

Your advisor
can help
put active
management
to use in
your portfolio.

Active vs. passive investment management

In the ongoing debate over which management style generates the greatest return, one critical factor — asset allocation — is often overlooked.

The debate over whether actively managed mutual funds or index funds and exchange-traded funds offer better outcomes for investors has been waged for years, and it probably won't end anytime soon. Proponents of each can make a strong argument that their approach is the one that has the potential to generate the greatest amount of return over time. And the truth is, depending upon goals and risk tolerance, both types of investments could be part of a broad investment portfolio.

What ultimately determines the best investment approach isn't necessarily how a fund is managed, but how well a portfolio is allocated among its different, non-correlated investments, taking into account an investor's goals, investing time frame and comfort with risk — and depth of investing knowledge.

Active vs. passive: Understanding the basics

Let's start by looking at the advantages and disadvantages of different investing approaches, then we'll take a look at the importance of strategic asset allocation.

The objective of **active management** is simple: beating the market, as measured by a benchmark or index (or the returns of peer funds). An investment manager or team of investment professionals hand-picks investments that meet the fund's objective, such as long-term growth or capital preservation, and that support their fund's specific charter or mandate

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Investors should consider the investment objectives, risks, charges and expenses of a fund carefully before investing. For a prospectus containing this and other information for the Ivy Funds, call your financial advisor or visit us online at www.ivyfund.com. Please read the prospectus carefully before investing.

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Market Perspectives

JANUARY 2010

(for example, the degree to which the fund will be exposed to a given market sector or industry or the amount of assets that will be held in cash at any given time). The manager or management team make their portfolio selections based on their investing experience, research, personal opinion, economic trends, intraday market moves and market irregularities.

Active management has a definite allure, particularly for less risk-averse investors. Active managers use sophisticated, technical tools and analysis to help them find stocks that they believe offer a sustainable competitive advantage, and they usually have some freedom and flexibility to adjust their exposure to different sectors and industries. They can often sidestep troubled areas of the market and can aggressively pursue perceived opportunities, which then provides the ability to potentially outpace the market. Actively managed funds have yet another opportunity to outperform: the portion of their assets that must remain in cash to fund redemptions and maintain liquidity provides some potential cushion during down markets, because that portion remains on the sidelines instead of declining with the market.

However, that cash cushion can also restrain an actively managed fund. In an up market, when cash flows tend to be heaviest, it can be difficult for an active manager to quickly and strategically invest inflows into core assets. As a result, this “parked” money can at times impede performance.

In addition, actively managed funds generally include management fees and sales charges, which funds that simply match an index do not incur.

Passive management, also called indexing, seeks to produce a return that’s consistent with a given market index, such as the S&P 500 or the Russell 2000. It’s built on the efficient market hypothesis — the idea that prices are always fair and quickly reflective of information. In such an environment, the theory goes, it’s impossible for anyone to consistently identify winning and losing stocks. So, passive investments simply own the same exact securities, and in the same amounts, as the index, and should generally produce the same performance.

The most prevalent passive investment options are **index funds and exchange-traded funds (ETFs)**. Because an index’s holdings remain largely unchanged, an index fund manager doesn’t trade as much as an active fund manager. That means index funds typically have lower trading expenses and pass on fewer short-term capital gains to shareholders than actively managed funds. Index funds also do not have research expenses; they typically use computer models to identify any changes needed to keep the fund in line with its index. ETFs track stock market indexes too, but they’re traded throughout the day on a stock exchange. Like index funds, ETFs have fewer operating costs.

Because passively managed funds are generally less expensive to operate, their fees are usually significantly lower than those of actively managed funds. And, passively managed funds are fully invested, mimicking the indicated index. The investor benefits fully from market rallies (or suffers fully from pullbacks) because all of their money is invested. Another benefit of passive investments is their tax-efficiency; because their shares are created and traded “in kind,” there are generally fewer taxable gains for the fund to pass on to shareholders.

But buyer beware: Passive management is a buy-and-hold approach that may prevent an investor from ever outperforming the market. Forfeiting an opportunity for above-market returns is a risk for investors with aggressive investing goals, and a potential liability during extended bear markets. Think of it as the risk of lost opportunity. Their managers cannot capitalize on market inefficiencies, which are often abundant during down markets or periods of economic recession, nor can they take defensive action, such as moving out of a given sector or industry if they anticipate negative performance. When it comes to returns, investors in passively managed funds have to be content with whatever the market returns, because that’s generally the best they’ll do — ever.

A two-pronged approach to successful investing: Asset allocation and your advisor

While the active vs. passive debate rages on, consider the importance of asset allocation — selecting the types of investments that fit your goals, investing time frame and comfort with risk — and the role your financial advisor plays in helping you create and maintain a strategic asset allocation.

Research from Ibbotson Associates, a leading market research firm, has shown that 90 percent of a mutual fund’s return over time was based on how its assets were allocated among various types of investments. The same can be true for your portfolio. In fact, how you allocate your investments among different asset classes — and during different market environments — may be the most important factor in your portfolio’s overall long-term performance. It’s also an important way to minimize your investment risks.

IVY FUNDS Market Perspectives

JANUARY 2010

Why Ivy Funds?

Ivy Funds is an exceptional combination of investment managers that offers global reach and capabilities to advisors and their clients. Ivy seeks to enable its fund shareholders to remain comfortably committed to their long-term goals. We are:

Proven: We're part of an organization whose roots date to 1937, with an investment style emphasizing participation in positive markets and, especially, seeking to manage risk.

Focused: We do our own work, believe in our own research and act on our own ideas. Our steady approach is guided by a belief in fundamentals over fads.

Constant: We say what we mean, and do what we say. What we value most, and remember every day, is the trust that we have earned, and must continue to earn, from our shareholders.

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