Active and passive

Different investment approaches that could work for you

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At Edward Jones, we believe your financial goals can be achieved through portfolios ranging from all active to all passive, or a mix of the two. Your allocation between active and passive investments should be based on your individual objectives and preferences, including your long-term performance objectives for the investments (for example, outperform the market) and your sensitivity to fees and taxes.

As you work with your financial advisor to build your portfolio, you may also consider which asset classes present on average the best opportunities for active investment strategies to provide returns exceeding their market indexes.

What makes an investment active or passive?

Active and passive investing refers to different types of investment approaches. Passive investments attempt to match the performance and risk of an entire asset class, an asset class investment style (such as value and growth styles in equities), or a sector by replicating the returns of a specific index. Alternatively, active investments seek to do something more than just match performance of an index — they attempt to outperform the market, target less investment risk or produce more income.

What about strategic beta strategies?

Like passive investment strategies, strategic or smart beta investment strategies are rules-based and track an index. However, strategic beta investment strategies track unique indexes that are designed to outperform a traditional market-capitalization-weighted index, target a different amount of investment risk or achieve a specific outcome, such as a targeted yield. Strategic beta investment strategies are considered active because they attempt to do something more than simply track the performance of an index that represents an entire asset class, an asset class investment style or a sector.

Building your portfolio

Before selecting specific investments for your portfolio, it's important to identify the right mix of asset classes based on your goals, time horizon and comfort with market ups and downs. We use this mix of asset classes to set reasonable expectations for the risk and return of your investments. These long-term expectations are set using the index for each asset class.

As a result, we believe you can achieve your goals using passive investment strategies that replicate those indexes. Ultimately, your individual considerations, such as performance objectives and sensitivity to cost and taxes, can help determine the right blend of active and passive investments for you.

Performance objectives: Active strategies invest differently from their benchmarks, often leading to returns that can be above or below the benchmark's returns. If you can accept some degree of risk in pursuit of generating a higher return, an active management strategy may be the way to go. However, if you prefer to more closely match the returns of the market, then a passive approach may be a better fit.

Sensitivity to costs: While it is difficult to forecast the returns of an investment strategy, its fees are known. If you desire to keep your costs as low as possible, you may consider passively managed strategies. They are generally less expensive than actively managed strategies within the same asset class.

Taxes: Taxes are an important consideration for investments held in taxable accounts. Passively managed investment strategies tend to trade less frequently than actively managed ones, leading to less portfolio turnover and lower capital gains. If the potential for greater tax efficiency appeals to you, a passively managed investment (especially an exchange-traded fund, or ETF) may be appropriate.

Common misconception

Passive investing is often associated with ETFs, while active investing is typically associated with mutual funds. Despite most ETFs being passively managed and most mutual funds being actively managed, that difference is increasingly being blurred by a growing number of active investment strategies available in the ETF structure.

How should you allocate your investments?

Consideration	May prefer passive	May prefer active
Performance objectives	Want to match the returns of the market	Want to try to outperform the market
Sensitivity to costs	Focused on minimizing costs of investment products	Willingness to pay a relatively higher cost to pursue a higher return
Tax situation	Taxable accounts	Tax-deferred accounts

Does active perform better than passive in some asset classes?

We believe active management can be successful across all asset classes. But some asset classes present increased opportunities to outperform the respective benchmark. This may impact how you build your portfolio using active and passive investments.

The graphic below illustrates our assessment of the range of conditions over a market cycle for the average active manager in each asset class. Some areas of the market, such as international small- and mid-cap (SMID cap) stocks or emerging-market debt, tend to offer more favorable conditions for active management when compared with asset classes such as U.S. large-cap stocks or U.S. investment-grade bonds.

