

Bonds are Different: The Active Advantage in Fixed Income ETFs

Are you “aggressively passive” when it comes to fixed income ETFs? You might want to think twice. When it comes to bonds, we believe active management matters more than ever – to both maximise return potential and mitigate risks inherent in today’s markets and indices.

WHAT ARE ACTIVE AND PASSIVE BOND INVESTMENT STRATEGIES?

Passive investment strategies involve investing in bond funds or exchange-traded funds (ETFs) that track bond indices. Passive approaches may suit investors seeking some of the traditional benefits of bonds. However, investors should be aware of inefficiencies that may exist in how bond indices are constructed as they do not attempt to capitalise on the current interest rate, credit or market environments.

Active investment strategies, by contrast, aim to outperform bond indices, often by buying and selling bonds to take advantage of price movements. To outperform indices successfully over the long term, active investing requires the investor to form opinions on the direction of the economy, interest rates and credit environment, and to trade efficiently and manage risk.

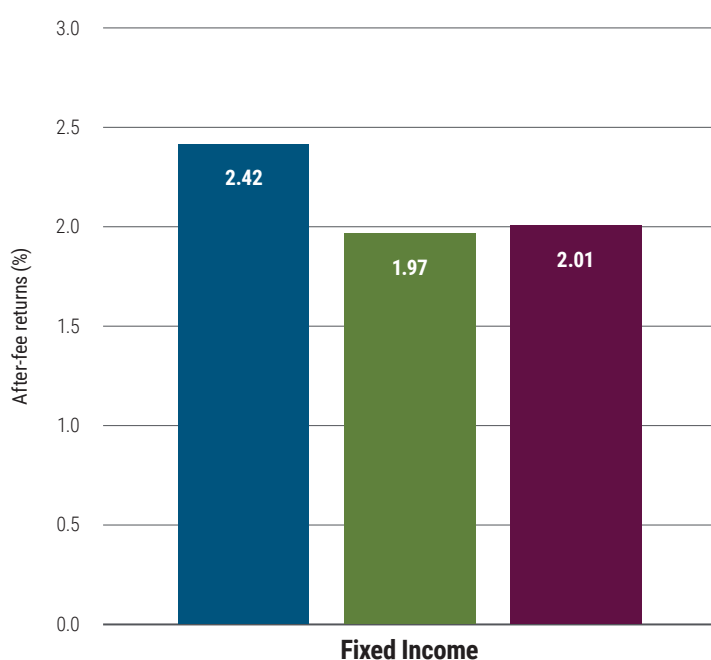
WHY CHOOSE AN ACTIVE BOND ETF OVER A PASSIVE BOND ETF?

Investors often have to weigh the pros and cons of allocating to an active or passive strategy. The persistent underperformance of active equity managers over the last 10 years explains much of the growing preference for passive equity ETFs. But the story with bonds is different.

The U.S. has the largest debt market in the world. The chart below shows the performance of the median active and passive U.S. managers in the 10 years to 31 December 2025, in the largest bond and equity category tracked by Morningstar. You can see from the chart that the median active bond manager outperformed their passive counterparts and the benchmark. The same cannot be said for equities, however, with the median active equity manager underperforming the benchmark and the median passive manager.

Passive fixed income ETFs typically underperform the index due to trading costs and fees. Active fixed income managers have the potential to overcome those cost headwinds, and more, by diversifying away from static index positions.

10-Year Medium Returns of U.S. Active and Passive Managers



Source: Morningstar as of 31 December 2025. Based on Morningstar U.S. Fund Intermediate Core and Intermediate Core-Plus categories and US Funds Large Blend. Institutional share class. Benchmarks: Fixed Income = Bloomberg U.S. Aggregate Index. Equities = S&P 500 Index.

Past performance is not a guarantee or a reliable indicator of future results. Figure is provided for illustrative purposes and is not indicative of the past or future performance of any PIMCO product. Other time periods will have different results.

