

Fund Essentials™

investing for

income



THE **Vanguard** GROUP

Vanguard® bond funds

A convenient, low-cost choice for investors who seek income



Reliable income, especially during retirement, is one of the main reasons **investors turn to bonds.**

there are other types of investments that generate monthly interest income—money markets, certificates of deposit, and bank savings accounts, to name a few—these instruments typically provide lower yields than bonds.

So if you need steady income, **consider investing in a bond mutual fund.**

By adding bond funds to your portfolio, you'll earn monthly interest income that you can either receive as cash or reinvest for compounded growth. And what better place to look than Vanguard, the leading provider of low-cost bond funds.

Why use bond funds for your income needs?

Diversification. Purchasing a bond mutual fund instead of individual bonds will help diversify your portfolio. Because bond funds hold bonds from many different issuers, the performance of any one security is unlikely to have a significant impact on your investment.

Professional management. After you choose the type of bond fund that meets your income needs and tolerance for risk, you can then rely on professionals to manage the fund's holdings.

Convenience. Bond funds offer daily liquidity; you can buy or sell your shares in a bond fund whenever you like. In addition (just as with money market funds*), many bond funds offer checkwriting and telephone redemption options.

A quick look at the bond market segments

		. . . Average Maturity . . .			
		Short	Medium	Long	
. . . Credit Quality . . .					Treasury/Agency
					Investment-Grade Corporate
					Below Investment-Grade

Most bond funds tend to fall into one of the nine boxes in this grid, showing the focus of a fund in terms of two attributes: average maturity (short, medium, or long) and average credit quality (Treasury/agency, investment-grade corporate, or below investment-grade).

What are the risks?

Bonds are generally considered less risky than stocks, but as with any investment, there is always some risk involved. Before you purchase bond funds, these are the chief risks you should consider:

- **Interest rate risk.** Bond funds decrease in value when interest rates rise, and they increase in value when interest rates fall. The

*Money market funds are 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.

longer the average maturity or duration of a bond fund, the greater the interest rate risk.

- **Credit risk.** Bonds can lose value if an issuer's credit rating is lowered or if the issuer defaults by failing to make interest or principal payments. But, because a mutual fund invests in many bonds, the impact of a downgrade or default by any one issuer is significantly lessened. Unlike corporate bonds, Treasury bonds have a negligible credit risk because they are backed by the full faith and credit of the U.S. government. **Note:** U.S. government backing of Treasury or agency bonds applies only to the fund's underlying securities; it does not prevent share-price fluctuations.
- **Income risk.** Income from bond funds may fall because of declining interest rates. If you need current income for living expenses, you should be able to tolerate a fluctuating yield from your bond funds. Income risk is higher for short-term bond funds and lower for long-term bond funds.

What should you consider when selecting a fund for income?

To determine whether a particular bond fund is right for you, ask yourself a few questions. Keep in mind that the more income you need, the more risk you'll probably have to accept.

1. **How much interest rate and income risk can you live with?** The degree of risk you can comfortably assume dictates whether you should invest in a short-, intermediate-, or long-term bond fund. If you're worried about fluctuations in the bond market, consider funds that have lower average maturities, because those funds have lower price volatility than longer-term funds. If you have a long time horizon and seek more stable income, you are more likely to choose a long-term bond fund.

- 2. How much credit risk can you tolerate?** If you seek the highest investment quality, you should consider U.S. Treasury and agency bond funds; if you need higher yields and can accept a bit more risk, you might favor corporate bond funds. For something in between, consider a bond index fund that invests in both government and corporate bonds.
- 3. Are you in a high tax bracket? Is the investment being made outside of a tax-deferred retirement plan?** If the answer to both questions is yes, you may want to investigate tax-exempt bond funds rather than taxable bond funds.

Check your marginal tax bracket to see if tax-exempt bond funds are for you

Investors in lower tax brackets are less likely to benefit from owning tax-exempt bonds than investors in higher tax brackets.*

Your Marginal Tax Bracket	Is a Tax-Exempt Bond Fund Appropriate?
15%	Unlikely
28%	Likely
31%	Quite Likely
36%	Highly Likely
39.6%	Highly Likely

*You may wish to consult a tax adviser to discuss your specific tax situation.

Need help making the right investment choices?

help

The Vanguard Investment Planner, from our Plain Talk® Library, can help you choose the appropriate investment. You can download the brochure from our website, Vanguard.com™. To receive a copy by mail, complete the attached reply card or call us at 1-800-642-8999.

Some Vanguard bond funds to meet your income needs

We offer a broad selection of **low-cost bond funds** suitable for almost every investor.

The following Vanguard bond funds all seek to provide a **high level of current income**.

They follow various investment strategies and cover the entire spectrum of maturities—from short-term to intermediate-term to long-term.

