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The ABCs of active ETFs

Exploring how actively managed exchange-traded funds (ETFs) are expanding investor opportunities

Key takeaways

It's easy to see why investors are increasingly using active ETFs to help enhance their long-term investment portfolios:

- **Alpha potential through active management**
- **Benefits of the ETF structure**
- **Combining these two aspects has broadened innovation and investor choice**

The ETF market has experienced significant growth and advancements over the past decade. Once synonymous with passive, index-based investing, that view is increasingly changing, driven by the tremendous growth of active ETF strategies now available. Indeed, some market forecasts project that the number of active ETFs is on track to surpass index-based ETFs over the next few years. This offers investors and their advisors an exciting—and likely increasingly important—way to expand their portfolio toolkits.

A primary advantage of active ETFs is that they are designed to enhance performance relative to their benchmarks, seeking to leverage the manager's investment skill and expertise. In this paper we explore the potential opportunities offered by active ETFs and why more and more investors are increasingly adopting them as part of their investment strategies.

Alpha potential through active management

The evolution into active ETFs isn't that surprising as investors look for more choice beyond passive investments alone. Over the past decade or so, the age-old active-versus-passive debate has largely moved past an either/or argument, with investors increasingly seeing the value in both types of investment management approaches, depending on their specific objectives and expectations, the market(s) being invested in, the overall risk/return potential and the ability to add repeatable investment value.

The professional portfolio managers of active ETFs can be proactive in their portfolio design and security selection, unlike passive ETFs, which are designed to reactively reflect a benchmark and its holdings. This active positioning can help pursue additive risk/reward characteristics.

Active ETFs can proactively prepare for and respond to evolving market conditions, which can be particularly important in volatile periods to help minimize risk and potential downside exposures.

Active portfolio managers can apply extensive investment research backed by their experience and deep understanding of specific markets, sectors and/or investment styles as they pursue investment opportunities.

Active ETFs can quickly adapt investment strategies and portfolio holdings in ways that are simply out of reach for passive ETFs.

Today, there is an increasingly wide selection of active ETFs to choose from across a broad array of market segments, investment objectives, research styles and portfolio management approaches.

> Active ETFs offer a unique structure where portfolio decisions are based on research and skill, rather than purely reflecting an index, providing investors with the potential for more dynamic investment strategies while maintaining the agility, transparency and cost efficiencies that an ETF wrapper can provide.
>
> — Bob Groenke, Chief Executive Officer

Benefits of the ETF structure

Similar to a mutual fund, ETFs are investment vehicles that hold diversified portfolios of securities based on the goals and guidelines of the specific strategy. This can provide investors convenient and easily accessible access to a broad range of asset classes and investment styles, by pooling investments into a single fund. However, unlike a mutual fund, ETFs are bought and sold on stock exchanges, just like individual stocks, allowing investors to enter, add to, or exit positions throughout the trading day.

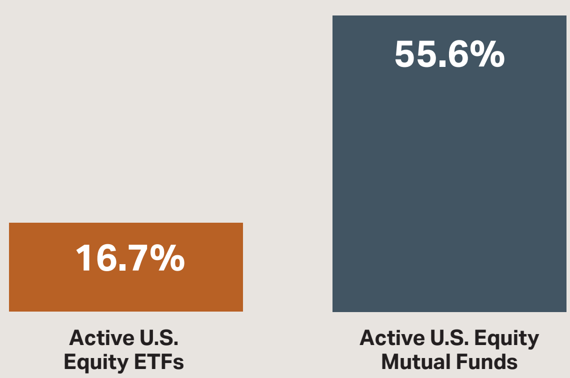
The ETF structure offers a number of attractive features for investors:

Broad diversification	ETFs offer an efficient way to diversify investment holdings, without having to select individual securities, and allocations can be easily scaled to fit.
Accessibility and intraday liquidity	Investors can buy and sell ETF shares throughout the trading day at real-time market prices, providing enhanced accessibility and flexibility compared to open-end mutual funds, which only trade at the end of the day.
Cost-effectiveness	ETFs generally entail lower expense ratios compared to open-end mutual funds, with lower operational and transaction costs.
Daily transparency	ETFs are fully transparent and disclose their full portfolio holdings each trading day.
Tax efficiency	Because of their unique structure, ETFs can adjust their portfolio compositions without necessarily triggering taxable events. This can help limit capital gains distributions compared to open-end mutual funds, potentially offering investors more control around when they may realize capital gains.

