

Active vs. Passive: Data-Driven Insights

Each year, RVK conducts a broad-based study evaluating long-term active management results across public equity and fixed income asset classes. The analysis uses averages of 3-year rolling periods dating back to 2001 in most cases. The methodology seeks to minimize survivorship and end-point bias to provide a realistic estimate of the excess returns provided by active portfolios. Additionally, fees reflecting typical institutional pricing are incorporated to produce net-of-fee results for each asset class.

Figure 1: Average Long-Term Net Excess Returns: 2021–2025 (%)

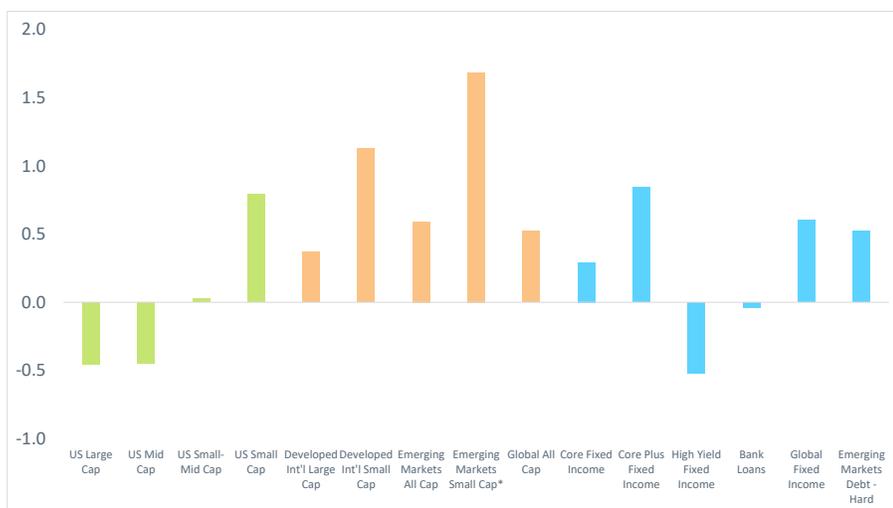


Figure 1 summarizes results from our most recent study, across commonly used asset classes. Additional methodology details are included in the appendix.

How Recent Market Regimes Have Shaped Active Performance

Institutional investors have long debated the merits of active versus passive management. Since 2019, markets have moved rapidly through multiple macro regimes: the late-cycle environment preceding the COVID-19 drawdown, the subsequent liquidity-driven recovery, an extended phase of

Source: eVestment. * EM Small Cap begins on December 2009 with a population of 21.

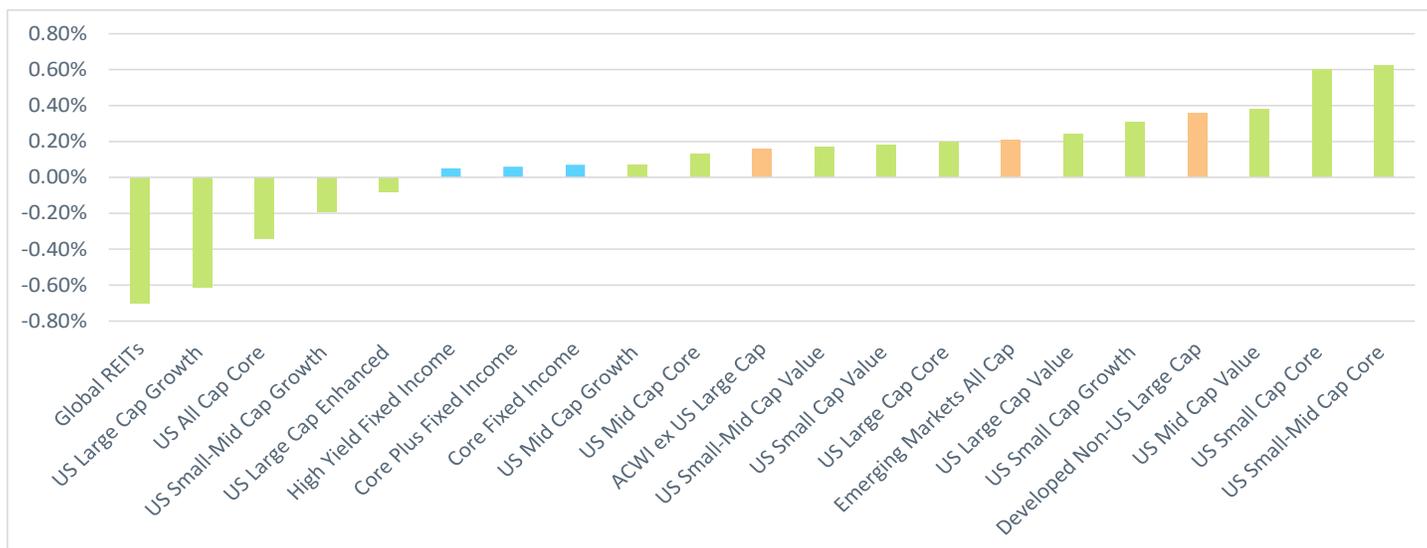
extraordinary monetary accommodation, and then an abrupt pivot toward elevated inflation and aggressive monetary tightening. These shifts meaningfully influenced dispersion, correlations, and style leadership—all key drivers of active management results.

