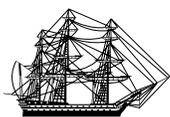
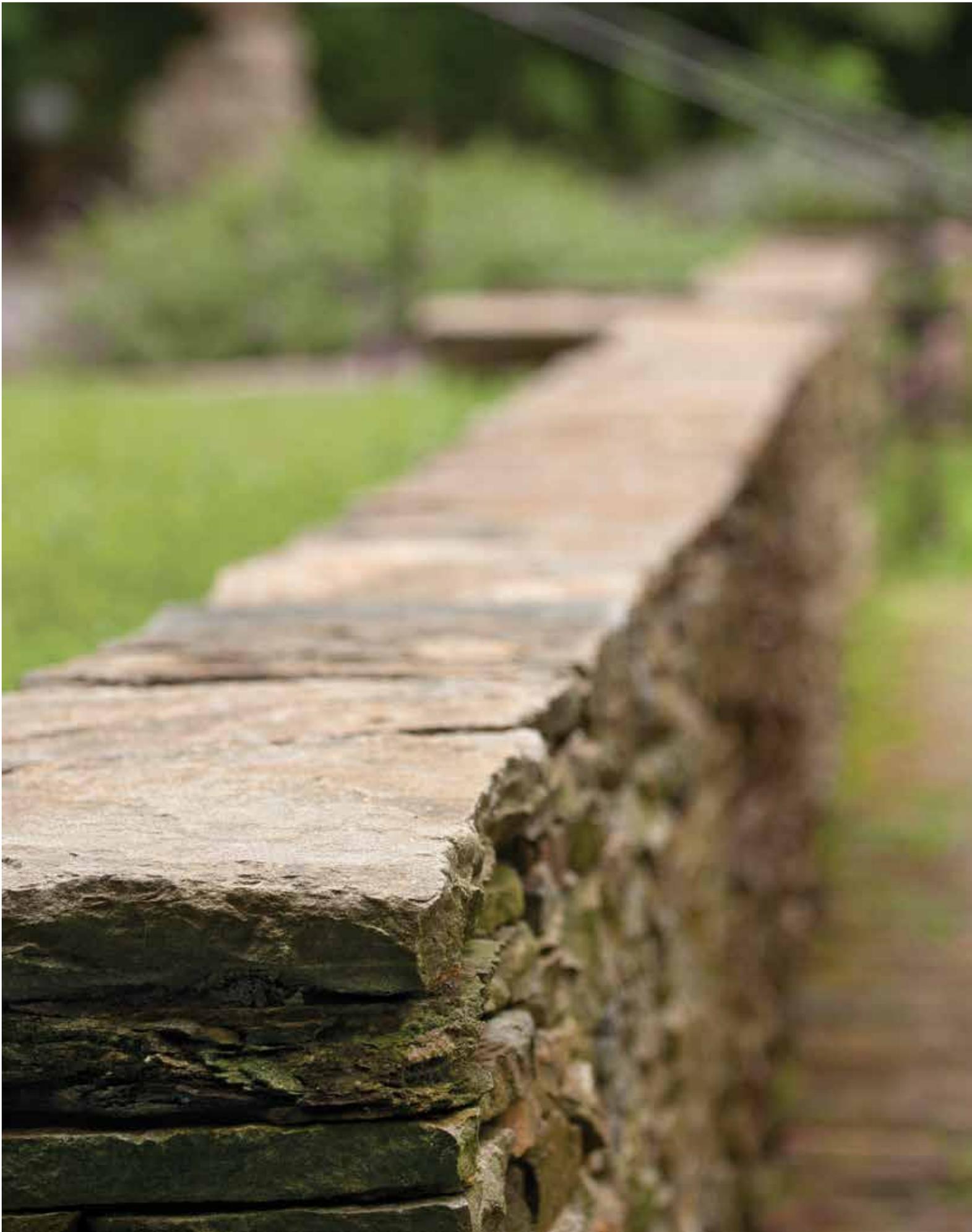


Learn about asset allocation

Investor education



Vanguard[®]



Building a strong foundation

Asset allocation is one of the key ingredients of a successful investment strategy.

