

What should plan sponsors offer in retirement plan investment menus: Active or passive mutual funds?

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For years, the investment industry has robustly debated whether investors are rewarded for the fees of actively managed mutual funds, which are higher compared to passively managed mutual funds. Proponents of active management believe the fees are warranted because a manager can potentially provide better total returns and/or risk-adjusted returns (a higher return profile and/or lower volatility).

A preference for passively managed funds has emerged in recent years, most notably among retail investors. A 2021 Gallup Investor Optimism Survey found that 71% of investors say passive investing is superior to active investing (29%) over the long term.¹

TruePlan's analysis

TruePlan Benefit and Retirement Advisors conducted research on investments (mutual funds) that are typically available to investors through company-sponsored retirement plans (e.g., 401(k) plans for “for-profit” companies and 403(b) plans for not-for-profit companies). TruePlan’s investment team conducted this research to gauge the percentage of actively managed mutual funds that outperform their respective benchmarks, and as a result, the passive index funds that track those benchmarks (net of fees).

TruePlan’s method is meaningful to retirement plan sponsors who are tasked with making more nuanced decisions regarding a diversified, multi-asset-class/category lineup for their participants, often in consideration of employees with varying degrees of risk tolerance and time horizons.

TruePlan’s research process compared all mutual funds within a peer group (category) to the respective benchmark/index for that peer group over the trailing one-, three-, five-, 10- and 15-year periods ending in December 2023 based on a fund’s institutional/retirement plan share class.

This approach contrasts with studies that have compared large swaths of equity mutual funds to benchmarks that are not an “apples to apples” comparison, which led many to derive opinions on the active management industry as a whole. For example, studies have compared large groups of U.S. equity mutual funds to the S&P 500 Index, rather than comparing small cap funds to small cap benchmarks, mid-cap funds to mid-cap benchmarks, etc.

¹ Lydia Saad. (Sept. 20, 2021) U.S. Investors See Passive Investing as Path to Wealth. Gallup. <https://news.gallup.com/poll/354821/investors-passive-investing-path-wealth.aspx>

TruePlan's analysis spanned ten U.S. equity categories (e.g., large, mid and small cap value, blend and growth categories, and real estate investment trusts), international equity, emerging market equity, U.S. intermediate core and core plus bond, inflation protected bond, and U.S. high yield bond.

TruePlan chose these categories because they are commonly available in participant-directed, defined contribution retirement plans, such as 401(k) and 403(b) plans. The analysis focused on one share class per fund — the share class typically available in retirement plans — rather than including all share classes for a fund, such as those with sales commissions embedded into their expenses, which are no longer common in defined contribution retirement plans.

Results of TruePlan's analysis

TruePlan concludes that active management's outperformance of passive management is prevalent in certain asset classes, even when accounting for certain biases that come with performance comparisons over varying timeframes, most notably, survivorship bias. Asset classes/categories that have proven conducive to active management include:

- large cap value;
- small caps (value, blend and growth);
- real estate investment trusts;
- U.S. intermediate core bond; and
- U.S. intermediate core plus bond.

Conversely, the data clearly point to low prevalence of outperformance of active management over passive management in:

- large cap blend;
- large cap growth;
- mid-caps (value, blend and growth);
- international equity;
- emerging market equity,
- inflation protected bond; and
- U.S. high yield bond.

As a result, TruePlan continues to recommend that retirement plan investment menus contain a combination of actively and passively managed mutual funds. This can help balance the pursuit of favorable long-term total and risk-adjusted returns while striving to control fees.

The data used in this report are driven by Ycharts and respective benchmarks and actively managed mutual fund returns (net of fees).

Survivorship bias

It is important to note that the actively managed mutual fund data TruePlan analyzed carries survivorship bias. Survivorship bias is “a type of sample selection bias that occurs when a data set only considers ‘surviving’ or existing observations and fails to consider observations that ceased to exist.”² This can create overly optimistic historical performance by removing the performance of funds that failed and liquidated. For example, a fund may close due to underperformance or low asset levels, with low asset levels driven by subpar performance. Therefore, it is reasonable to presume that a complete universe of actively managed funds, including both active and closed funds, would show a larger percentage of funds underperforming their benchmarks, especially over longer time periods.