In US equity, rising concentration in mega-cap growth companies and the dominance of market beta created a challenging backdrop for traditional active managers, especially in large-cap segments. International equity benefited more recently from a weaker US dollar, differentiated sector composition, and more varied policy responses, leading to a more favorable environment for active stock selection. In US fixed income, interest rate volatility and spread tightening in plus sectors generally supported active managers with greater flexibility.

These trends are reflected in the exhibit on the following page, which shows changes in long-term average excess returns across asset classes. While the success of active management tends to be somewhat cyclical, the past five years have been particularly challenging for certain asset classes, such as US Large Cap Growth

and other growth-oriented strategies, which are compared to increasingly concentrated, top-heavy benchmarks.

Figure 2: 5-Year Change in Average Long-Term Net Excess Returns



Source: eVestment. Asset classes with insufficient history over the full five-year period are excluded from this chart.

Factors That Influence Active Management Results

Active managers typically seek to generate excess returns through fundamental, quantitative, or macro insights that allow them to exploit temporary valuation opportunities that are not fully reflected in market prices or benchmark weights. The breadth and persistence of these opportunities are shaped by three broad categories of variables: (1) market structure, (2) market regime, and (3) investor behavior.

- Market structure** includes index concentration, liquidity, and benchmark construction rules. Highly concentrated indices dominated by a few mega-cap issuers can compress the opportunity set for diversified active managers. Conversely, broader universes with more mid- and small-cap representation—or markets with greater information frictions—tend to offer more opportunities for differentiated security selection.
- Market regimes** determine the level and volatility of returns. In trending, liquidity-driven bull markets, index beta often dominates outcomes, making relative performance more dependent on exposure to the narrow set of winners. In regimes with more modest returns, higher dispersion, and episodic volatility, security selection and sector allocation play a larger role, creating more favorable conditions to express active skill.
- Investor behavior**—including the rise of passive ownership, short-horizon trading, and performance sensitivity—can reinforce or counteract structural and macro forces. For example, rapid passive inflows can amplify demand for the largest index constituents, increasing concentration and potentially exacerbating future reversals.

Several underlying market variables help explain when and why active managers are more or less likely to succeed:

Market Variable	What It Measures	Why It Matters for Active Managers
Market Return (Beta)	Level and direction of broad market performance.	Strong, steady beta can dominate total returns and reduce the impact of stock selection.
Dispersion	Cross-sectional spread of returns across securities.	Higher dispersion increases the potential payoff from security selection and relative value views.
Correlation	Co-movement among securities or sectors.	Lower correlations allow idiosyncratic insights to influence outcomes.
Valuation Spreads	Difference between cheap and expensive securities on fundamental metrics.	Wide spreads often benefit valuation-based strategies.
Volatility	Speed and magnitude of price changes.	Moderate volatility supports opportunity recognition; extreme volatility may disrupt execution and risk budgets.

