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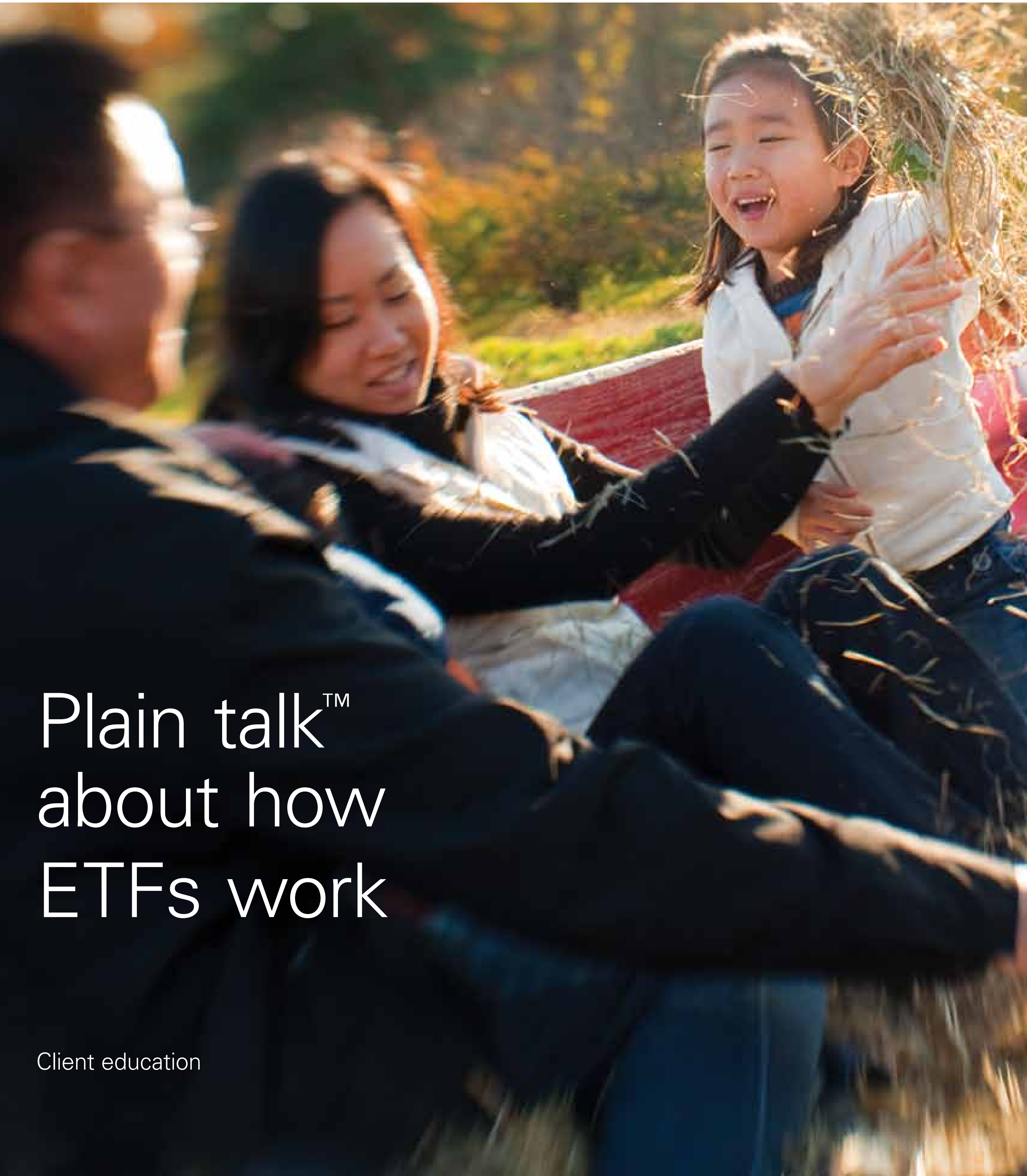

Plain talk™ about how ETFs work

Client education

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Exchange-traded funds (ETFs) are attracting ever-greater attention from investors. They continue to grow globally, with assets of more than $1.40 trillion.[1] That trend translates to Canada, where they are becoming a low-cost investment vehicle of choice. Canadian-listed ETF assets have more than doubled since 2008.

But just what is an ETF? Use this guide to learn what ETFs are, how they work, and what makes them different from other investment types. You'll gain an appreciation of why your financial advisor may suggest ETFs for your investment portfolio.