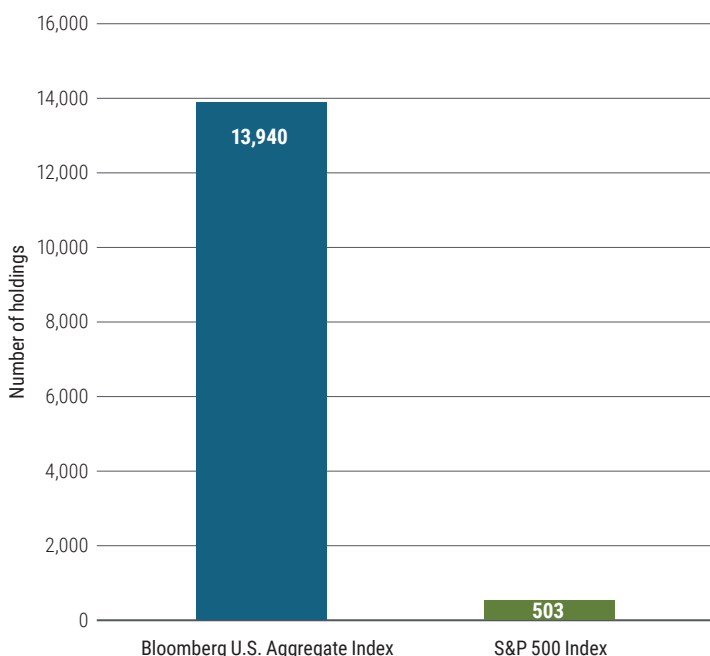
WHY ARE BONDS DIFFERENT?

We believe the reason why active bond strategies have been more successful than active equity approaches for this period lies in the bond market's unique structure. Equity and bond markets are fundamentally different. Equities are traded in milliseconds on public exchanges, while bonds are bought and sold "over-the-counter," slowly and in large sizes. These differences carry over into the major stock and bond indices.

Market capitalisation weighting in stock indices may make sense, but in a bond index the approach gives greater weight to issuers with the most debt outstanding. That means passive fixed income investors may load up on the most indebted issuers, which puts them at great risk of rotating blindly into the wrong sectors just as these issuers become more vulnerable.

If we look at the Bloomberg U.S. Aggregate Bond Index, it has over 25 times more holdings (over 13,000) than the S&P 500. And because bonds have specific term lengths and are constantly maturing, approximately 40% of the index's holdings change every year, compared to the S&P, with just 4% annual turnover (in the form of IPOs, delistings or reconstitutions).

Larger bond universe gives active managers a potential edge



Source: Bloomberg, provider websites as of 31 December 2025.

Active bond managers can pick and choose what they buy to gain the best returns for investors. Active managers with deep credit research teams regularly pass on new deals they view as overpriced. Passive managers, by contrast, have an incentive to buy all bonds that enter the index or replicate these exposures to maintain consistency with the index regardless of price.

These differences make bonds and bond indices far less efficient than equities, and this gives active bond managers more opportunity to drive returns. And in bonds, where overall returns may be modest relative to equities, that outperformance can have an outsized impact for investors.

WHAT THIS MEANS FOR INVESTORS

The median active bond manager in the U.S. has outperformed the median passive manager over the last 10 years. While the gains may not seem large, they compound over time and, if sustained, could represent meaningful total return potential.

While U.S. median active bond funds have largely outperformed their passive peers over the past 10 years, this does not necessarily mean that all active funds outperformed passive. Active fund managers invest in different ways, so investors may want to compare a range of funds to assess differences including investment philosophy and performance.

All investing involves risk. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increase this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **Management risk** is the risk that the investment techniques and risk analyses applied by an investment manager will not produce the desired results, and that certain policies or developments may affect the investment techniques available to the manager in connection with managing the strategy. **Alpha** is a measure of performance on a risk-adjusted basis calculated by comparing the volatility (price risk) of a portfolio vs. its risk-adjusted performance to a benchmark index; the excess return relative to the benchmark is alpha.

Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. **S&P 500 Index** is an unmanaged market index generally considered representative of the stock market as a whole. The Index focuses on the large-cap segment of the U.S. equities market. **It is not possible to manage directly in an unmanaged index.**

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