Short-Term Corporate Fund invests primarily in short-term, high-quality corporate securities and maintains an average maturity of 1 to 3 years. This fund usually generates the highest income of all our short-term bond funds.

Intermediate-Term Tax-Exempt Fund invests in a variety of high-quality municipal securities that have an average maturity of 6 to 12 years. The fund provides income that is exempt from federal income tax.*

Total Bond Market Index Fund seeks to track the performance of the Lehman Brothers Aggregate Bond Index, which measures the performance of the entire U.S. bond market—including government, corporate, and mortgage-backed bonds.

GNMA Fund invests primarily in Government National Mortgage Association securities, which offer timely payment of principal and interest backed by the U.S. government. Although the fund doesn't observe specific maturity guidelines, its average maturity normally falls within an intermediate range of 5 to 10 years.

Long-Term Treasury Fund invests primarily in long-term U.S. Treasury bonds, whose principal and interest payments are backed by the full faith and credit of the U.S. government.

The fund generally maintains an average maturity of 15 to 30 years.

Insured Long-Term Tax-Exempt Fund generally invests in a variety of high-quality municipal securities having an average maturity of 12 to 25 years and provides income that is exempt from federal income tax. At least 80% of the fund's assets are invested in high-quality municipal bonds that are covered by insurance that guarantees the timely payment of principal and interest.**

High-Yield Corporate Fund seeks a high level of current income by investing in speculative ("junk") bonds. Bonds held in this fund typically have higher-than-average credit ratings compared with those held in the average high-yield bond fund.

*Although the interest income from a municipal bond fund is exempt from federal income tax, capital gains realized either through a fund's trading or from a redemption of shares are taxable. For some investors, a portion of the fund's income may be subject to the alternative minimum tax.

**Bond insurance guarantees only the creditworthiness of bonds held in the fund—it does not protect shareholders from fluctuations in bond prices. It is also possible that an insurer may not be able to meet its commitments.

Key fund facts

	Inception Date	Interest Rate Risk	Credit Risk	Income Risk	Average Maturity**	Fund Expense Ratio***
Short-Term Corporate Fund*	October 29, 1982	Low	Low	High	2.4 Years	0.25%
Intermediate-Term Tax-Exempt Fund*	September 1, 1977	Medium	Low	Medium	7.8 Years	0.18%
Total Bond Market Index Fund*	December 11, 1986	Medium	Low	Medium	8.7 Years	0.22%
GNMA Fund*	June 27, 1980	Medium	Negligible	High	8.6 Years	0.27%
Long-Term Treasury Fund*	May 19, 1986	High	Negligible	Low	18.5 Years	0.28%
Insured Long-Term Tax-Exempt Fund*	September 30, 1984	High	Negligible	Low	14.4 Years	0.19%
High-Yield Corporate Fund	December 27, 1978	High	High	Medium	6.5 Years	0.28%

*Also offers Admiral™ Shares, a separate class that offers lower expenses. The minimum initial investment for this share class is \$250,000.

**As of March 31, 2001.

***For the fund's most recent fiscal year.

Vanguard—the leader in bond funds

The Vanguard Group is the leading provider of bond mutual funds, and we offer one of the largest selections in the industry. Our expert bond fund managers oversee more than \$90 billion in assets. In addition to the seven funds already described, here are other Vanguard bond funds to consider for your income needs. You can get more details about all of our funds by visiting our website, Vanguard.com, or by calling us at 1-800-642-8999.

Open your account online today

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

Other Vanguard bond funds

Short-Term

Short-Term Bond Index Fund

Short-Term Federal Fund

Short-Term Treasury Fund

Intermediate-Term

Intermediate-Term Bond
Index Fund

Intermediate-Term
Corporate Fund

Intermediate-Term
Treasury Fund

Long-Term

Long-Term Bond Index Fund

Long-Term Corporate Fund

Long-Term Treasury Fund

Tax-Exempt

High-Yield Tax-Exempt Fund

Limited-Term Tax-Exempt Fund

Long-Term Tax-Exempt Fund

Short-Term Tax-Exempt Fund

State-Specific (for residents of the respective states)

California Insured Intermediate-
Term Tax-Exempt Fund

California Insured Long-Term
Tax-Exempt Fund

Florida Insured Long-Term
Tax-Exempt Fund

Massachusetts Tax-Exempt Fund

New Jersey Insured Long-Term
Tax-Exempt Fund

New York Insured Long-Term
Tax-Exempt Fund

Ohio Long-Term
Tax-Exempt Fund

Pennsylvania Insured Long-Term
Tax-Exempt Fund





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Vanguard funds are offered by prospectus only. Prospectuses contain more complete information on risks, advisory fees, distribution charges, and other expenses and should be read carefully before you invest or send money. Prospectuses can be obtained directly from The Vanguard Group.

World Wide Web

www.vanguard.com

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