Reviewing hypothetical performance

The benefits, risks, limitations, criteria and assumptions

Investment strategies and investments can play an important role in helping you achieve your financial goals. But evaluating and choosing between the different strategies or investments can be difficult. Reviewing hypothetical performance (or hypotheticals) can help.

Hypotheticals can help you evaluate how an investment strategy of an adviser, such as Edward Jones, may have performed over a wide range of periods and market environments or form a reasonable expectation about how that strategy or an investment may perform in the future.

But it is very important that you understand the risks and limitations of hypothetical performance. For example, there is no guarantee that you will achieve the results represented in the hypothetical. Indeed, your results may vary significantly from those illustrated. Hypothetical performance should not be used as the sole basis for an investment decision.

In this report, we discuss the benefits, risks and limitations of hypothetical performance, as well as assumptions that are often used. But please do not limit yourself to this educational piece. To help you understand hypotheticals generally and how they may be helpful to your specific circumstances, we encourage you to discuss hypothetical performance with your financial advisor.

What is hypothetical performance?

As its name implies, hypothetical performance is just that — hypothetical results that are not based on actual trading in client accounts. Hypothetical performance does not reflect actual performance and cannot account for the impact that economic, market and other factors may have on the implementation of an actual investment program. Rather, hypothetical performance simulates investment results based on a specific set of criteria or assumptions.

It is important to remember that hypothetical performance does not guarantee future performance. In fact, your investing results may be significantly different from those in a hypothetical.

There are three common types of hypothetical performance. First is model performance, such as the performance of a model portfolio that does not reflect actual trading in client accounts.

Second is backtested performance, which is the application of an investment strategy to past periods that occurred before the strategy was created. You should understand that the securities in backtested performance hypotheticals were selected with the full benefit of hindsight, after their performance during the period shown was known.

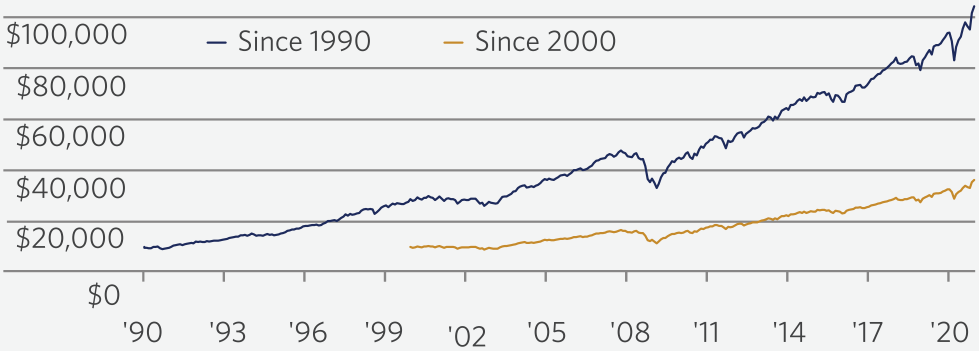
The third type of hypothetical performance is targeted or projected performance. This includes any representation of results that may be achieved in the future based on goals that an adviser seeks to achieve with a particular investment strategy or the likelihood of various investment outcomes. All targets and projections are based on current expectations and assumptions about future events, which may not prove to be accurate.

Hypothetical performance can be presented in many forms, such as in charts, tables or commentary, or built into tools that demonstrate potential investment outcomes. On Page 2 are illustrations of hypothetical performance.

For example, hypothetical performance may display:

1. Hypothetical model portfolio performance

2. Backtested performance of a strategy

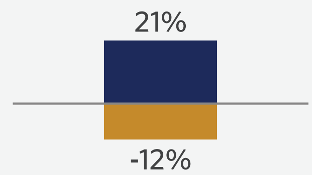


3. Projections

Expected average annual return

4.0%-6.0%

Expected range of returns in any one year



These charts are for illustrative purposes only and do not represent the hypothetical performance of an actual portfolio.