Data support active management in some categories

After conducting this research, TruePlan believes the data support the case for active management in certain asset classes/categories. This is particularly notable when considering the market volatility in recent years and more limited impact of survivorship bias. Regarding the latter, shorter time periods have a much larger number of managers to sample and evaluate in what many believe was a very difficult and, therefore, very telling environment for active management, with elevated inflation and interest rate volatility.

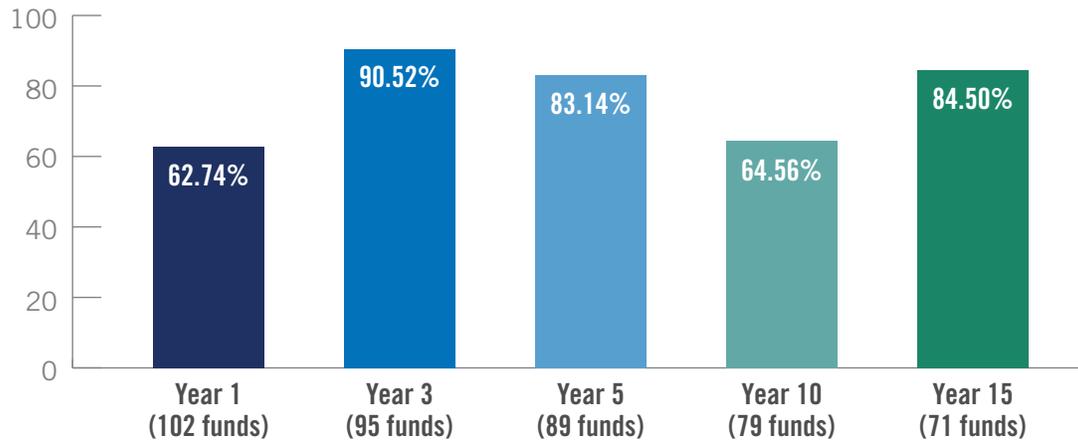
The debate of active versus passive management should continue and be encouraged as market dynamics change over time and active managers have more environments in which to test their value.

Specific category data (charts) are provided in the remainder of this report. [Reach out to TruePlan’s investment team](#) for more detailed information on this research paper.

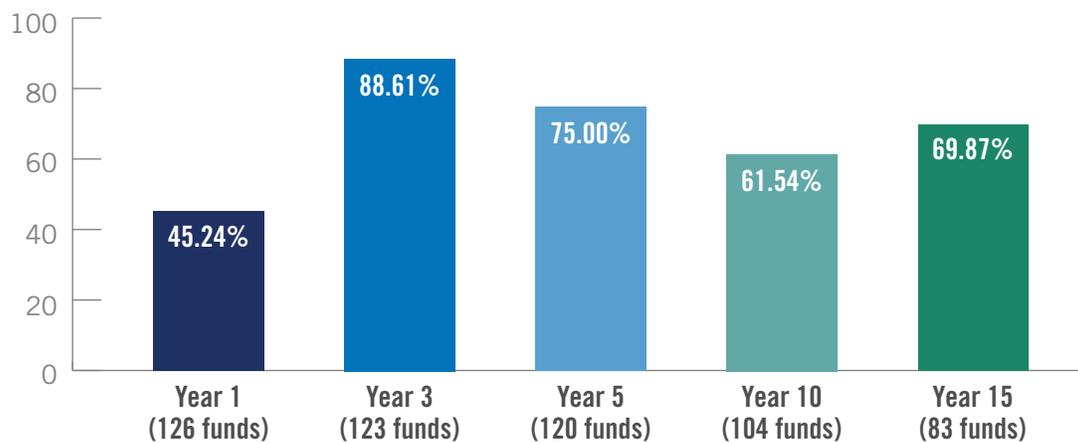
² CFI. Survivorship Bias. <https://corporatefinanceinstitute.com/resources/capital-markets/survivorship-bias>