1 Source : Morningstar, Inc. as of 30 September 2011.

What are ETFs?

Simply put, ETFs are mutual funds that are listed and traded on a regulated stock exchange. ETFs offer the diversification benefits of mutual funds and the liquidity and trading flexibility of individual stocks. And ETFs, on average, cost less than mutual funds.

Like mutual funds, ETFs offer the opportunity to invest in a portfolio of securities, such as stocks or bonds.

While most mutual funds in Canada are *actively managed* funds, which try to outperform the market, ETFs in Canada are primarily *passively managed* index investments. They seek to track the performance of a broad market benchmark or a specific portion of it. ETFs invest in all or a representative sample of the securities of the indexes they seek to track.

ETFs' characteristics and advantages include:

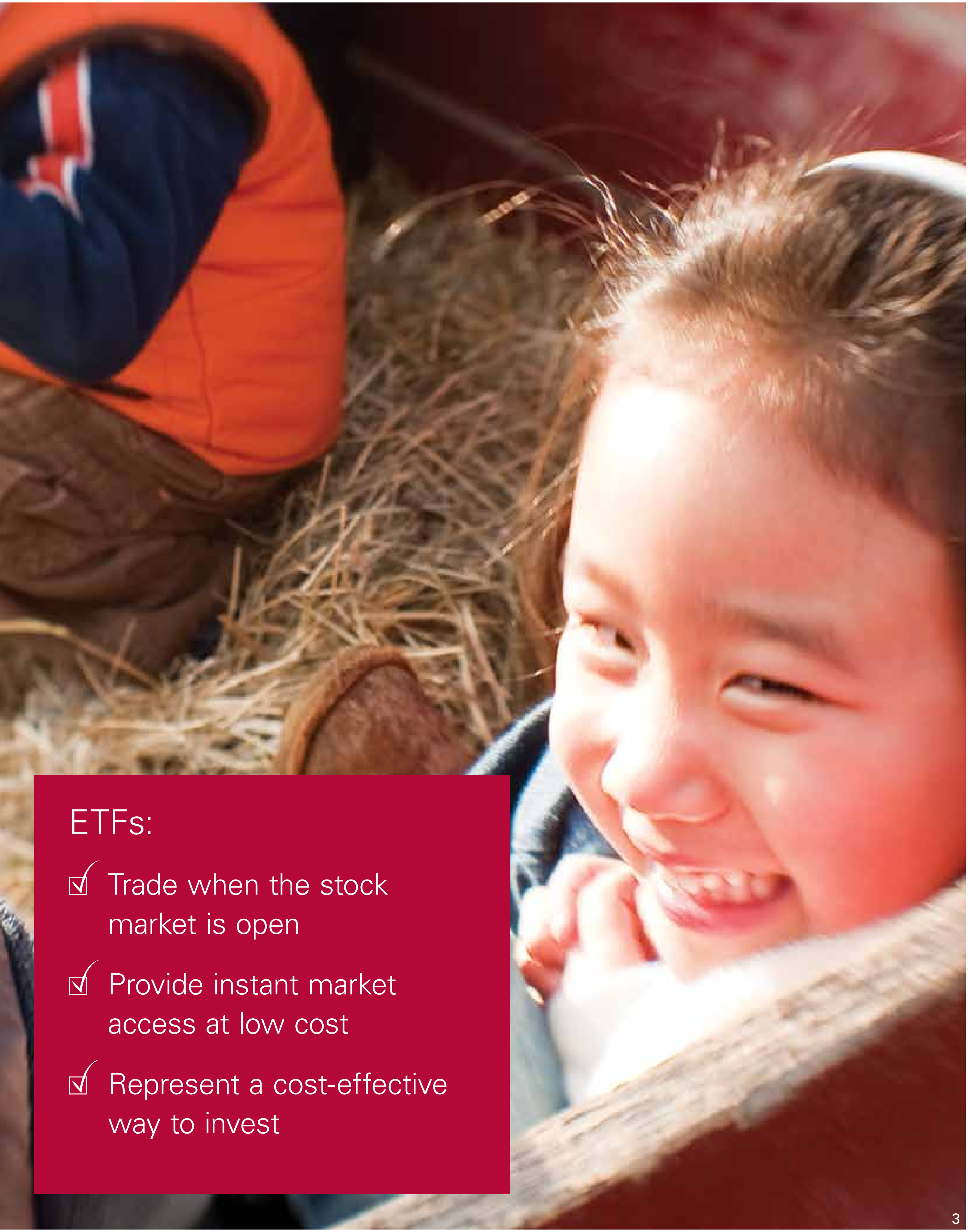
- Low costs
- Secondary market trading
- Relative predictability of tracking a market
- Diversification within a market segment
- Potential for tax efficiency compared with mutual funds
- Consistent management strategy

