.	Vanguard® Fund Name (Inception Date)	Ticker Symbol	Average Annual Total Returns For Periods Ended December 31, 2001			
			1 Year	5 Years	10 Years	Since Inception ¹
Growth and Income Funds						
934	Selected Value (2/15/1996)	VASVX	13.84%	6.36%	—	7.24%
101	Tax-Managed Growth and Income Investor Shares (9/6/1994)	VTGIX	-12.81	10.73	—	14.93
5101	Tax-Managed Growth and Income Admiral Shares (11/12/2001)	VTGLX	—	—	—	0.81
Growth Funds						
59	PRIMECAP Investor Shares (11/1/1984)	VPMCX	-14.22%	17.03%	17.56%	17.38%
559	PRIMECAP Admiral Shares (11/12/2001)	VPMAX	—	—	—	6.61
102	Tax-Managed Capital Appreciation Investor Shares (9/6/1994)	VMCAX	-16.18	10.59	—	14.39
5102	Tax-Managed Capital Appreciation Admiral Shares (11/12/2001)	VTCLX	—	—	—	2.18
Aggressive Growth Funds						
111	Capital Opportunity Investor Shares (8/14/1995)	VHCOX	-10.58%	20.70%	—	17.86%
5111	Capital Opportunity Admiral Shares (11/12/2001)	VHCAX	—	—	—	8.32
52	Health Care Investor Shares (5/23/1984)	VGHGX	-7.80	23.71	19.93%	22.11
552	Health Care Admiral Shares (11/12/2001)	HGHAX	—	—	—	1.81
861	Small-Cap Growth Index (5/21/1998)	VISGX	-1.27	—	—	3.80
860	Small-Cap Value Index (5/21/1998)	VISVX	13.13	—	—	6.45
116	Tax-Managed Small-Cap (3/25/1999)	VTMSX	3.87	—	—	15.43
International Funds						
533	Emerging Markets Stock Index (5/4/1994)	VEIEX	-3.85%	-5.18%	—	-0.26%
127	Tax-Managed International (8/17/1999)	VTMGX	-22.91	—	—	-9.31
Balanced Fund						
103	Tax-Managed Balanced (9/6/1994)	VTMFY	-4.50%	8.60%	—	10.53%

††**Next Report/Prospectus Online:** The fund's next annual report (A), semiannual report (S), or prospectus (P) is expected to be available on our website (Vanguard.com) no later than the last day of the indicated month. Account statements are posted online approximately eight days after the end of each calendar quarter.

*The U.S. government backs the fund's underlying investments but not its shares' net asset value.

**Share prices for the Vanguard Variable Annuity Plan are accumulation unit values that reflect the investment results of the respective portfolios as well as the reinvestment of all dividends and capital gains, reduced by daily mortality, expense risk, and administrative expense charges. The one-, five-, ten-year, and since inception period returns, considered "Standardized," are adjusted for the \$25 annual fee charged on contracts valued at less than \$25,000. With respect to contracts issued in New York State, performance figures shown are based on the actual performance of Vanguard Variable Insurance Fund as if the contracts were being offered in New York prior to their first New York offering date in November 1992. The Plan is a flexible-premium, multifund variable annuity issued by Peoples Benefit Life Insurance Company, Form No. Series NA 100A (AUSA Life Insurance Company, Inc., in New York only, Form No. Series AV423 101 109 498 CRT).

†30-day yield for bond funds; 7-day yield for money market funds (as of December 31, 2001). The money market yields listed more closely reflect the current earnings of the portfolio than the average annual total returns shown.

• MSCI Provisional Index Series returns beginning November 16, 2001.

¹Since inception returns for less than one year are not annualized.

²Yield stated in real terms; not adjusted for projected inflation.

Individual investors may not purchase or redeem Vanguard® Total Stock Market VIPERs™ directly from the issuing fund. Instead, these investors must buy or sell VIPER™ Shares in the secondary market with the assistance of a stock broker. Also note that brokerage commissions and other fees will result in total returns that are lower than those shown here.

After-tax returns are calculated using the highest individual federal income tax rates in effect at the time of each distribution. They do not reflect the impact of state and local taxes. Your after-tax return depends on your individual tax situation and, therefore, may differ from the return presented here. If you own fund shares in a tax-deferred account such as an individual retirement account or 401(k) plan, this information does not apply to your investment because these accounts are not subject to current taxes. The fund's past performance—whether before or after taxes—does not indicate how it will perform in the future.

After-tax total returns are available for many of the Vanguard funds on our website, **Vanguard.com**. To view after-tax returns, select a Vanguard fund in the "Funds" area of the website and click on "Performance."

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