Factors That Influence Passive Management Results

Passive strategies seek to deliver market returns at low cost. Outcomes are shaped primarily by benchmark design, implementation mechanics, and structural flow dynamics.

1. **Benchmark design and embedded exposures**—such as capitalization weighting, eligibility criteria, sector classifications, and rebalancing rules, define the systematic tilts implicitly accepted by passive investors. Cap-weighted benchmarks, for example, naturally increase exposure to securities with strong recent price appreciation, often resulting in higher concentration and momentum characteristics over time.
2. **Index concentration and representation** affect the diversification and completeness of passive exposures. Highly concentrated indices heighten single-name and sector risk, while benchmarks that exclude parts of the investable universe will not capture those opportunities.
3. **Implementation efficiency and structural flows** influence realized performance relative to the benchmark. Tracking error may arise from replication methods (e.g., full replication versus sampling), transaction costs, rebalancing turnover, and cash management practices. Large passive flows can also affect price dynamics around index constituents.

Taken together, passive management results are shaped not only by low fees but also by the structural properties of the benchmark and the mechanics of implementation. Understanding these embedded exposures and constraints is essential when evaluating passive implementation as a strategic portfolio decision.

Potential Guidance for Institutional Investors

Recent trends suggest several practical steps for institutions evaluating active versus passive allocations across public markets:

1. Institutions should tie their active risk budget to the expected utility of excess return within the context of total portfolio objectives. For example, forecasts of significant returns from alternative asset classes may deem alpha from traditional asset classes less necessary to reach long-term return targets.
2. Governance and behavioral considerations should not be overlooked. Active strategies require monitoring, manager evaluation, and an ability to remain committed through inevitable periods of underperformance. This is especially true in regimes where market structure and macro forces temporarily favor passive exposures. Institutions with predefined decision rules are better positioned to avoid procyclical reallocations that lock in underperformance.
3. Manager selection and portfolio construction should reflect a clear view on capacity, diversification, implementation risk, and a coherent benchmark framework to help ensure that the aggregate active risk taken is both intentional and appropriately compensated over full market cycles.
4. Cost considerations—including fees, transaction costs, tax implications, and governance resources—should be explicitly integrated into the active/passive decision.

Conclusion

For institutional allocators, the implication is not to abandon active management, but rather to deploy it where it is most likely to add value and aligns with portfolio objectives and constraints. Grounding decisions in a regime-aware, market-structure-sensitive framework helps build more resilient portfolios capable of navigating both tranquil and turbulent market environments.

Appendix: Methodology Specifics

Manager returns data is sourced from eVestment.com.

Benchmarks used are asset class specific.

Constrained analysis to start in January 2001, mitigating survivorship bias from periods before population levels reached significant levels. For more recently established asset classes, earlier starting points are used, which coincide with the asset class reaching a strategy population of at least 20.

Performance shown represents rolling 3-year performance at each quartile, and does not correspond to the long-term experience of any specific manager. Peer group constituents and managers' rankings change over time.

Rolling periods and peer groups inclusive of inactive strategies are used to capture the historical performance of each peer group rather than the historical performance of the remaining managers.

The study examines the average performance of the peer group, but does not account for actual assets invested in the various products.

Fee assumptions based on eVestment peer group median fees for the following mandate sizes:

\$500M Mandate Assumption

*Core and Core Plus Fixed Income
US All-Cap Equity
US Large-Cap Equity
Developed Non-US Large-Cap Equity
ACWI-Ex Non-US Large-Cap Equity
Global All-Cap Equity
Global Large-Cap Equity*

\$200M Mandate Assumption

*High Yield Fixed Income
Global Fixed Income
Bank Loans
Emerging Market Debt
US Mid-Cap Equity
US Small-Mid-Cap Equity
US Small-Cap Equity
US Micro-Cap Equity
Non-US Small-Cap Equity
Emerging Markets Equity
Global REITs*

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