SMALL CAP EQUITY

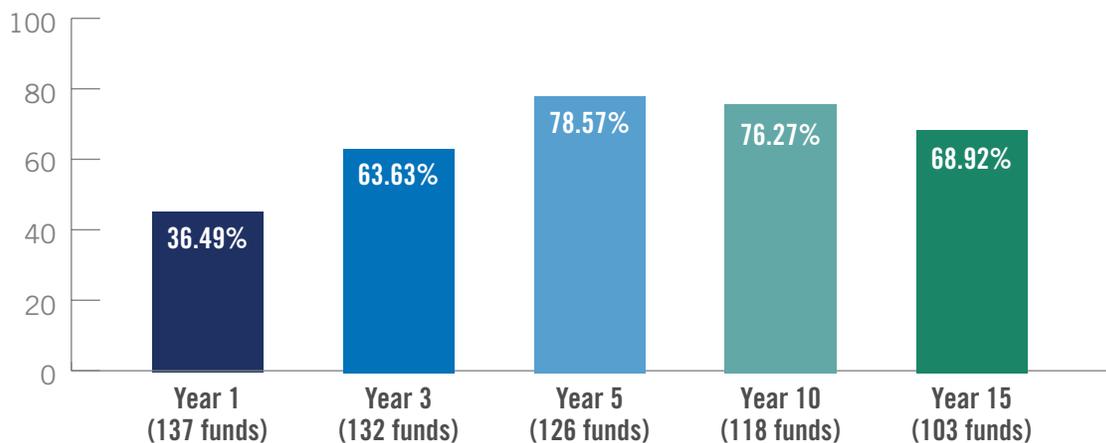
Small Cap Value Category (Percentage of funds that outperform the Russell 2000 Value Total Return Index)



Small Cap Blend Category (Percentage of funds that outperform the Russell 2000 Total Return Index)

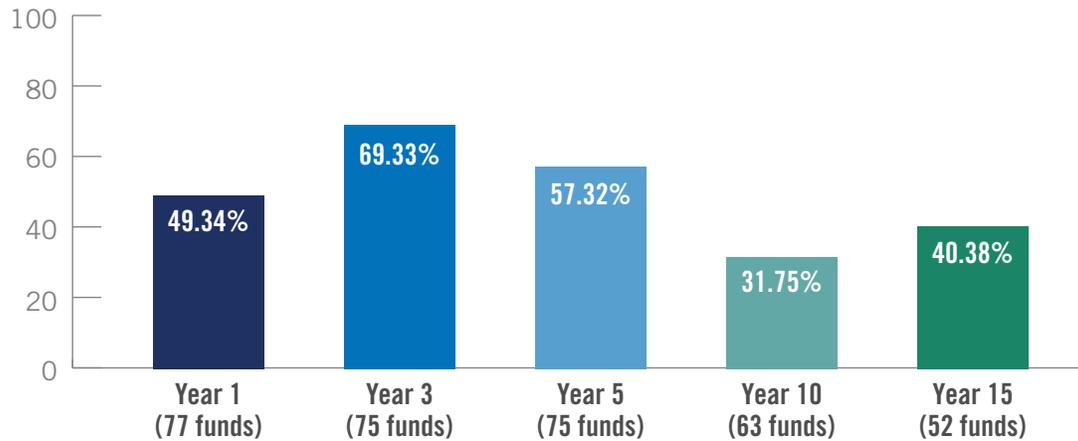


Small Cap Growth Category (Percentage of funds that outperform the Russell 2000 Growth Total Return Index)

