

# Should You Stick With Index-Based Investments?

You may have heard that you can simplify your investment strategy just by owning index-based or passive investments. But is this a good idea? You'll want to consider the different aspects of this type of investment style.

To begin with, an index-based investment is a vehicle such as a mutual fund or an exchange-traded fund (ETF) that mimics the performance of a market benchmark, or index — the Dow Jones Industrial Average, the S&P 500, and so on. (An ETF is similar to a mutual fund in that it holds a variety of investments but differs in that it is traded like a common stock.) You can also invest in index funds that track the bond market.

Index investing does offer some benefits. Most notably, it's a buy-and-hold strategy, which is typically more effective than a market-timing approach, in which individuals try to buy investments when their prices are down and sell them when the prices rise. Attempts to time the market this way are usually futile because nobody can really predict when high and low points will be reached. Plus, the very act of constantly buying and selling investments can generate commissions and fees, which can lower your overall rate of return. Thus, index investing generally involves lower fees and is considered more tax efficient than a more active investing style.

Also, when the financial markets are soaring, which happened for several years until this year's downturn, index-based investments can certainly look pretty good — after all, when the major indexes go up, index funds will do the same.

Conversely, during a correction, when the market drops at least 10% from recent highs, or during a bear market, when prices

fall 20% or more, index-based investments will likely follow the same downward path.

And there are also other issues to consider with index-based investments. For one thing, if you're investing with the objective of matching an index, you may be overlooking the key factors that should be driving your investment decisions — your goals and your risk tolerance. An index is a completely impersonal benchmark measuring the performance of a specific set of investments — but it can't be a measuring stick of your own progress.

Furthermore, a single index, by definition, can't be as diversified as the type of portfolio you might need to achieve your objectives. For example, the S&P 500 may track a lot of companies, but they're predominantly large ones. And to achieve your objectives, you may need a portfolio consisting of large- and small-company stocks, bonds, government securities and other investments. (Keep in mind, though, that while diversification can give you more opportunities for success and can reduce the effects of volatility on your portfolio, it can't guarantee profits or prevent all losses.)

Ultimately, diversifying across different types of investments that align with your risk tolerance and goals — regardless of whether they track an index — is the most important consideration for your investment portfolio. Use this idea as your guiding principle as you journey through the investment world.

*This article was written by Edward Jones for use by your local Edward Jones Financial Advisor.*

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