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Indexing
a smarter way

Costs matter. That sums up the simple case for index funds.

—John C. Bogle in *Index Mutual Funds: Profiting from an Investment Revolution*

shareBUILDER 401K

index what?

You may have heard that indexing is a **smart way to invest** for your future. But what does 'indexing' mean, exactly?

Indexing, or **index investing,** is the practice of buying into index-based funds that track the investment returns of a specified stock or bond benchmark index such as the S&P 500 or the Russell 2000.

Index Examples

S&P 500	500 widely-held stocks thought to be representative of the U.S. stock market as a whole
Russell 2000	the 3000 largest companies (by value) in the U.S. market, minus the 1000 largest

How index funds are different

A traditional mutual fund is **actively managed**: that is, the investment company employs one or more persons to conduct extensive research and make frequent stock trades in an attempt to garner returns for their investors. To measure the fund's success, it's often compared to a peer index.

Index-based funds, by contrast, are **passively managed**: they hold a portfolio of stocks or bonds selected to mirror the makeup and performance of a particular index. Portfolio decisions are automatic based on the holdings of the benchmark, and trading of securities is typically infrequent.

Index funds come in two flavors: index mutual funds and exchange-traded funds (ETFs). **Index mutual funds** are purchased through investment companies on a daily basis, just like other mutual funds. An **ETF** is a fund that tracks an index, but may be bought and sold on the market throughout the day just like a single stock.

There's one more term that's very important for fund investors, and that is **expense ratio**: the combined operating costs and management fees charged to holders of a fund, expressed as a percentage of the fund's average annual net assets. So for example, if the expense ratio for a given fund is 2%, and your holdings in that fund have been worth an average of $1,000 over the course of the year, then for that year you will pay $20 to the fund provider.

index why?

So what are the **specific benefits** of index investing?

1 • Index funds are diversified

When buying individual stocks and bonds, investors run the risk of putting too many eggs in one basket. Investments that track the major indexes are by their very nature diversified, thereby limiting the amount of financial risk.

2 • Index funds are low-cost

Index funds tend to have much lower expense ratios than their actively-managed peers, which have higher operating costs in the form of research, sales charges from trading activity, and the managers' time. Those costs are all passed on to the investor. Also (though this is relevant only to taxed accounts), the fact that passively-managed funds trade less often tends to make them more tax-efficient — that is, they generate fewer short- and long-term capital gains each year.

3 • Index funds are tough to beat

Okay, but if the objective of index funds is to *match* the index, and often the objective of actively-managed funds is to *beat* the index, why would anyone want to pick the former?

Well, it turns out that despite all efforts to the contrary, a large majority of actively-managed funds perform **below** their benchmark index. For example, over a five-year period ending in March 2007:

Fund Category	Comparison Index	Funds Underperforming the Index*
Large-cap blend	S&P 500	74.69%
Mid-cap blend	S&P MidCap 400	74.24%
Small-cap blend	S&P SmallCap 600	80.39%
International	S&P/Citigroup PMI World EX US	81.69%

*Standard & Poor's Indices Versus Active Funds Scorecard, 25 April 2007.

index why?

Other academic studies find that there is no dependable persistence in performance: a fund manager who outperforms the associated index in one year is not likely to repeat that performance the next.* Picking a consistently winning fund manager is no easier than picking consistently winning securities.

4 • Index funds have performed better over the long term

Of course in the world of investing past performance is no guarantee of future results, and this is no less true of index funds.

But when it comes to retirement savings, your time horizon may be twenty years or more, which allows the advantages of index investing to really shine.

Consider this example: from 1980–2005, S&P index-based mutual funds averaged 12.3% net return (12.5% return less 0.2% expense ratio). The average actively-managed mutual fund provided a net return of 10.0% (after fees) during the same period. In other words, **investors gained a 2.3% annual advantage** by owning the index-based funds, which amounts to **42.5% greater returns** over the 25-year period!**

Or to put some actual dollar numbers to those percentages: if you'd invested just $1,000 in an S&P index mutual fund in 1980, you'd be sitting on **$17,080** in 2005. Someone who invested $1,000 in an average managed mutual fund would have only **$9,820** in 2005. That's a pretty significant difference!

We used index mutual funds in this example because the first ETF wasn't created until 1993, but the lower expense ratios of ETFs versus index mutual funds can make the potential savings even more dramatic.