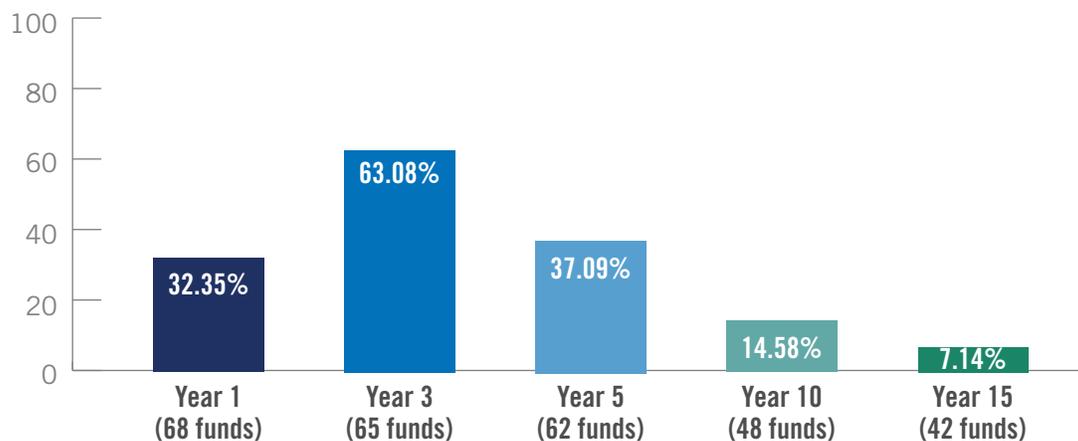


MID CAP EQUITY

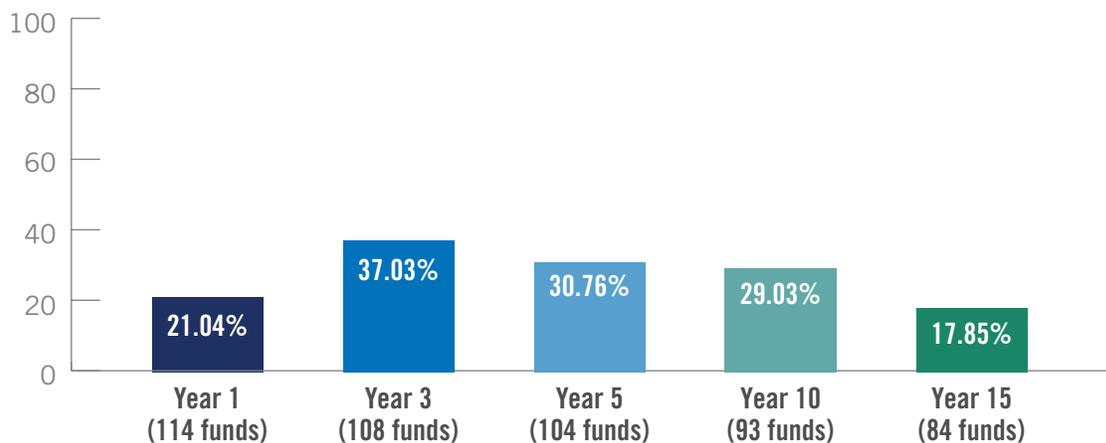
Mid Cap Value Category (Percentage of funds that outperform the Russell Mid Cap Value Total Return Index)



Mid Cap Blend Category (Percentage of funds that outperform the Russell Mid Cap Total Return Index)

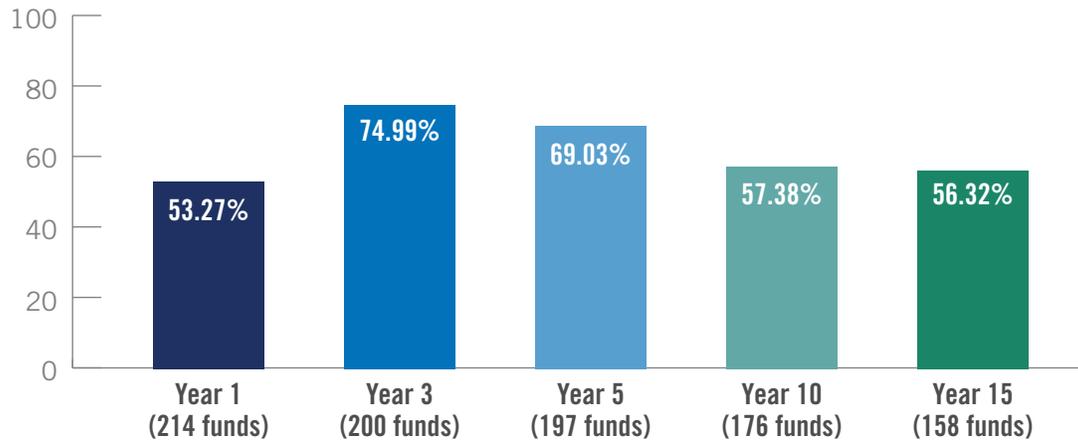


Mid Cap Growth Category (Percentage of funds that outperform the Russell Mid Cap Growth Total Return Index)

