

# From Evolution to Revolution: The Power of Active Fixed Income ETFs

## Strategic summary

### Introduction

The fixed income market has seen a significant transformation over the past decades, with the introduction of exchange-traded funds (ETFs) being one of the most transformative developments. ETFs have enhanced liquidity in the global fixed income market and provided managers with new tools to manage portfolios effectively. This report discusses the benefits of active management in the fixed income market, the growing influence of ETFs, and the future of active fixed income ETFs.

### Active fixed income today

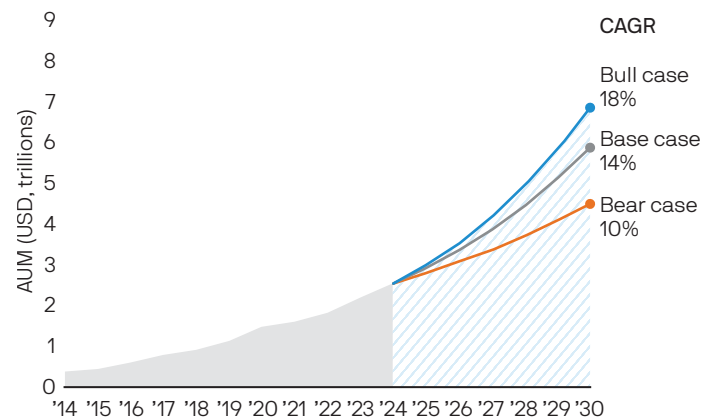
ETFs have played a pivotal role in modernizing the fixed income market. The global fixed income market is at a pivotal moment, offering unique opportunities for diversification, which can be accessed through actively managed ETFs. This year, globally, active ETFs have captured 37% of the flows within fixed income ETFs, despite only accounting for 15% of the total fixed income ETF AUM.

By 2030, active fixed income ETFs are expected to represent nearly

**30%** of the projected **\$6** trillion fixed income ETF market

Global fixed income ETF assets are projected to grow to over \$6 trillion in 2030

Exhibit 1: Global fixed income ETF AUM growth projection



Source: Bloomberg, J.P. Morgan Asset Management; data as of December 31, 2024.

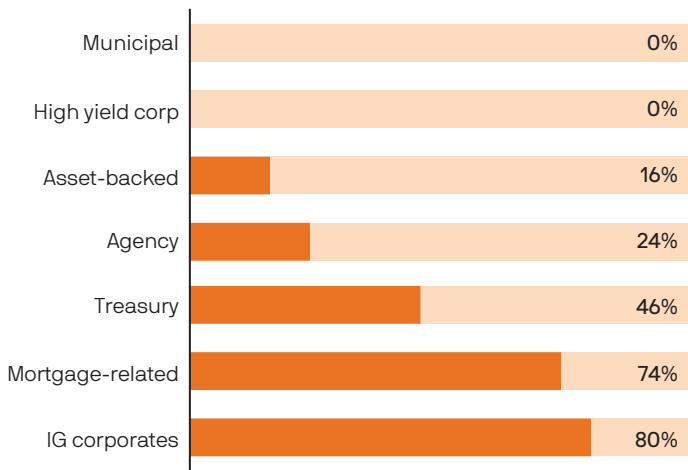
### Investing in fixed income

The fixed income market, a \$141 trillion market, is vast and diverse, consisting of over 3 million securities varying across maturity, quality and type. The vast size of this market poses challenges in achieving meaningful diversification, especially when investing through individual bonds, which demands significant time, knowledge and capital.

Fixed income indices also have their limitations given their rules-based construction. For example, the Bloomberg US Aggregate Index, which is often viewed as a proxy for the U.S. bond market, represents only about half of the U.S. public bond market and excludes asset classes such as high yield corporates and non-agency MBS. Passive products that follow these inadequate indices then pose further complications by using benchmark replication, which often requires samplings and leads to variations in replicating an index.