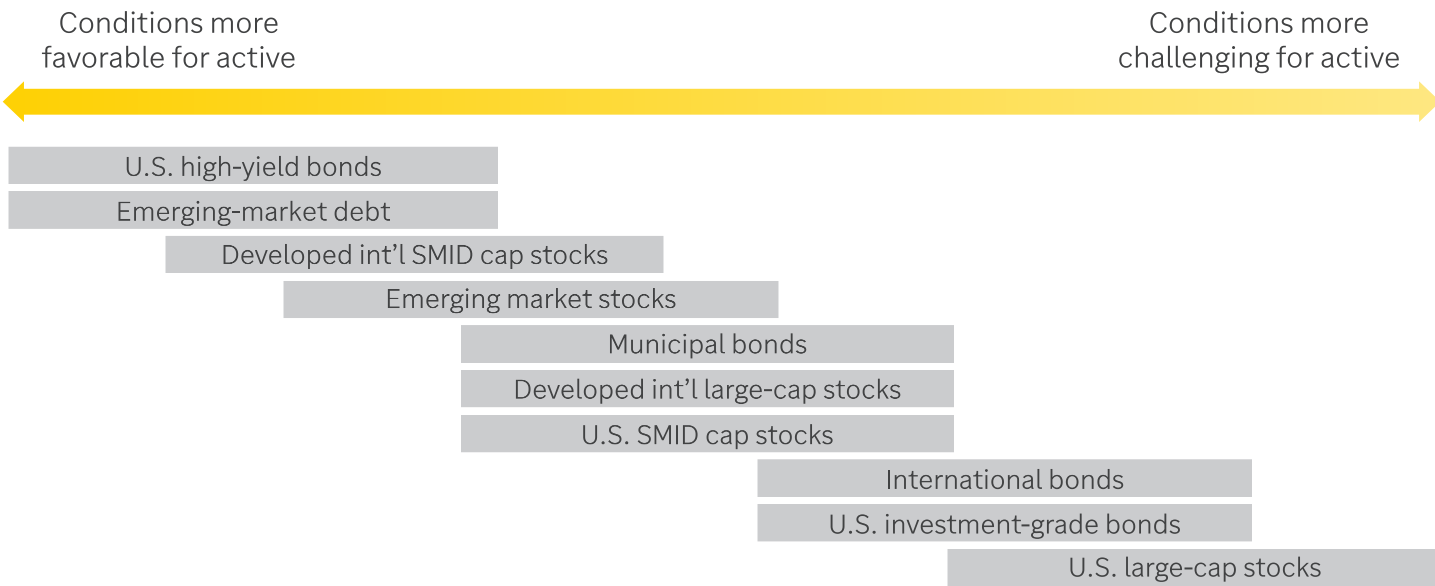
Active managers in international SMID cap are more likely to select stocks that will outperform, as a result of a larger number of mispriced stocks because of fewer research analysts covering each stock and less information incorporated into stock prices. In other asset classes, like emerging-market debt, the index may not represent the entire opportunity set in the asset class, which allows active investment strategies to benefit from investing in bonds that are not included in the index.

When building your portfolio, you may want to consider active approaches in the asset classes that provide more favorable conditions for active management. In turn, consider passive investments in the asset classes that are more challenging for active management.

Investment manager research process

The Edward Jones Investment Manager Research team supports your financial advisor by identifying, monitoring and recommending the active and passive investment strategies we believe are best suited for your investment portfolio.

The analysts on the Investment Manager Research team conduct multiple meetings and on-site visits with investment teams. They also perform deep analysis to ensure they recommend quality investments that have fees appropriate to the value they provide.



Overall, the average performance results depend on the specific asset class, market environment and time horizon; it's difficult to know how well each approach will work ahead of time. While some asset classes may offer conditions that are more or less favorable for active management, we believe you can be successful using passive, active or a mix of both in every asset class.

If you prefer active investments, our Investment Manager Research team has a recommended set of actively managed funds that we believe will perform above their benchmarks and peers over a market cycle.

Using active and passive investments

To determine whether active, passive or a combination of the two investment approaches can best help you achieve your financial goals, you'll want to draw on your individual considerations, which include your performance objectives and your sensitivity to costs and taxes. If you decide to construct a portfolio with active and passive investments, start building your active exposure in the asset classes that provide the most favorable conditions and with managers recommended by our Investment Manager Research team.

Ultimately, your goals and preferences are the most important factors in determining how much of your portfolio is allocated between active and passive investments. You can achieve your financial goals using either investment management style, or both.

Partner with your financial advisor to understand the number of ways to build your portfolio using active and passive investment strategies.