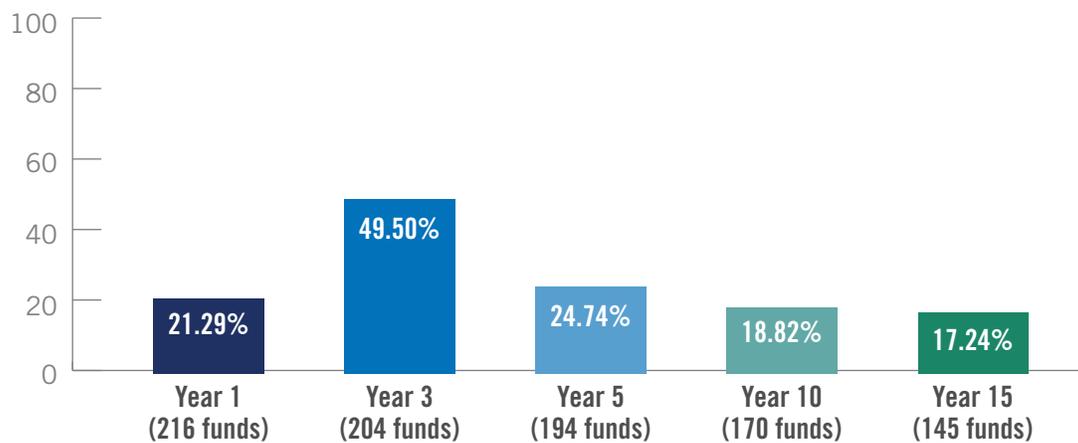


LARGE CAP EQUITY

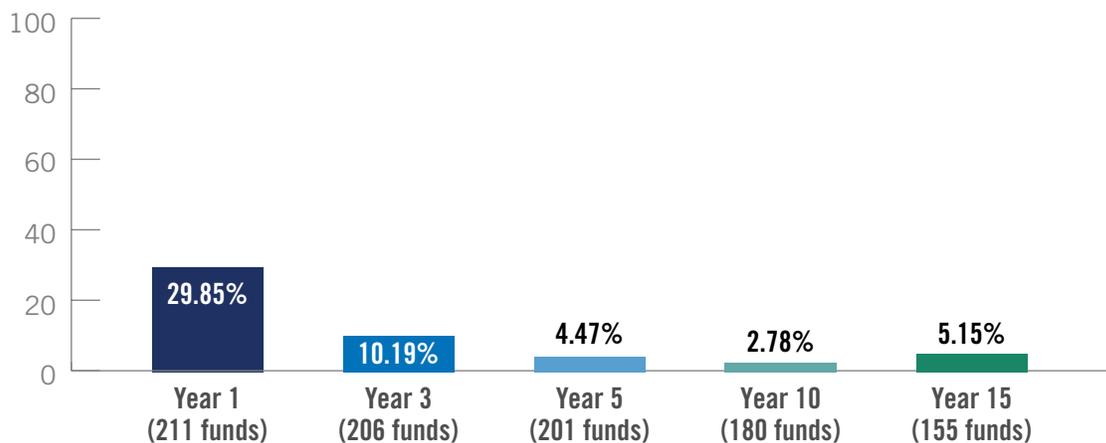
Large Cap Value Category (Percentage of funds that outperform the Russell 1000 Value Total Return Index)



Large Cap Blend Category (Percentage of funds that outperform the Russell 1000 Total Return Index)

