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Outlook 2010: Anticipating a stock-picker's market

The U.S. equity market extended the rebound that began in March during the final quarter of 2009, and global stocks did even better than U.S. equities, due to renewed strength in developed markets and a powerful rise in emerging markets. Investors who had regained their appetite for risk as recession concerns diminished continued their re-entry into global markets. The fourth quarter also saw improvements in rising home sales, better retail sales, strengthening industrial activity, less negative employment trends and continued low interest rates as the Federal Reserve kept the Fed's Fund rate accommodative. Here, members of the Ivy Funds Asset Strategy team discuss recent market events, Fund positioning and their outlook on investing and the economy in the months ahead.

Not much changed during the fourth quarter of 2009 with respect to the Asset Strategy Fund's structure. Currently, the Fund's equity position stands at about 80 percent of assets on a gross basis. About 15 percent of assets remain in gold bullion, and the remaining 5 percent is in cash, all of which is fairly consistent with earlier positioning.

Past performance is not a guarantee of future results. The opinions expressed are those of the Fund managers and are not meant as investment advice or to predict or project the future performance of any investment product. The opinions are current through January 25, 2010, and are subject to change due to market conditions or other factors. ● The Fund allocates from 0-100% of its assets primarily among stocks, bonds, and short-term instruments, across domestic and foreign securities. ● International investing involves additional risks, including currency fluctuations, political or economic conditions affecting the foreign country, and differences in accounting standards and foreign regulations. These risks are magnified in emerging markets. ● With regards to fixed income securities in which the fund may invest, these are subject to interest rate risk and, as such, the net asset value of the fund may fall as interest rates rise. ● Because the Fund may concentrate its investments, the Fund may experience greater volatility than an investment with greater diversification. ● The Fund may use short-selling or derivatives to hedge various instruments, for risk management purposes or to increase investment income or gain in the Fund. These techniques involve additional risk. ● Investing in physical commodities, such as gold, exposes the Fund to other risk considerations such as potentially severe price fluctuations over short periods of time. These and other risks are more fully described in the Fund's prospectus. ● Holdings information is not intended to represent any past or future investment recommendations. Holdings and allocations can and do change frequently.

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.

Ivy Asset Strategy Fund

Thinking Beyond Boundaries

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However, as events played out in January, our concern about policy risk in emerging markets intensified and we placed a substantial hedge on the Fund's equity exposure. Our world view has not changed, but we do anticipate a choppy market ahead and would not be surprised to see a 10 percent to 15 percent correction.

From a sector perspective, the Fund's top three allocations remain largely unchanged. Financials is still the Fund's greatest sector exposure, although it's down slightly from the end of 2009, currently at about 18.5 percent of assets. We continue to like technology stocks, which represent about 15 percent of assets, with energy stocks totaling about 9 percent.

We believe country allocation is important, and we continue to favor China. China remains among our largest country weightings, at about 21 percent of assets. The United States represents about 24 percent of assets. We have a smattering of Asia, Ex-China and India. Taiwan and Korea dominate at about 16.5 percent, and Europe represents about 9 percent. These allocations have not changed much, but it's important to note that the Fund's exposure to some of the smaller emerging market countries has shrunk slightly.

Stock selection critical going forward

One of the significant themes we're anticipating in the months ahead is a transition from a liquidity-driven market to a "stock picker's" market. We're less concerned with where a company is domiciled than we are in identifying the steady-growth companies that fit our criteria for sustainable competitive advantage. It's true that given

the big run they had in 2009, emerging markets' stocks are more expensive than they have been, which quite honestly puts the premium for being right much higher. We think that in 2010, companies in areas such as the U.S., Europe and Japan that have a view that's pointed toward emerging markets consumption may make more sense in the portfolio now than some of the emerging markets stocks themselves. We want to stress that there is no thematic change here — we are still doggedly focused on consumption growth outside the United States — but we believe that some of the emerging markets, among them Brazil, India and even China to some extent, have become more expensive over the course of the last 12 months. The point is, the emphasis on getting the stocks right and getting the bonds right becomes much greater as opposed to when we have valuation working in our favor, and right now, we don't.

As a result, you may likely see more "developed market" exposure in the Fund. The bottom line is that for Asset Strategy, domicile is not critical. Rather, we're looking for the best companies at the best price.

Fundamentally, what's important to know is that generally what we do and have done well is growth. What we look for in developed markets is free cash flow yield advantage, because it speaks to not only profitability but also to the ability of management to sustain margins. Sustainability is important in our framework, so we look for companies with high free cash flow yields. In emerging markets we look for companies with high growth cash flow yields because it reflects profitability. You can't penalize these fast growers for reinvesting when growth is good.

Volatility ahead

Looking out, we think 2010 will be a more volatile year due to policy fluctuation between countries. We anticipate that the United States, Europe and Japan will take little action on the monetary policy front, although they may take fiscal action. In contrast, we anticipate that countries such as Brazil, Russia, India and, in particular, China are going to be doing more on the policy front, and therefore will be injecting more policy risk back into their markets. China in particular is interested in “mopping up” liquidity, and we think the outcome will be very favorable. However, the government is going to attack different liquidity pools throughout the year to mitigate asset bubbles, which will clearly have an impact on sentiment both in the Hong Kong market and the Shanghai market. That’s one of the reasons we’ve started to use some futures to reduce some of our beta exposure to that market. We’re looking at hedging and index futures as our preferred tools, although we can use index options as well, which will be more prevalent in 2010 than it was in the latter half of 2009. Then we were looking to participate more in a directional market.

On the fixed-income side of the equation, we think credit spreads will continue to grind a bit tighter. The antithesis to this, of course, is that you want to be lower down in the

capital structure — that is, you want to own equity. If you like corporate and you think spreads will tighten, you’re likely going to like the performance you get out of equities. This is actually paramount to Asset Strategy’s framework. If it’s equities versus corporate, we like equities. We’re in the middle of a massive credit bull market in corporates, and it continues both on the issuance side and on the spread side. We’re a bit less sanguine on the sovereign debt side; we think we’re still in a deflationary state, and we think Treasuries are fairly range-bound. As they’ve crept up, they’re more attractive than they have been, but we think we can find better opportunities elsewhere.

In summary, we believe the way to succeed in 2010 is to spend less time on the macro view and more time on micro analysis and individual security selection. This plays very well into the investment theme that we’ve had in place for some time — our belief in the opportunities presented by the emerging middle class as the global economy rebalances.

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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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