Use this brief guide to gain a more complete understanding of the importance of asset allocation and the decisions your financial advisor makes regarding your portfolio.

| | |
|----------------------------------|----|
| The major asset classes | 3 |
| Understanding investment risk | 4 |
| Getting the right mix | 8 |
| Understand your risk tolerance | 10 |
| The importance of asset location | 12 |



The major asset classes

Investing in a mixture of asset classes helps reduce risk and position your portfolio for better long-term success. The primary asset classes are stocks, bonds, and short-term investments.

Stocks

Stocks represent shares of ownership in a particular company. Stock funds have historically provided the highest long-term returns—typically an average of about 10.2% per year.¹ However, to enjoy these returns, investors have had to withstand some very volatile years when returns were far from positive.

Bonds

In essence, bonds are loans to a government or a company. Over the long term, bond funds have provided average annual returns of just over

5.5% and are generally less volatile than stocks.² Investors usually invest in bond funds to earn interest income and to help compensate for the ups and downs of stock investing.

Short-term investments

CDs, U.S. Treasury bills, and money market funds are all considered to be short-term investments. All, or nearly all, the returns from short-term investments come from interest. When investors know that they will need to cover a big expense, or when they want to have money on hand for emergencies, they turn to short-term investments.

¹ U.S. stock market returns from 1926–2014. The returns are derived from index data from Standard & Poor's 90 Index from 1926 to March 3, 1957; S&P 500 Index from March 4, 1957, through 1974; Dow Jones Wilshire 5000 Index from 1975 to April 22, 2005; MSCI US Broad Market Index from April 23, 2005, to June 2, 2013; and CRSP US Total Market Index thereafter. Assumes all distributions were reinvested.

Sources: Standard & Poor's, Dow Jones, MSCI, and Vanguard.

² U.S. bond market returns from 1926–2014. The returns are derived from index data from S&P High Grade Corporate Index from 1926 through 1968, Citigroup High Grade Index from 1969 through 1972, Lehman Brothers U.S. Long Credit AA Index from 1973 through 1975, Barclays U.S. Aggregate Bond Index from 1976 through 2009, and Barclays U.S. Aggregate Float Adjusted Index thereafter. Assumes all distributions were reinvested.

Sources: Standard & Poor's, Barclays, and Vanguard.

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

Understanding investment risk

It's very important to understand the trade-off between investment performance and risk. Holding diversified investments across all asset classes can moderate the overall risk to your portfolio. Unfortunately, no matter how well diversified your portfolio, risk can't be eliminated completely.

Here are descriptions of some important investment risks associated with stock fund investing.

Inflation risk

Inflation can erode the value or purchasing power of your investments. Although there have been periods when stock market returns have failed to keep up with inflation, historically stock returns have beaten inflation by a wider margin than bonds or short-term investments.

Market risk

One of the most significant risks you face is the volatility of the market. Over the years stock prices have risen—and fallen—over very short periods, but long term, the upside has won out. Market risk can be reduced by holding stock investments for a long time—at least ten years.



Manager risk

Investment managers can make good decisions that result in market-beating returns, but they can also make bad decisions. That's why it's always prudent to look at an investment manager's experience and track record before investing in a mutual fund.

Your financial advisor can explain how the fund has performed compared with similar

funds and its benchmark. Your financial advisor can also help explain the fund's investment objective and how well the fund manager has adhered to it.

Sector risk

A portfolio concentrated in a few specific industry groups increases risk. That's why your financial advisor has developed a well-diversified portfolio that includes investments that span the asset classes.

Diversification does not ensure a profit or protect against a loss. Past performance is no guarantee of future returns.

Bond investing is generally less risky than investing in stocks. Still, bonds present certain risks. Here are some that you should be aware of.

Interest rate risk

The prices of bonds fall when interest rates rise, and they rise when rates fall. The longer a bond's maturity, the greater the interest rate risk. Interest rate risk can be reduced, but not eliminated, by investing in shorter-term bonds.

Income risk

When interest rates decline, a bond fund's interest income may fall, so an investor could lose income. Income risk is higher for short-term bond funds than for long-term funds because short-term bonds mature sooner and their principal must be invested at the new interest rate, which can be higher or lower.

Credit risk

Bond investors can lose money if an issuer defaults or if a bond's credit rating is lowered. Because a mutual fund invests in many bonds, the credit risk from a single default or rating change is reduced.