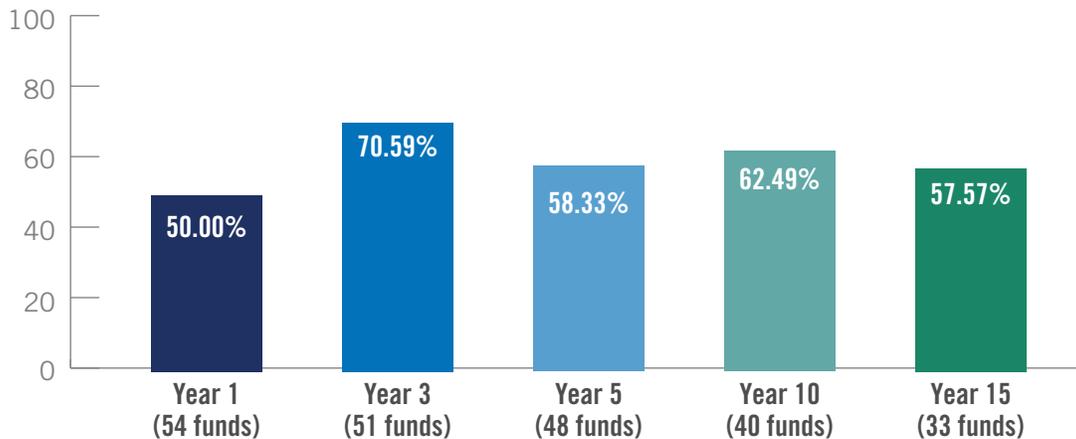


Large Cap Growth Category (Percentage of funds that outperform the Russell 1000 Growth Total Return Index)



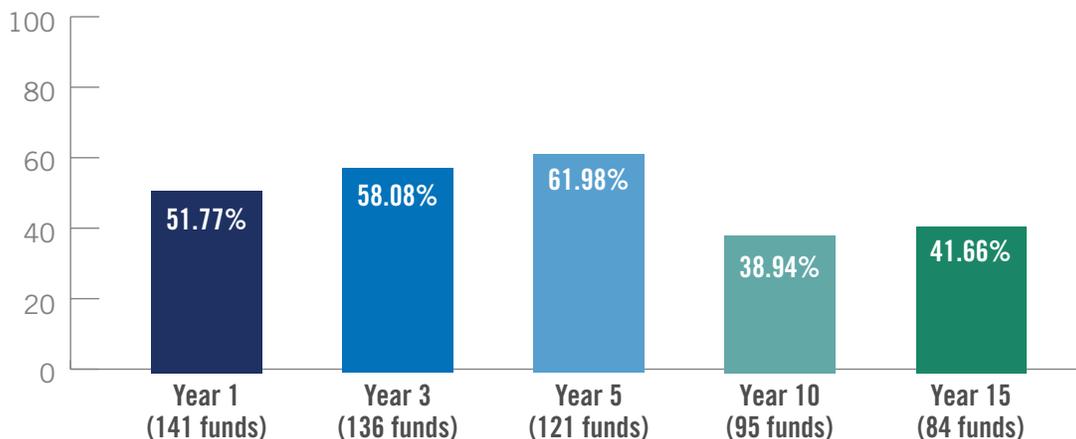
REAL ESTATE, INTERNATIONAL EQUITY, EMERGING MARKETS

Real Estate Investment Trusts – Actively managed mutual funds investing in publicly traded real estate equity securities (Percentage of funds that outperform the Vanguard Real Estate Index Fund*)

