

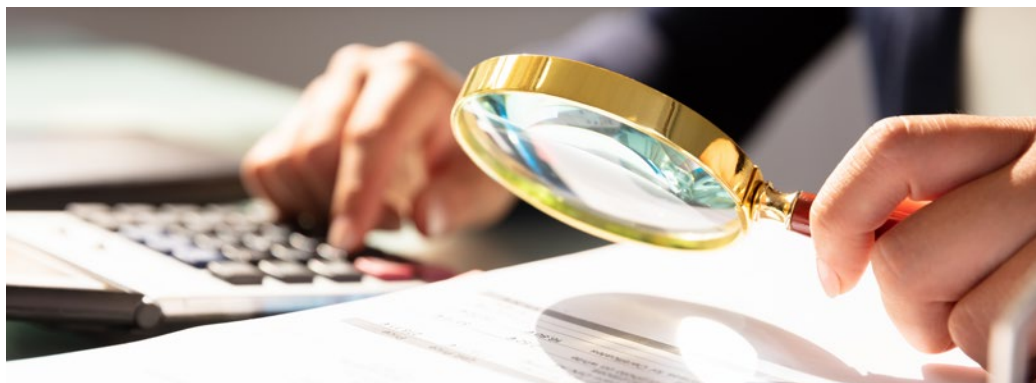
Perspective from
Global Index
Portfolio Management

The silent majority: How 90% of ETF assets are proactively managed

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The rapid expansion of the global exchange-traded funds (ETFs) industry continues to reshape the investment landscape. In the United States alone, nearly 500 ETFs were launched in the first half of 2025, contributing to flows exceeding half a trillion US dollars.¹ Europe has seen at least 220 new ETFs brought to market this year, also with remarkable inflows over the first six months of approximately US\$182 billion, while Asia pulled in about US\$40 billion with 383 launches.² Notably, assets invested in European ETFs reached an all-time high of US\$2.74 trillion at the end of June 2025, surpassing the previous record of US\$2.61 trillion set in May.³

Sustained growth and market dynamics

The scale of ETF flows underscores their central role in both institutional and retail portfolios. At the end of June, global flows for 2025 approached US\$780 billion.⁴ Within this expansion in the United States, index-based strategies captured approximately 63% of inflows, of which 8% went to non-market-cap-weighted approaches.⁵ Meanwhile, actively managed ETFs attracted around 37% of net flows, reflecting an increasing appetite for tactical solutions alongside core exposures.⁶

These figures show that ETFs have moved beyond the old “active vs. passive” divide. Today, the industry spans a spectrum of strategies—supporting both long-term allocations and more targeted, outcome-driven approaches. While actively managed ETFs are garnering significant attention, index-based strategies aren’t standing still and continue to dominate portfolio construction. Over 90% of global ETF assets under management are indexed strategies. Despite this prominence, portfolio management of indexed ETFs still frequently gets mischaracterized as automatic or even “hands off.” Such perceptions obscure the discipline, precision and constant skilled oversight required to manage them effectively.

Innovation in indexed approaches

Index-based ETFs have expanded well beyond traditional market-cap-weighted benchmarks. They are also increasingly leveraging non-traditional and more granular data sources—such as supply chain metrics, natural language models, satellite imagery and revenue disaggregation—to capture targeted investment themes.

Factor-based strategies—long established in academic and practical investment discourse—have experienced renewed adoption. By incorporating single or multifactor tilts across dimensions such as quality, value, momentum or volatility, we believe these vehicles provide investors with refined tools for portfolio diversification. In periods of heightened market dispersion and volatility, such approaches can offer a mechanism for adjusting exposures with precision.

Operational discipline

A common misconception we often hear is that index tracking requires minimal oversight. In practice, maintaining alignment with a benchmark requires rigorous processes and continuous decision-making. Indexes undergo scheduled rebalances as well as intraperiod adjustments to reflect changes in countries, sectors, liquidity and corporate events. Portfolio managers need to respond to mergers, acquisitions, initial public offerings, spinoffs and delistings with timely adjustments to maintain fidelity.

Additional layers of complexity come from dividend reinvestment, currency fluctuations across global markets and differences in market trading hours. For ETFs with hedged share classes, foreign-exchange exposures must be managed dynamically. Cash management—whether in the context of rebalancing, subscriptions or redemptions—requires careful execution to minimize market impact and tracking error.

These day-to-day decisions, while individually small, collectively have a real impact on long-term performance. Effective index tracking is therefore not a “passive” exercise but rather a disciplined application of portfolio management expertise.

Tracking error

Tracking error, defined as the standard deviation of excess return between that of an ETF and its benchmark, remains a critical measure of index-based ETF performance. It can arise from transaction costs, expense ratios, replication strategies, cash drag or implementation limitations. Mitigating these deviations requires the integration of advanced trading strategies, understanding of index methodologies and continuous performance monitoring.

Through these measures, portfolio managers seek to preserve the integrity of benchmark alignment to ensure that investors receive the outcomes they expect from index-based ETFs.

Still, results can vary. Not all index ETFs track as tightly as they should. That’s why we believe investors need to look under the hood. Regardless of whether a fund is indexed or active, it all comes down to performance.

Potential advantages for investors

The structural benefits of index-based ETFs continue to resonate with investors across segments. These vehicles deliver diversification by offering exposure to hundreds or even thousands of securities within a single instrument. Their cost efficiency, supported by lower management fees, compounds over time to enhance long-term outcomes.

Transparency and potential tax advantages are other key benefits. ETFs trade throughout the day on exchanges, and holdings are disclosed daily, affording investors a level of visibility not typically available in traditional mutual fund structures. Moreover, intraday liquidity enables flexible portfolio adjustments, while the breadth of available exposures allows for precise tilts by country, sector or theme. In markets like the United States¹, ETFs are structured in a way that can help minimize capital gains distributions, offering additional tax efficiency for investors subject to those rules.

Finally, indexed ETFs facilitate the capture of market dispersion. While they provide broad market access, they also enable investors to concentrate selectively in regions/countries, industries or themes that exhibit favorable fundamentals or valuation characteristics.

Passive, not an absence of action

Index-based investing is, in fact, an exercise in discipline, systematic oversight and operational rigor. Behind every indexed ETF is a team working to ensure alignment with benchmarks, manage cash flows, execute trades strategically and mitigate deviations.

As innovation in strategy design expands and adoption accelerates globally, index-based ETFs continue to be foundational to modern portfolio construction. What we hope investors realize is that index-based ETFs are not merely “passive” instruments, but proactive tools designed to help deliver both consistency and adaptability in an increasingly complex investment environment.

Endnotes

1. Source: Morningstar Direct, as of June 30, 2025.
2. Source: Ibid.
3. Source: ETFGI Research, July 11, 2025.
4. Source: Morningstar Direct, as of June 30, 2025.
5. Source: Ibid.
6. Source: Ibid.

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Equity securities are subject to price fluctuation and possible loss of principal.

Diversification does not guarantee a profit or protect against a loss.

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