Call risk

Some bonds can be called, or redeemed by the issuer, before they mature. When a bond is called, investors must reinvest their money, often at a lower yield.

Inflation risk

Just like stock investments, a bond investment can lose purchasing power as prices rise. So inflation risk is a serious concern if you rely on income from bonds. For example, if inflation ran at 3% for five years, the value of a \$100 interest payment would fall to \$86 in purchasing power.

Talk to your financial advisor about investment risk and how asset allocation can help protect you from the ups and downs of investing.



Getting the right mix

Your financial advisor understands that the key to a successful portfolio is creating the right mix of assets. The most appropriate asset allocation is unique for each investor and is based on a range of factors. Among them is understanding your investment objectives and time horizon.

This is the time to work closely with your financial advisor in order to answer the critical questions that will lead to an asset allocation designed to fit your particular needs.

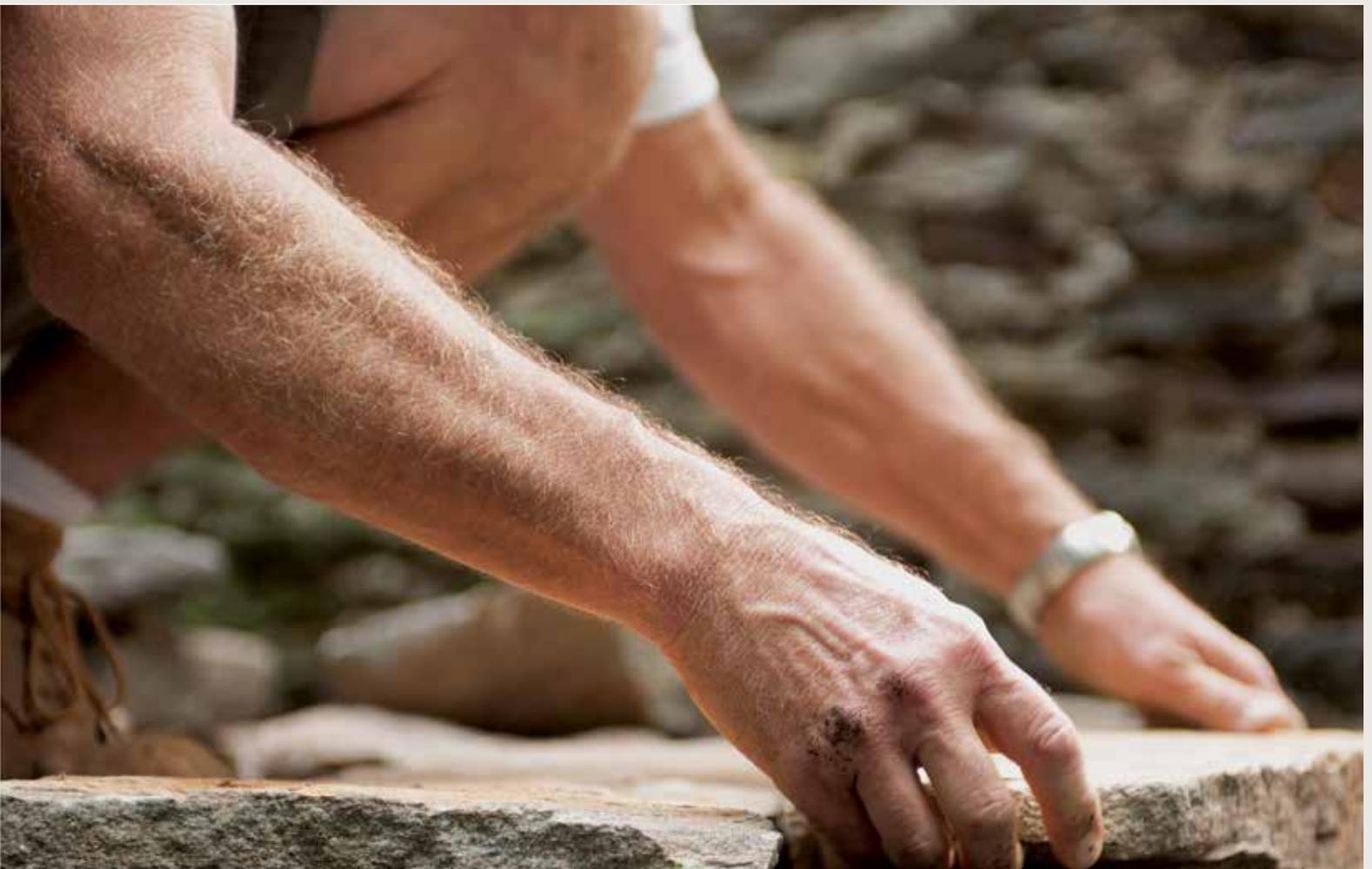
Determine your objectives and time horizon