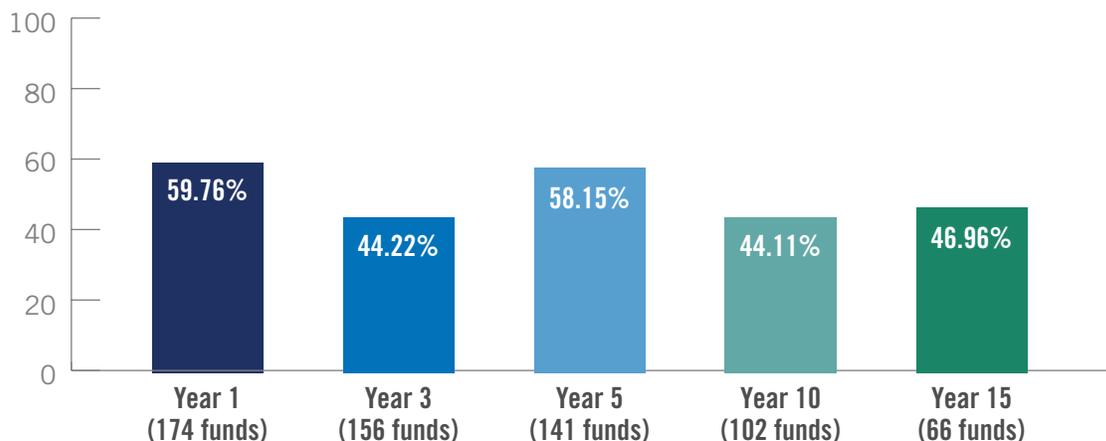


*Vanguard's Real Estate Index Fund (VGSNX) is referenced because it has a 15-year track record, which is not characteristic of other common REIT indices.

International Equity (Foreign Large Blend) Category (Percentage of funds that outperform the MSCI ACWI Ex-USA Total Return Index)



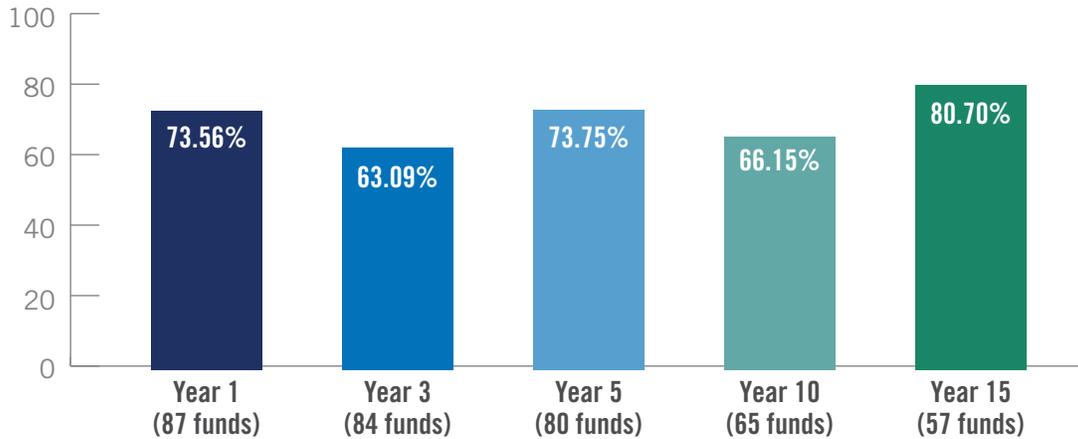
Emerging Market Equity Category (Percentage of funds that outperform the MSCI Emerging Market Total Return Index)



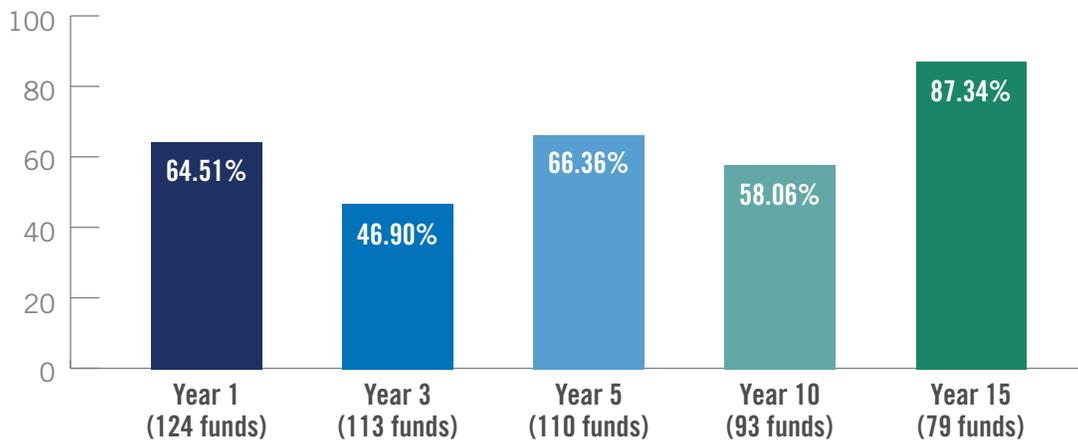
Data are through December 2023 | Source: TruePlan and Ycharts (net of fees).

