Active continues to outperform

The age-old 'active versus passive' debate remains very much a hot topic. Two years ago, our in-depth study of Morningstar data on global fixed-income fund returns revealed that active global bond fund managers outperformed their passive counterparts after fees as of 31 December 2020. We have updated this research with the latest data from the past decade (2014-2023), capturing recent inflationary trends.

ILLUSTRATION: SHUTTERSTOCK

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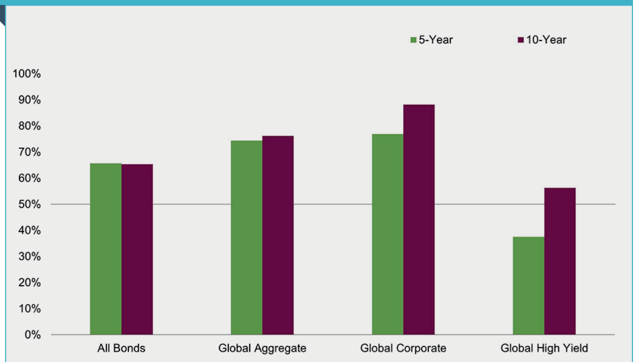
Active management still outperformed passive management. Below, we drill down into our findings to see how active bond managers have historically given investors an advantage over their passive peers.

Active outperforms passive

Figure 1 reinforces our previous findings: over 60% of active global bond funds outside the US[1] have outperformed their median passive counterparts, net of fees, over the long term. That is to say that, in the past decade, investors choosing active bond solutions had a better than 60% chance of outperforming passive alternatives. Notably, global aggregate and global (investment grade) corporate managers excelled, with more than 75% of these funds outperforming their median passive peers[2].

The global high yield category, however, presents a unique challenge: active high yield funds in general benchmark against qualitatively different indices than passive funds, making direct comparisons unfair. That being the case, we have compared excess returns of active high yield funds against the corresponding median excess return of passive peers – both over their respective benchmarks. This approach neutralizes benchmark differences,

FIGURE 1: COMPARISON ACTIVE GLOBAL BONDS VERSUS THEIR PASSIVE COUNTERPARTS, NET OF FEES



Past performance is not a guarantee or a reliable indicator of future results. Outperformance does not necessarily mean positive performance.

As of 31 December 2023; Source: Morningstar Direct, Bloomberg. Based on three Morningstar E.A.A Global Bond Fund categories (institutional shares and ETFs only): Global Bond, Global Corporate Bond, Global High Yield Bond, Global Bond category is divided into Global Aggregate and Global Treasury sub-categories according to benchmark characteristics. Funds without prospectus benchmark or benchmarked to cash indices are excluded. NOTE: To address the issue of heterogeneous benchmarks within the same categories, we define more granular sub-categories according to benchmark characteristics and compare active and passive funds within each sub-category. Refer to the important information at the end for additional Morningstar category and risk information.

revealing that median active high yield funds consistently outperformed their passive counterparts.

The active advantage

It is a widely held view – supported by empirical analyses – that, in general, active equity funds have not offered value (after fees) relative to their passive counterparts. There are several structural reasons why we nonetheless expect active bond funds to outperform passives.

Unlike passive peers, whose primary goal is to track the benchmark, active fixed income managers have a large toolbox of strategies to fine-tune positions and express investment views to potentially outperform their respective benchmarks. Active managers can be more selective in what they buy and sell than passive funds, which have to follow the index much more closely.

Also, a higher proportion of fixed income investors operate under constraints that create opportunities for active managers. Investors such as central banks and insurance companies, for example, must balance economic considerations with accounting, capital and other regulatory requirements. Insurance companies, operating under such capital constraints, eschew bonds that have been downgraded to high yield – purchasing such 'fallen angels' has provided a robust source of alpha for active managers able to add them opportunistically to their portfolios.

Excess turnover in fixed income benchmarks also creates opportunities for active bond managers – new securities have represented about 20% of bond market capitalisation each year. New issue premia enhance returns and active managers can maximize their allocations to these sources of alpha.

These factors combined create a range of opportunities for skilled active managers to find value in global fixed income markets to potentially deliver returns that exceed any additional fees they may charge.

Gaining a potential advantage

In a constantly shifting investment landscape it can be advantageous to seek out funds that can deliver proven, strong performance against benchmarks and Morningstar peer group categories over the long term. ■

1 Funds are selected and grouped from the Morningstar database based on their prospectus benchmarks
2 In a case of multiple share class data for a given fun, the institutional share class with the lowest fee ratio was selected and thereafter the series with the longest history

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SUMMARY

Active global bond funds have outperformed passive counterparts, net of fees, over the period from 2014 to 2023.

Over 60% of active funds outperformed their median passive peers, with global aggregate and investment-grade corporate bond funds excelling.

Active high yield funds also outperformed passive ones when comparing excess returns over benchmarks.

Active managers benefit from more flexibility, enabling selective investments and exploiting opportunities like 'fallen angels' and new issue premia.

PHOTOS: ARCHIVE PIMCO