To understand what you want to do with your money and when you'll need it, your financial advisor will ask a number of questions, including:

- Why do you want to invest your money?
- What do you expect from your investments?
- How long is your investment horizon?

One of the first steps is to prioritize your investment goals. Whether you're saving for retirement, a child's education, a house, an estate plan, or a charitable legacy, clearly defined goals will help your financial advisor create an effective portfolio that helps you achieve those goals.

Your financial advisor will also ask about your investment time horizon, since your investments will rise and fall in value throughout the time you own them.



The longer your time frame, the greater your ability to ride out the ups and downs of the markets. If you won't need money right away, you can more reasonably work with your financial advisor to select investments whose values might fluctuate in the short term in hopes of earning greater returns over time.

For example, if you're saving for retirement, your time horizon may span several decades. With that much time, the emphasis may be on stocks. For short-term goals, your financial advisor will probably look to a more stable investment, such as a money market fund.

Understand your risk tolerance

Once you've worked with your financial advisor to determine your investment goals and time horizon, it's time to think about your reaction to the risks of investing.

Emotions matter

How you react to risk is important when creating an investment portfolio. Do you become anxious during a drop in the markets? Or do you tend to shrug it off as the normal ebb and flow of business on Wall Street? The important thing to remember is that you're more likely to stick with an investment plan that fits your investment personality.

The following examples help illustrate how investors choose significantly different asset mixes depending on their financial situations and views on risk.

The wary investor

An investor in his 30s is saving for retirement, and you might expect him to meet his goal by investing primarily in stock funds. Yet he's wary of the stock market and inexperienced with investing, and sees that stocks have suffered recent declines. He finds that he's most comfortable with a portfolio that includes 20% stock funds and 80% bond funds.

The dual-income couple

A dual-income married couple in their 40s want to accumulate additional savings for retirement in about 20 years. A portfolio that consists of 70% stock

funds and 30% bond funds might be appropriate. However, the husband's job (which provides nearly half of their income) has become unstable, and they're anxious about their economic future. They may settle on a more conservative asset allocation of 50% stocks, 40% bonds, and 10% short-term investments.

The recently retired couple

A newly retired couple in their 60s at first considered a portfolio of 30% stock funds and 70% bond funds. However, they believe their retirement benefits are ample for their income needs. The couple want to build a larger estate to benefit their grandchildren. They decide on a more aggressive asset allocation consisting of 50% stock funds and 50% bond funds. Here the additional risk is expected to generate higher long-term returns.

The risk questionnaire

One of the techniques your financial advisor may use to help determine how well you can tolerate investment risk is a risk questionnaire. Typically, the questionnaire asks about the length of time you plan to hold your investments, how you might react to a variety of market scenarios, your current and future income sources, and how much money you believe you'll need to reach your goals.

The importance of asset location

Taxable, tax-deferred, or tax-exempt?

While asset allocation is one of the most important factors in determining long-term portfolio performance, less understood is the impact of asset location.