Keep in mind that diversification does not ensure a profit or protect against a loss in a declining market, and that it is not possible to invest directly in an index. While Vanguard ETFs are designed to be as diversified as the original indexes they seek to track and can provide greater diversification than an individual investor may achieve independently, any given ETF may not be a diversified investment.

Trading flexibility

ETFs are traded on a stock exchange, so they can be bought and sold through your advisor or a brokerage account any time the exchange is open. Investors can use stock-trading techniques such as stop and limit orders and short-selling. And ETFs can be bought on margin.

Of course, like stocks, ETFs are subject to the traditional risks and potential rewards of the markets. The value of ETF shares will rise and fall as markets fluctuate, so an ETF can gain or lose value over short periods or long. Your financial advisor can work with you to establish an asset mix with a risk/reward profile that suits you.



ETFs:

- ☑ Trade when the stock market is open
- ☑ Provide instant market access at low cost
- ☑ Represent a cost-effective way to invest

How ETFs work

ETFs are created by investment companies working with certain institutional investors. They are traded on a stock exchange whenever the stock exchange is open, and their value changes throughout the day.

Most ETFs use an indexing approach. They're built so their value can be expected to move in line with the index they seek to track. For example, a 2% rise or fall in the index should result in approximately a 2% rise or fall for an ETF that tracks that index.

Investors and their financial advisors must trade ETFs through a brokerage firm. Shares can be bought and sold at the current market price whenever the stock exchange is open. Share prices typically reflect the approximate value of an ETF's underlying shares at any given point in the day.

Mutual funds, conversely, are bought and sold directly through the fund company. Regardless of when you place an order, the purchase or sale takes place only once, at the end of the day, at the same price for all investors.

Unlike mutual funds, ETFs generally do not experience cash flows into or out of the fund. That's because only certain institutional investors (brokerage houses, for example) are authorized to purchase or redeem shares directly, and they typically do so using securities.

When these institutional investors, known as dealers, purchase shares of an ETF, they typically give the ETF specific quantities of securities that are part of the index the ETF seeks to track. Similarly, when these institutions redeem their ETF shares, the ETF provides them with securities, not cash.

Through these "in-kind" transactions, the ETF incurs minimal transaction costs and does not realize capital gains.

Institutional investors sell their ETF shares to individual investors on the open market. These individual investors may then sell their shares to other investors for cash.

These market trades, however, have no effect on the ETF itself; no cash flows into or out of the ETF that would require it to purchase or sell portfolio securities, pay brokerage commissions, or realize capital gains. As a result, the ETF is largely able to hold down its operating costs and limit the distribution of capital gains to shareholders.

Of course, individual shareholders would be subject to any brokerage commissions and capital gains triggered by their own trades.

Comparing ETFs and mutual funds

	ETFs	Index mutual funds	Actively managed mutual funds
Access	Shares bought and sold through a investment advisor or platform offering brokerage services	Shares bought and sold directly through the fund company or through an advisor	Shares bought and sold directly through the fund company or through an advisor
Pricing	Share prices set by the market throughout the trading day	Net asset values determined once per trading day, after financial markets close	Net asset values determined once per trading day, after financial markets close
Management expense ratios[3]	0.88%	1.14%	2.05%
Transaction costs	Brokerage commissions and bid-ask spreads on each direct purchase and sale	None for funds that don't have a sales charge when purchased or redeemed directly with the fund. (Some funds do have sales charges)	None for funds that don't have a sales charge when purchased or redeemed directly with the fund. (Some funds do have sales charges)
Dividend reinvestment	Availability depends on the fund sponsor or your broker, who may charge for the service	Generally available at no charge	Generally available at no charge
Client services	Provided by an advisor	Provided by the fund sponsor or an advisor	Provided by the fund sponsor or an advisor

3 Source: Vanguard calculations using management expense ratios compiled from annual and semiannual Management Reports of Fund Performance and/or financial statements by Morningstar, Inc. Data may include sector ETFs and leveraged ETFs, which usually have higher MERs than all-market index funds.