FIXED INCOME

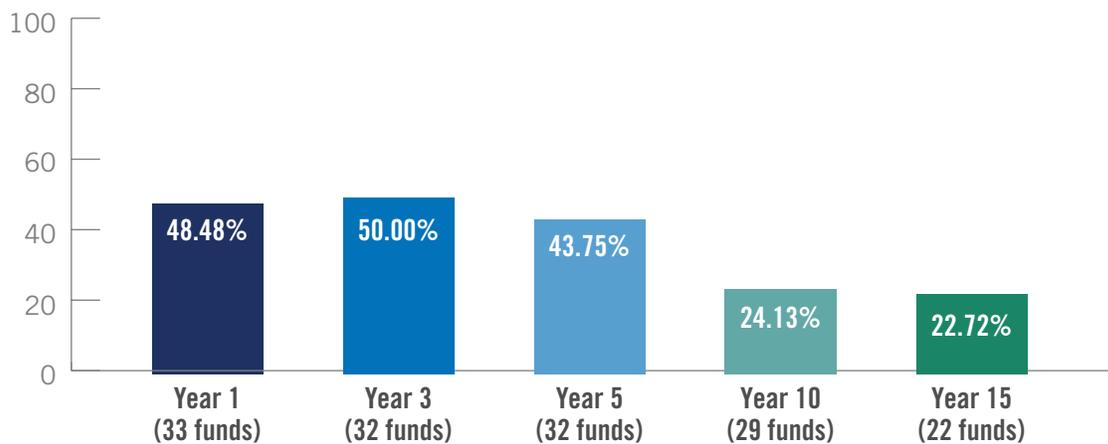
Intermediate Core Bond Category (Percentage of funds that outperform the Bloomberg US Aggregate Bond Total Return Index)



Intermediate Core Plus Bond Category (Percentage of funds that outperform the Bloomberg US Universal Total Return Index)

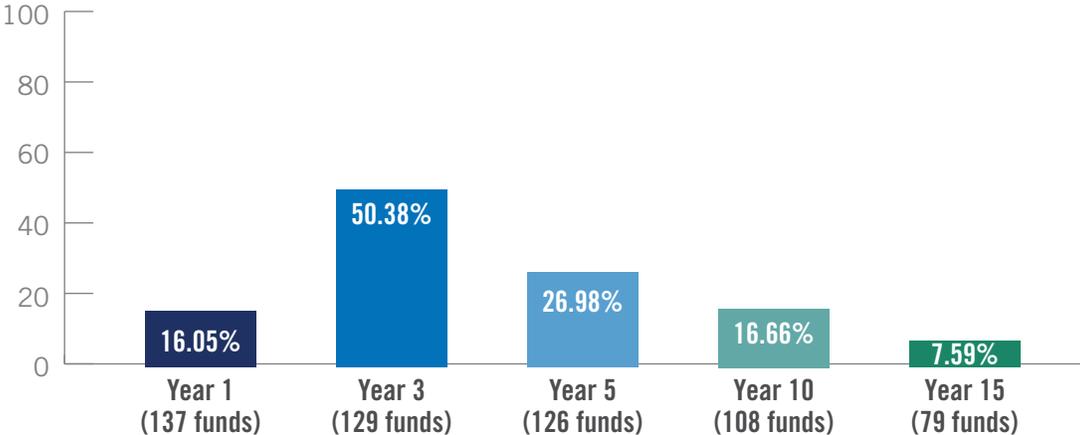


Inflation Protected Bond Category (Percentage of funds that outperform the Bloomberg US TIPS Total Return Index)



FIXED INCOME

High Yield Bond Category (Percentage of funds that outperform the Bloomberg US HY Corporate Total Return Index)



Data are through December 2023 | Source: TruePlan and Ycharts (net of fees).

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