

Active and Passive

Different Investment Approaches That Could Work for You

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Passive and Active: What You Need to Know

- A passive investment tries to replicate the market performance of an asset class. Active investments try to do something different, such as outperform the market performance of an asset class or take less risk.
- A combination of active and passive investments can improve overall portfolio diversification, particularly in asset classes with large allocations. These may include:
  - U.S. large-cap stocks
  - International large-cap stocks
  - U.S. investment-grade bonds
  - U.S. small- and mid-cap stocks
- There is no universal figure for the amount of active or passive investments to include in a portfolio. Your considerations may include desired level of involvement, sensitivity to fees, tax sensitivity and long-term expectations for the investments (e.g., outperform the market).

The difference between active and passive investments has blurred over time. We believe it has become more relevant to think about investments on a spectrum — from passive to more active. A passive investment attempts to replicate the performance of an entire asset class, neither outperforming nor underperforming how an average dollar invested in that asset class would perform (net of fees).

Investments become more active as they attempt to do something other than track a particular asset class, usually to outperform the market, take less risk or achieve some other outcome, such as producing more income. As you move across the spectrum toward active investments, more decisions are based on human judgment rather than rules. The most active investments are those clients choose themselves. It's also worth noting that the degree of active management can vary, even within the categories shown on the next page.

Which Will Perform Better?

Many people have tried to determine whether the active or passive approach will outperform over time. The reality is in each asset class, there are long periods in which the majority of active managers may outperform the passive strategy, and vice versa. The answer depends on the specific asset class, market environment and time horizon; it's difficult to know how well each approach will work ahead of time.

That is why, at Edward Jones, we believe investments all along the spectrum have merit. You should consider your desire for additional diversification, your willingness to be involved in decision-making and your sensitivity to fees and/or taxes. These factors can better determine what type of investment to choose, regardless of where we are in the market cycle.

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The Spectrum of Active Investments

	Passive			More Active[1] →	
	Passive Funds	**Strategic Beta Funds**	**Unit Investment Trusts**	**Actively Managed Funds**	**Individual Securities**
Professional Fund Management	Yes	Yes	Yes	Yes	No
Portfolio Construction	Investment professionals buy and sell securities to replicate a market cap-weighted index	Investment professionals use judgment to build a rules-based index, then buy and sell securities to replicate that index	Investment professionals initially select securities, then holdings typically remain constant for the life of the trust	Investment professionals use judgment to buy, monitor and sell securities in the portfolio	Client and financial advisor work together to select and monitor securities
Tax Impact[1]	Low	Low	Low to Moderate	Highest	Lowest
Ongoing Cost[2]	Lowest for professional management	Low	Moderate	Highest	None
Client Involvement	Lowest	Low	Low	Low	Highest
Other Names	Index Funds	Factor Investing Smart Beta	UIT	Active Management	Stocks, Bonds
Example	S&P 500 ETF	Russell 1000 Value ETF	U.S. invesment-grade bond UIT	U.S. large-value mutual fund	U.S. large-cap stock

1 These represent reasonable expectations for the category but may not be the case for every investment within the category.
2 Excludes commissions, sales charges and account fees.

Which Is Right for You?

If the idea of lower expenses and the potential for greater tax efficiency appeal to you, a passively managed fund (especially an ETF), UIT or individual stocks or bonds may be appropriate. If you prefer not to make individual investment decisions and want the chance to outperform the index, a strategic beta or active fund may be appropriate. If you're looking to maximize diversification, owning a combination of passive funds and active investments could make sense.

It's really about evaluating what you want and prioritizing your goals. We recommend working with your Edward Jones financial advisor to help determine which combination of investment approaches is most appropriate for you.

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Building Your Portfolio

Before choosing a type of investment, it's important to consider the allocations to stocks and bonds, the mix of investment categories and the mix of asset classes. Because passive and active investment approaches have benefits and trade-offs, we believe you may benefit from owning a combination of the two.

For Additional Diversification, Blend Passive and Active

- We recommend splitting large asset class allocations between active and passive investments to enhance diversification.
  - In many portfolios, these asset classes include U.S. large-cap, international large-cap, U.S. investment-grade and potentially U.S. small- or mid-cap.
  - If you have no preference, an equal split is a reasonable starting point. Your unique situation and preferences for different attributes may warrant tilting toward one or the other.
- For smaller asset class allocations, we recommend choosing either an active or passive investment.

Owning All Passive or All Active Is Fine

While we believe owning a blend of active and passive investments adds diversification, depending on your circumstances and preferences, owning all passive or active investments may be more appropriate than owning both.

Moving Toward Owning Both

The table at right shows ways to begin adding this type of diversification to a portfolio. In considering any change, of course, you'll want to ensure the benefits outweigh the costs (e.g., transaction costs, taxes, etc.).

Potential ways to improve diversification	
All-active portfolio	**All-passive portfolio**
• Add a passive investment in the largest asset class(es) in your portfolio, to better diversify that asset class. • Add a passive investment in an investment category or asset class you don't currently own in your portfolio. • Add a passive ETF to each investment category for potentially more efficient rebalancing, or to be used in the case of an unexpected distribution.	• Add an active investment in the largest asset class(es) in your portfolio, to better diversify that asset class. • Add an active investment in an investment category or asset class you don't currently own in your portfolio.

How much of your portfolio is allocated to active and passive investments depends on your objectives and preferences. Work with your financial advisor to understand the number of ways to build your portfolio along the active/passive spectrum.

Diversification does not ensure a profit or protect against loss in a declining market.

ETFs and mutual funds are offered by prospectus. You should consider the investment objective, risks, and charges and expenses carefully before investing. The prospectus contains this and other information. Your Edward Jones financial advisor can provide a prospectus, which you should read carefully before investing. Your investment return and principal value will fluctuate, and you may lose money.

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