Data as of 30 September 2011. Cost comparisons are for illustrative purposes only and are not meant to be all-inclusive. MER is expressed as an annual percentage of fund assets. It is composed of the base management fee plus certain operating expenses, such as administrative costs, plus applicable taxes. Different components contribute to the respective MER calculations for actively managed funds and index funds. Transaction costs associated with the issue, exchange, sale, and redemption of funds are not included. Trading, portfolio rebalancing and optional costs, and income taxes payable by any unit-holder, are also not included. There may be significant differences between the investments that are not discussed here.

How ETFs are traded

Some trading options your advisor may use

Because ETFs trade like stocks any time during regular exchange hours, your financial advisor can execute specific strategies to help you achieve your investment objectives.

Here are some ways that ETFs can offer greater flexibility than mutual funds:

A stop order is an order that triggers a market order to buy or sell a stock once it reaches a certain share price, known as the stop price. Be aware that stop orders may be triggered by temporary market movements or may be executed at prices higher or lower than the stop price because of market orders placed ahead of them.

A limit order is an order to buy or sell a security at a specified price or better. Limit orders may not be executed immediately. They may be executed only partially, or not at all, depending on the availability of buyers or sellers at the price you have specified.

Stop and limit orders can help protect you from trading a security at a lower or higher price than you want to.

Buying on margin allows an investor to borrow a percentage of an ETF's value from the broker in order to purchase the ETF. Be aware that if the value of the ETF drops substantially, the investor may have to deposit more cash in the account or sell some of the ETF.

Short-selling is an investment technique that involves borrowing a security and then selling it with the intent to buy it back at a lower price. Short-sellers hope to make money when the market goes down. If a security you have sold short rises in value, however, you can lose money—and there's no limit to how much you can lose.

In some cases, your financial advisor can short-sell ETF shares to hedge the risk of other investments you hold. Your advisor can also shift assets out of and back into an ETF on a short-term basis to realize any capital losses to better manage your tax liability.

Your advisor can help determine whether such strategies are right for you.

Costs

Because ETFs typically are indexed investments, they can cost less to own than actively managed investments. Transaction costs are lower for indexed investments because transactions are fewer. There aren't ever-changing bets on which securities will outperform the market. And there's no need to employ the expensive analysts who make these bets.

As with any investment, operating costs vary among ETFs. Generally, ETFs cost less to operate than both index and actively managed mutual funds. Because ETF investors place transactions through brokerage firms, the ETFs do not incur the administrative costs that mutual funds do for such things as correspondence, customer service, and account recordkeeping. That can allow ETFs to keep management expense ratios low, which leaves more money to work for investors over the long term.

Keep in mind, however, that your own ETF trades will incur transaction costs. You'll pay brokerage commissions whenever your financial advisor buys or sells ETF shares for your portfolio.