What are the benefits of using hypothetical performance presentations?

As long as you keep in mind the risks and limitations of hypothetical performance, it can be a useful tool when considering investment options. For example, hypothetical performance can help you:

- Understand and apply general investing concepts by providing a visual aid
- Understand Edward Jones' investment advice and guidance by providing a visual aid
- Illustrate how an investment strategy or investment may perform under different market conditions, particularly when evaluating possible steps to help achieve a financial goal
- Understand how investments, an investment strategy or a model portfolio may have performed over different periods of time

What are the general risks and limitations of using hypotheticals?

Although hypotheticals can be a useful tool, they have inherent risks and limitations. Two overarching risks and limitations are: Hypotheticals do not represent the actual performance achieved by any investor, nor do they guarantee future results. At right are other general risks and limitations that apply to hypotheticals.

Keep these risks and limitations in mind when you consider hypothetical performance:

- Hypotheticals cannot account for all factors impacting the markets in general or the management of your actual portfolio.
- Results of hypotheticals are based on the underlying assumptions and criteria, such as the ones identified on Page 3. A change in any of these could materially change the results of the hypothetical.
- Relatedly, your circumstances and investment portfolio can vary widely from the criteria and assumptions used to create a hypothetical, which decreases the likelihood that your investment experience will be similar to that displayed in the hypothetical.
- There can be significant differences between the methodologies used to calculate hypothetical performance.
- Hypotheticals make assumptions about the deduction of advisory fees, impact of brokerage fees, reinvestment of dividends, asset allocation and rebalancing. These assumptions may not reflect the actual fees you pay or the implementation of your investment strategy over time.

Work with your financial advisor when reviewing hypotheticals to better understand these risks.

What are some general criteria and assumptions built into hypothetical performance presentations?

The result a hypothetical displays directly depends on the criteria and assumptions that were used to create it. Changing even one criterion or assumption could materially alter the results of the hypothetical. At right are criteria and assumptions commonly used in hypothetical performance:

- **Time periods.** Hypothetical performance is tracked over a certain period of time. The time periods can differ in length (e.g., 10 years or 20 years) or whether it is forward looking (e.g., projections) or looks at historic market data (e.g., backtested).
- **Investments and portfolio allocations.** Hypothetical performance shows simulated results of investments. These investments may be represented by market indexes, such as the S&P 500, or actual investments, such as an exchange-traded fund (ETF). Also, the allocation (i.e., how much money is allocated to an investment) as well as how frequently the strategy is rebalanced (i.e., brought back to its planned allocation) may differ from the actual management of an investment strategy in real time.
- **Return calculations.** Return percentages are often used to display results of the investment strategy or investment in a hypothetical. Returns can be calculated in different ways. For example, calculations can differ in how they treat investing cash flows, which could include deposits, withdrawals, interest and dividends. Similarly, some hypotheticals reflect the impact of compounding (additional growth from a return being reinvested) over time while others do not.
- **Sequence of returns.** Hypotheticals may make different assumptions about the order of returns from period to period. For example, two hypotheticals may assume annual returns of 2%, 5% and 7% in three different years, but place those returns in different orders. Changing the order of returns can significantly impact the results of the hypothetical when the hypothetical also includes assumptions for contributions or withdrawals.
- **Costs and fees.** Hypotheticals may not incorporate costs and fees related to investing or other expenses you may bear, like taxes, all of which lower performance results.
- **Market scenarios.** Investments and investment strategies act differently in different market environments, such as in different phases of the market cycle or in extreme market events. Hypotheticals can be based on market events that have not occurred and may never take place.
- **Available data and analytical judgement.** Hypotheticals are based on data available at the time they are created. There may be adjustments made to the data based on the judgment of the investment professionals who created the hypothetical. Different professionals can have different judgments, and their judgments may change.

Work with your financial advisor when reviewing hypotheticals to better understand the criteria and assumptions used.