### Nearly half of the U.S. bond market is not represented in the Bloomberg US Aggregate Index

Exhibit 2: Segments of the \$53 trillion U.S. bond market



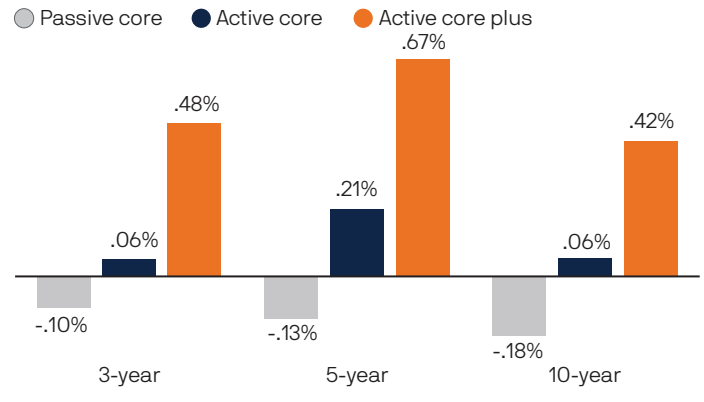
Source: Bloomberg, SIFMA, Bank of America. Figures reflect the most recently available data as of March 31, 2024. Some figures may be lagged. Core and core plus fixed income strategies do not typically include tax-free municipal securities.

### Active management in fixed income

Active managers can navigate these challenges and are not bound to the limitations of passive investing, expanding the investable universe to more opportunities for alpha generation. Active management offers exposure to skill, flexibility and options. Research plays a pivotal role. Active managers utilize fundamental, technical and quantitative analysis to select debt issuers they hold and adjust top-down positioning based on changing market conditions. Unlike passive strategies, they are not compelled to hold an issuer or security simply because it is part of an index.

### Active fixed income managers typically outperform passive strategies

Exhibit 3: Average excess annualized returns

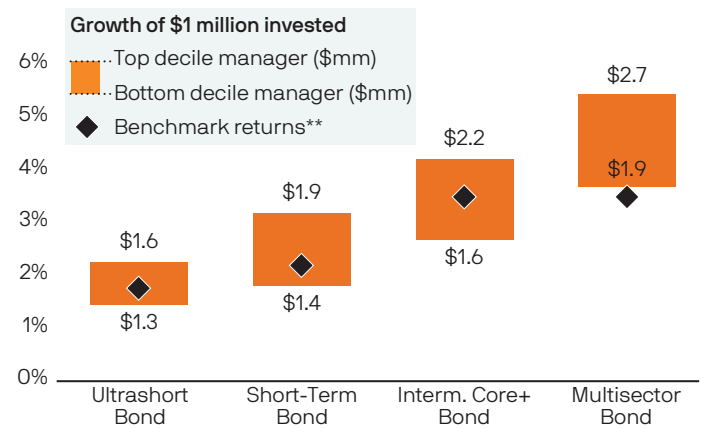


Source: Morningstar, J.P. Morgan Asset Management analysis; chart reflects the most recently available data as of January 31, 2025. Analysis includes mutual funds in the Morningstar intermediate core and intermediate core plus categories with a primary prospectus benchmark of the Bloomberg US Aggregate Bond Index. Only includes primary share classes as defined by Morningstar. Past performance is not indicative of future returns.

Active management has proven effective, with active core plus and active core managers delivering average annualized net of fee returns that exceed those of the Bloomberg U.S. Aggregate Index over the trailing 3-, 5-, and 10-year periods. Equally crucial is the selection of a manager with well-established research philosophies, robust processes and extensive experience across market cycles, as there is significant variation in returns between managers in the top and bottom deciles.

### Manager selection matters: There is a wide dispersion of returns between top and bottom managers

Exhibit 4: 20-year manager performance dispersion and growth of initial \$1 million investment



Source: Morningstar, J.P. Morgan Asset Management; data as of January 31, 2025.

<sup>1</sup> See endnotes for additional information.

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## The influence of ETFs

ETFs have revolutionized fixed income markets by providing a quick, simple and reliable way to access bond markets. Despite representing less than 2% of the total global bond market, ETFs are an emerging growth story with significant momentum that offer several advantages to investors, portfolio managers and the overall market. These benefits include...

### Deeper liquidity

On exchange trading matches buyers and sellers efficiently, providing real-time pricing information and orderly facilitation of trades. Robust secondary volumes can allow large trades to execute at minimal costs. When deeper liquidity is needed, market participants can tap into the primary market to create or redeem ETF shares, offering more liquidity than what appears on screen.