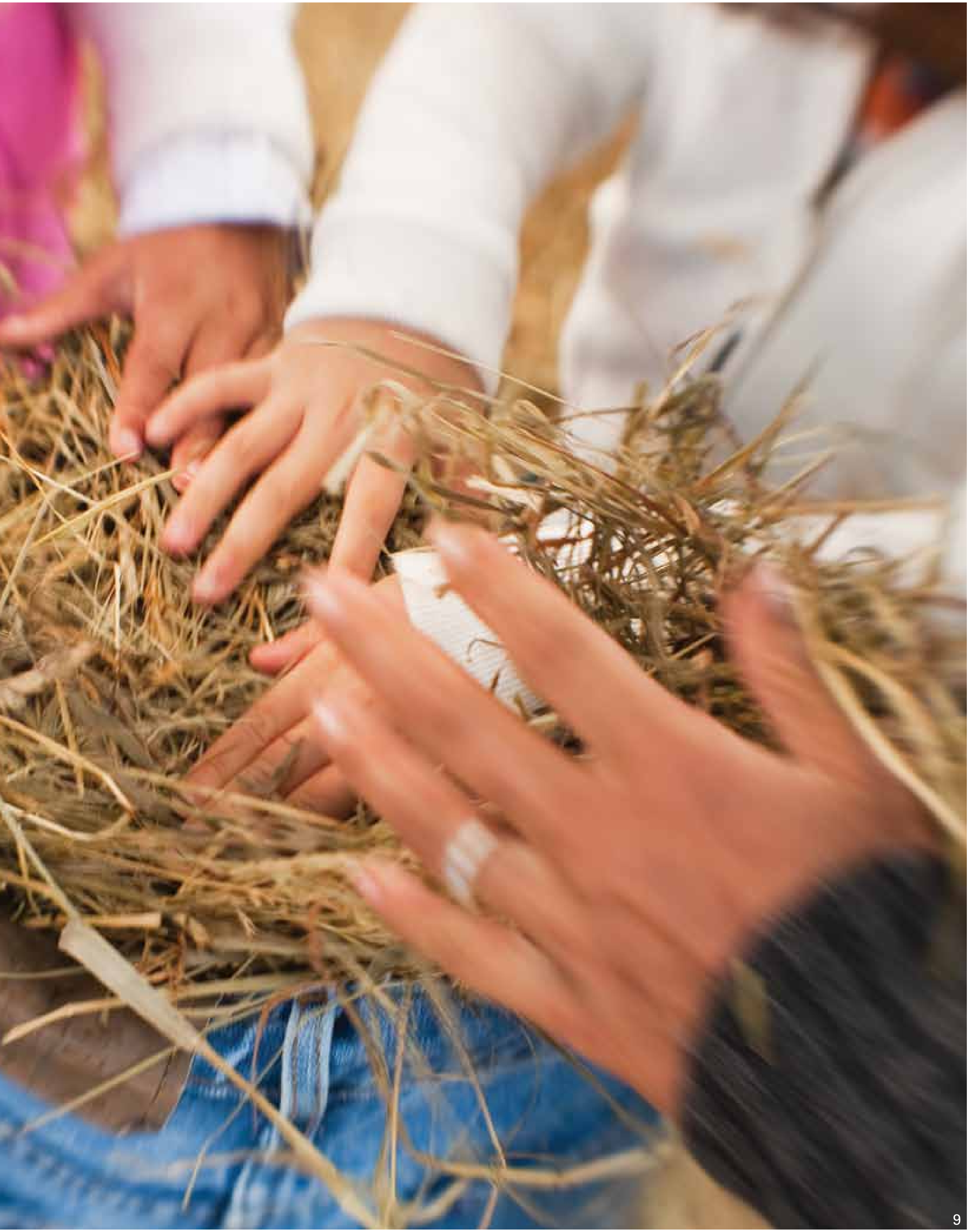
ETF market prices also reflect bid-ask spreads. This is the difference between what an investor sells a security for and the somewhat higher price at which the investor buys the same security. Like other investment costs, these expenses are borne by the individual investor and can affect investment returns.

Which ETFs are right for you?

Your financial advisor will consider a number of factors in detemining which ETFs may be right for you. Below are some of the factors you can discuss with your advisor as you construct your investment portfolio.

- Your investment goals
- Your tolerance for risk
- When you'll need your money
- How much you want to invest
- Costs, including trading costs and annual charges

Trust your financial advisor to answer your questions about ETFs and to explain how they can be used to help you achieve your financial goals.



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Commissions, management fees and expenses all may be associated with the Vanguard ETFs. This offering is only made by prospectus. The prospectus contains important detailed information about the securities being offered. Copies are available from Vanguard Investments Canada Inc. at www.vanguardcanada.ca. Please read the prospectus before investing. ETFs are not guaranteed, their values change frequently, and past performance may not be repeated.

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All investments, including those that seek to track indexes, are subject to risk, including the possible loss of principal. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index. Diversification does not ensure a profit or protect against a loss in a declining market. While Vanguard ETFs are designed to be as diversified as the original indexes they seek to track and can provide greater diversification than an individual investor may achieve independently, any given ETF may not be a diversified investment. Investing in ETFs involves risk, including the risk of error in tracking the underlying index. ETFs are subject to risks similar to those of stocks. ETFs that concentrate on a relatively narrow market sector face the risk of higher share-price volatility. Prices of mid- and small-cap stocks often fluctuate more than those of large-company stocks. Investments in exchange-traded bond funds are subject to interest rate, credit, and inflation risk. Because high-yield bonds are considered speculative, investors should be prepared to assume a substantially greater level of credit risk than with other types of bonds. ETFs in emerging markets are generally more risky than ETFs in developed countries. Foreign investing involves additional risks including currency fluctuations and political uncertainty.

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