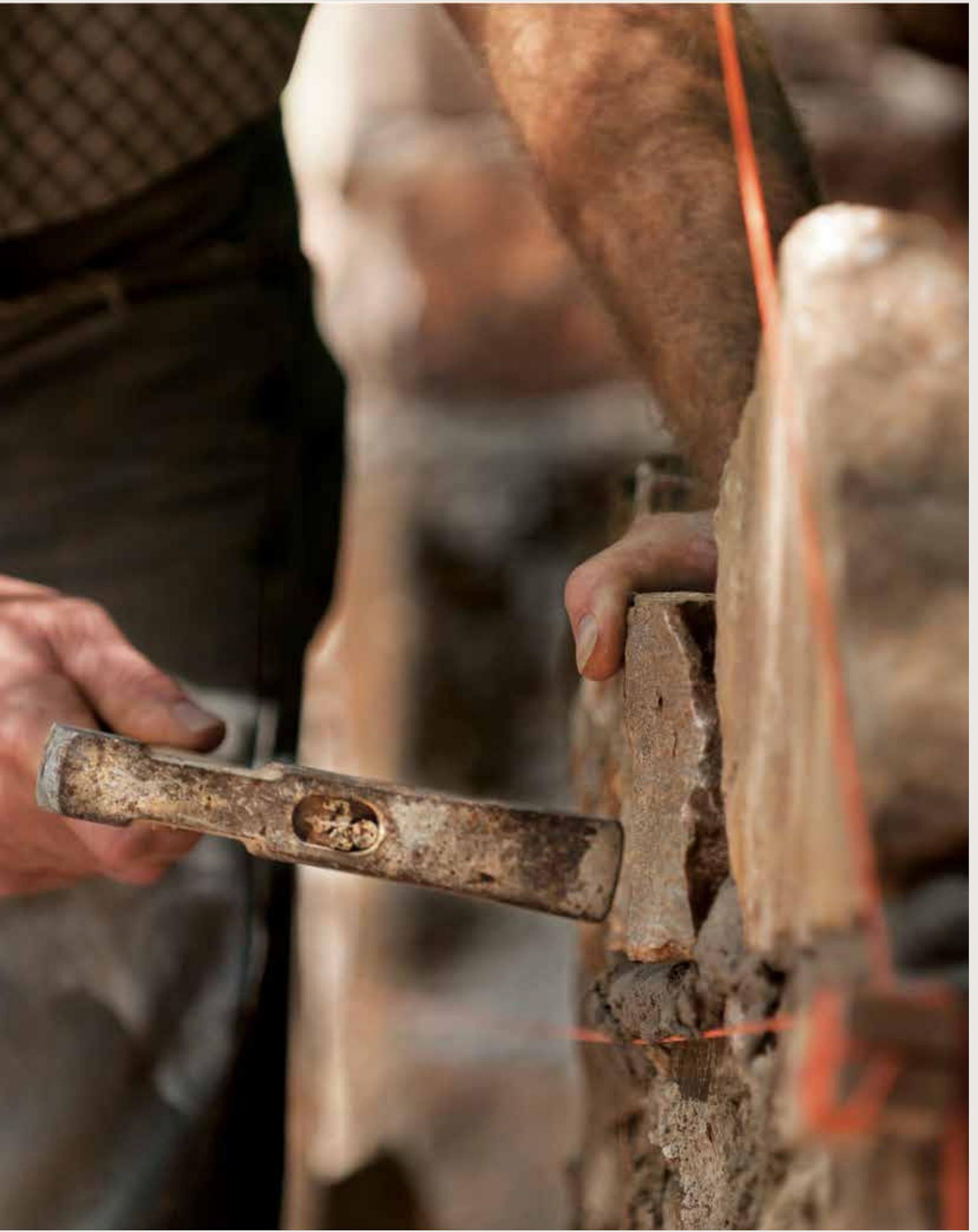
Asset location refers to where, or in which type of account (taxable, tax-deferred, or tax-exempt) you should place your investments. Once you have worked with your financial advisor to determine the appropriate asset allocation—including your preference for actively managed or index funds—the next step is to determine which type of fund should go in which type of account.

The objective of asset location is to maximize the tax efficiency of your portfolio. Therefore, your financial advisor would likely suggest that you place your tax-inefficient investments in your tax-advantaged accounts, such as your IRA, 401(k), SEP, or similar accounts. Conversely, you would place your tax-efficient investments in your taxable accounts.

Consult with your financial advisor to determine how asset location can most effectively be applied to your portfolio.

Talk to your financial advisor whenever you have questions about the performance or composition of your portfolio.

If you take withdrawals from a tax-deferred investment before age 59½, you may have to pay ordinary income tax plus a 10% federal penalty tax. Consult an independent tax advisor about your particular situation.





Vanguard Financial
Advisor Services™

P.O. Box 2900
Valley Forge, PA 19482-2900

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 such a fund.

All investing is subject to risk, including possible loss of principal.

Financial advisors: Visit advisors.vanguard.com
or call 800-997-2798.