WHY VANGUARD?

Primarily due to their low-cost structure, index funds generally outperform the majority of actively managed mutual funds.[1] Not surprisingly, index funds are now embraced by an increasing number of investors. But not all index funds are created equal. Today, there are thousands of index funds from which to choose. This paper explains why Vanguard's index funds stand out from the crowd.

INDEXING PIONEERS

There is not a more experienced company than Vanguard when it comes to managing index funds. In fact, you could say they created the index fund itself.

Vanguard's index funds trace their roots back to 1951, when John Bogle—who later founded the company—wrote his senior thesis at Princeton University. Bogle discovered most mutual funds earned lower returns than the Standard & Poor's 500 Stock Index. The obvious conclusion was the majority of mutual fund investors would be better off owning all the companies represented in the index rather than relying on managers attempting to pick only "winners." The trouble was, at the time, one could not invest in the index.

It would take over 20 years, but Bogle would eventually solve that problem. In 1974, he founded Vanguard and two years later the Vanguard 500 Index Fund was launched. The fund was the first to offer individuals the opportunity to invest in an index (The S&P 500). While the fund didn't exactly get off to the fastest start—it was not until 1979 that it was big enough to actually purchase all 500 stocks—the Vanguard 500 Index Fund now has over $100 Billion in assets.

CLIENT-OWNED FUNDS

Vanguard has led the index fund category from the very beginning, distinguishing the company in a number of ways. Today, The Vanguard Group is the world's largest manager of index funds. But perhaps Vanguard's most remarkable distinction is the structure of Vanguard itself—the company is owned by the mutual funds it runs. This means fund managers literally work for fund investors.

Vanguard's ownership structure stands in sharp contrast with almost all other fund companies which belong to either private owners or public shareholders. While most investment companies must balance investor objectives (returns) with owner objectives (profits), Vanguard is free to focus exclusively on what is best for investors. The interests of both managers and investors are aligned—a rarity in today's world.

INVESTOR ADVOCATES

From the beginning, Vanguard has demonstrated their commitment to putting individual investors first. Clearly, choosing to organize as a non-profit company confirmed Vanguard's commitment to individual investors.

Introducing index funds to the masses was another example of Vanguard's investor orientation. Back in the early 1970's, interest in indexing was limited and Bogle's early ideas were met with much industry skepticism. However, compelling academic evidence and an underlying commitment to doing what is right over what is popular gave Vanguard the courage to blaze a new trail.

For more than 35 years, Vanguard has continued to buck industry trends. While most firms focus on gathering assets by promoting the latest "hot performing" funds, Vanguard endeavors to educate investors about the risks of chasing yesterday's winners. Creating great index funds is just half the battle; teaching their customers how to be more successful investors is the other half.

A PENNY SAVED, A PENNY EARNED

What is better than low-cost investing? At-cost investing. Most index funds charge fees which, although quite low compared to actively managed funds, still include some margin for profit. Vanguard charges only what it costs to run the funds.

The absence of profit margins translates into cost savings for investors. Costs matter because they subtract from returns. Every penny used to cover expenses is a penny not helping investors to reach their goals.

The table below shows annual fees (expense ratios) for a select group of Vanguard index funds as compared to the average index fund in each comparable category.

THE BOTTOM LINE: PERFORMANCE

Among the reasons to invest with Vanguard, it is performance which speaks loudest. Ultimately, Vanguard's low-cost structure and investor-orientation should combine to deliver attractive long-term returns for investors. And deliver they have:

Take that original Vanguard 500 Index Fund, as an example. Over the past 15 years, it has outperformed the average return for all comparable index funds by more than half of one percent per year. On a $100,000 investment, that performance difference equates to an extra $15,649 in shareholders' pockets.

Even in the world of indexing, where the goal is not to "outperform" but to rather earn the return of the index, not all funds are created equal. Costs clearly matter. Overwhelmingly, lower costs should lead to higher returns in the long-haul.

Vanguard's at-cost structure, combined with its uncompromising commitment to serving its clients (who are also its owners) makes Vanguard one of the most appealing fund companies with which to invest.

Vista Capital Partners, Inc. is a fee-only investment advisor based in Portland, Oregon. We specialize in managing globally-diversified portfolios that minimize costs and taxes for individual clients with more than $2 million to invest. Call us at 503-772-9500 or visit www.vistacp.com.

TABLE 1: EXPENSE RATIOS—VANGUARD VS. AVERAGE INDEX FUND[2]

Data as of 11/30/2011

Asset Class	Fund/Category Average	Annual Expense Ratio (%)	Vanguard Discount
U.S. Large Cap Value	**Vanguard Value ETF (VTV)** Large Cap Value Index Fund Average	**0.12** 0.54	78%
U.S. Large Cap Growth	**Vanguard Growth ETF (VUG)** Large Cap Growth Index Fund Average	**0.12** 0.93	87%
U.S. Small Cap	**Vanguard Small Cap ETF (VB)** Small Cap Index Fund Average	**0.17** 0.67	75%
U.S. Real Estate (REITs)	**Vanguard REIT ETF (VNQ)** REIT Index Fund Average	**0.12** 0.34	65%
Int'l Real Estate (REITs)	**Vanguard Int'l REIT ETF (VNQI)** Global REIT Index Fund Average	**0.35** 0.49	29%
Inflation-Protected Bonds	**Vanguard Inflation-Protected Fund (VAIPX)** Inflation-Protected Bond Index Fund Average	**0.11** 0.18	39%
U.S. Treasury Bonds	**Vanguard Intermediate-term Treasury (VFIUX)** Government Bond Index Fund Average	**0.10** 0.34	71%

REFERENCES

[1] Morningstar and Lipper. Through January 2008, the Vanguard S&P 500 Index Fund outperformed 78% of all U.S. Large Cap Stock mutual funds over the prior 15 years. Over the same period, 80% of Intermediate-term U.S. Bond mutual funds underperformed the Barclays Capital U.S. Aggregate Bond Index. Of the top 20-performing stock U.S. stock mutual funds from 1983 to 1993, 16 (80%) failed to match the market return in the subsequent decade.

[2] Morningstar Principia data as of 11/30/2011.