*Burton G. Malkiel, The Efficient Market Hypothesis and its Critics, Journal of Economic Perspectives, Winter 2003
**Investment Choices and Human Values, Bogle Financial Markets Research Center, April 2006

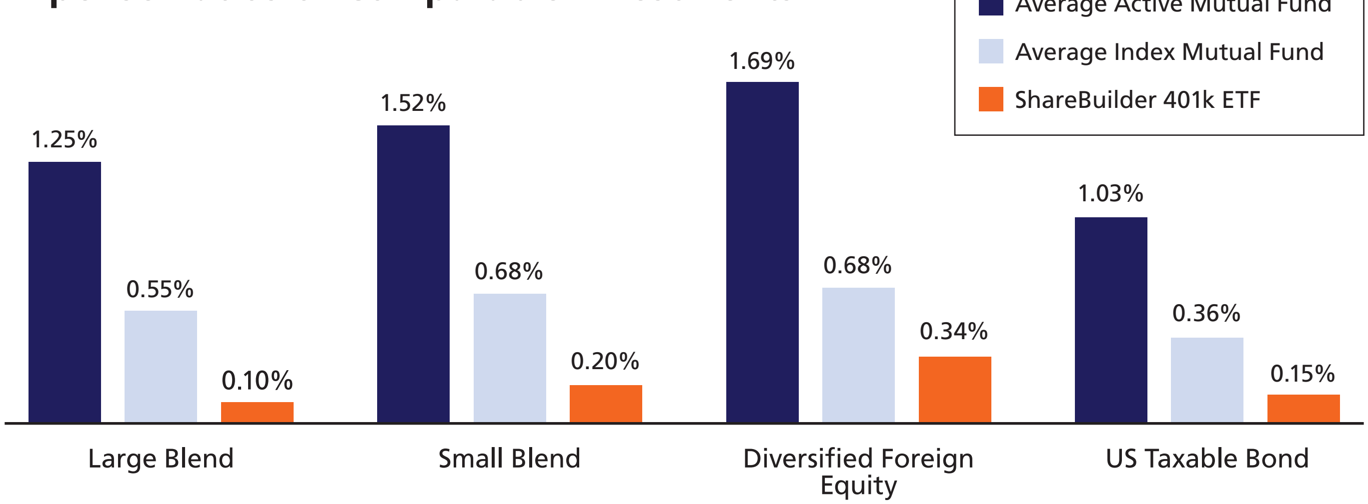
index how?

So now that you understand why indexing is a smart move, how do you get started? That's where ShareBuilder 401k can help.

Unique ETF-only solution

One fact which sets ShareBuilder 401k apart from the pack of industry providers is that we *only* offer Exchange-Traded Funds (including one money-market account). No actively-managed funds — in fact, no mutual funds whatsoever. Why? Because the rock-bottom expenses of ETFs help your money work harder. Compare the difference:

Expense Ratios of Comparable Investments*



Few people have time to devote to reading prospectuses, closely following stocks and bonds, or tracking the changing managers of mutual funds and their performances. With our 401k you can be confident that more of your money is **working for you** instead of bleeding off to cover fees and expenses.

* Strategic Insight, December 2007, and expense ratios for ShareBuilder 401k ETF options of: SPDRs, iShares Russell 2000, iShares MSCI EAFE Index Fund, and iShares Lehman 1–3 Year Treasury Bond, respectively. Average expense ratio is calculated on an equal-weighted average basis. Expense ratios of ShareBuilder 401k funds may be substantially less than those of most mutual funds. A specific mutual fund may compare favorably to a ShareBuilder 401k investment option.

index how?

No transaction fees

Our proprietary online solution also **eliminates trading costs** common to most ETFs when sold retail. So there are no extra transaction fees to consider in ShareBuilder's 401k funds.

We are a fully price-transparent provider. We do charge an asset management fee to serve each participant's account. Our goal is to enable all participants to keep their **total fees under 1%**, a real coup when you compare ShareBuilder 401k to other providers. For more information and a detailed cost comparison, see our guide to Understanding 401k Costs.

We hope this explanation of indexing has helped you understand how ShareBuilder 401k is working to make your retirement investing easy, smart, and affordable.

For more help with smart investing, see our *Saving Smart for Retirement* guides. They're loaded with practical, valuable information you can put to work immediately:

- Five Rules for Creating a Sound Investment Strategy
- Six Rules for Making Smart Investment Choices