### Transaction cost savings

As trading volume increases, ETF bid asks spreads often tighten, leading to lower transaction costs for investors than acquiring the underlying holdings. And unlike mutual funds, whose transaction costs are borne by all shareholders and embedded in the NAV, ETF transaction costs are externalized to the entering or exiting investor. ETFs generally offer lower total expense ratios as well.

### Tax efficiency

ETFs typically distribute fewer capital gains than mutual funds. Secondary market activity reduces the number of trades at the fund level, while the option to use in-kind capabilities allows holdings to be transferred out of the fund without the recognition of a taxable gain.

### Transparency

ETFs offer daily transparency, with most disclosing their holdings daily, unlike mutual funds that typically disclose monthly or quarterly. Better insight into the portfolio allows for greater pricing precision from market participants and more robust attribution of performance and risk for investors.

### Benefits during times of stress

Intraday pricing and secondary market trading have turned the ETF into a critical financial instrument in times of stress. During these periods, three themes regularly play out. First, ETF volumes typically increase, adding vital liquidity to asset classes under duress. Second, ETF spreads may become tighter than their basket spreads particularly in less liquid segments like high-yield bonds. Finally, ETFs serve as efficient price discovery tools, often reflecting levels where risk transfer occurs in the underlying bond market quicker than the NAV.

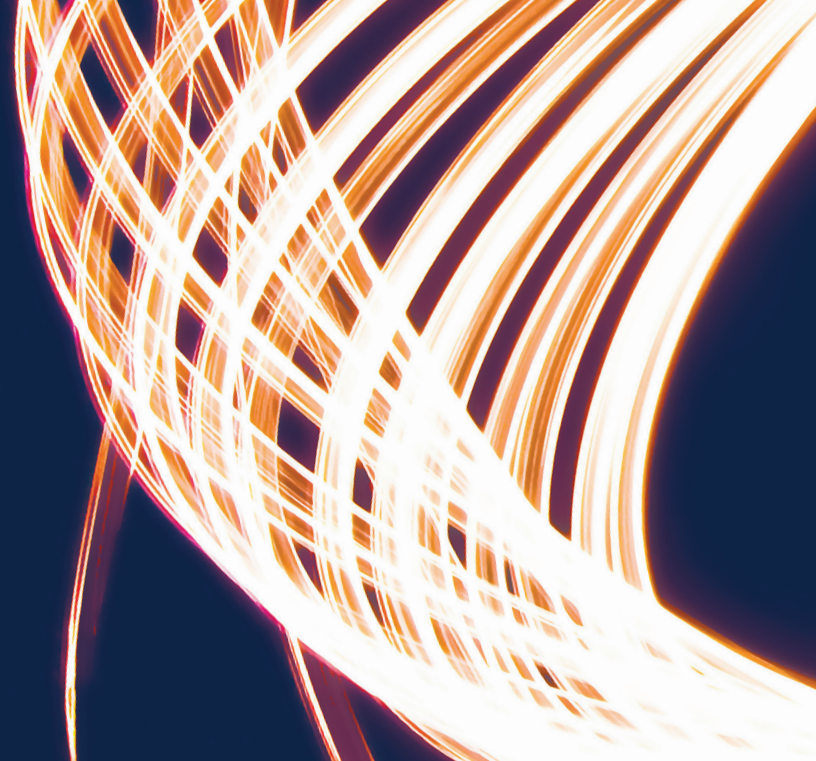
## The path forward

Active management, combined with the benefits of ETF structure, can be a key differentiator for investor portfolios. The ease with which investors can now integrate diverse segments of the bond market in their portfolios using this product has active fixed-income ETFs well on their way to becoming a cornerstone in asset allocation—and, in the process, revolutionizing how investors view and participate in fixed income.

### Endnotes for Exhibit 4

<sup>1</sup> Represents average annual portfolio return dispersion between the 10th and 90th percentile over a 20-year period for each Morningstar Category, including mutual funds and ETFs. Returns are updated monthly and reflect data through December 31, 2024. This information is for illustrative purposes only, does not reflect actual investment results, is not a guarantee of future results and is not a recommendation.

\*\*Ultrashort Bond: Bloomberg Govt/Corp 1 Yr Duration Index, Short-Term Bond: Bloomberg 1-3 Yr U.S. Govt/Credit Total Return Index, Intermediate Core Plus Bond: Bloomberg U.S. Universal Total Return Index, Multisector Bond: Bloomberg U.S. Universal Total Return Index.



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