The active ETF capital gain advantage

Over the past 4 years, fewer active equity ETFs have distributed capital gains compared to open-end mutual funds, and the median size of those gains has been lower.

Average % distributing capital gains, 2019-2023[1]



[1] Data from 1/1/2019 - 12/31/2023. Source: Morningstar Direct. Information sourced from third party. Analysis includes only actively-managed U.S. equity mutual funds and exchange-traded funds active for the entirety of the applicable observation year. Mutual fund universe includes only a fund's oldest share class. ETF universe only includes U.S.-listed funds.

> "Active ETFs offer a new, often advantageous way for investors to invest with their favorite active managers.
>
> — Bob Groenke, Chief Executive Officer

The tax discussion herein is general in nature. Investors should consult their tax advisers for advice regarding the tax consequences of an investment in ETFs.

Combining these two aspects has broadened innovation and investor choice

Given all of this, it is clear to see why investors are increasingly choosing to access actively managed strategies through an ETF structure. The investment industry has responded with a rapid expansion in the number of active ETFs now available from an ever-growing range of investment managers.

Building on a history of evolution and explosive growth

ETFs have continued to evolve in both size and scope ever since they were first introduced in the early 1990s, growing from a handful of products to the more than $10 trillion global assets under management in 2021— with projected growth of over $20 trillion by 2026.[1] Investors can now select strategies offering access to almost any asset class, sector, investment type or specific style imaginable.

Impact of the ETF rule

The first U.S.-listed active ETF was launched in 2008. While this market was initially slow to catch on, the passage of the Securities and Exchange Commission's (SEC) Rule 6c-11 in 2019, known as the ETF rule, opened meaningful opportunities by implementing a consistent, transparent and efficient regulatory framework and facilitating greater competition and innovation among ETFs through added flexibility and lower barriers of entry for new issuers.

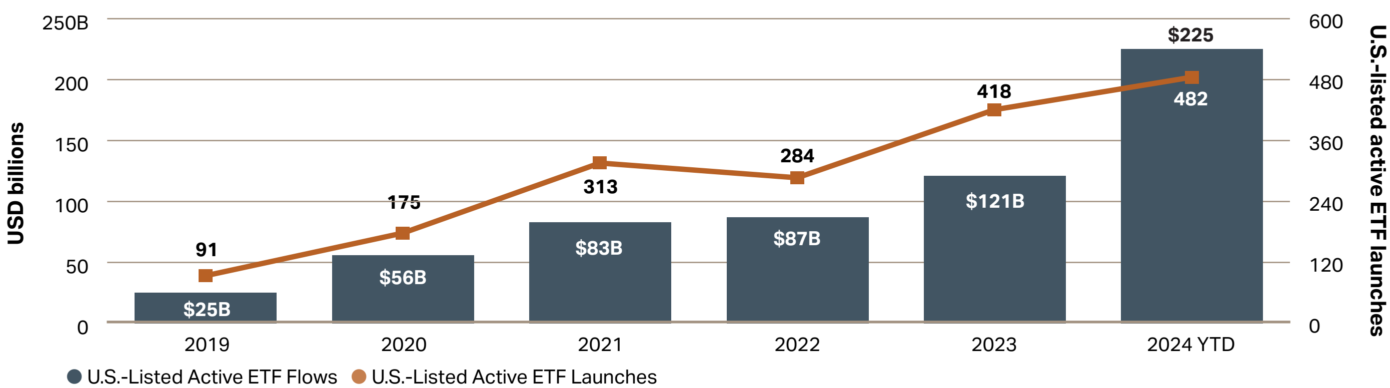
Surge in popularity

The implementation of the ETF rule prompted a surge in active ETFs that continues to gain momentum. There are now more than 1,750 U.S.-listed active ETFs to choose from, and active strategies accounted for almost 80% of all U.S.-listed ETF launched in 2024. While the overall assets invested in active ETFs is still considerably smaller than in passive ETFs, that is changing as well, with U.S. assets under management climbing from just over $25 billion in 2019 to more than $224 billion in June 2024.[2]

Growth of active ETFs: U.S.-listed active ETF launches and asset flows

Since the passage of the ETF rule active ETF growth has surged.

2019-2024

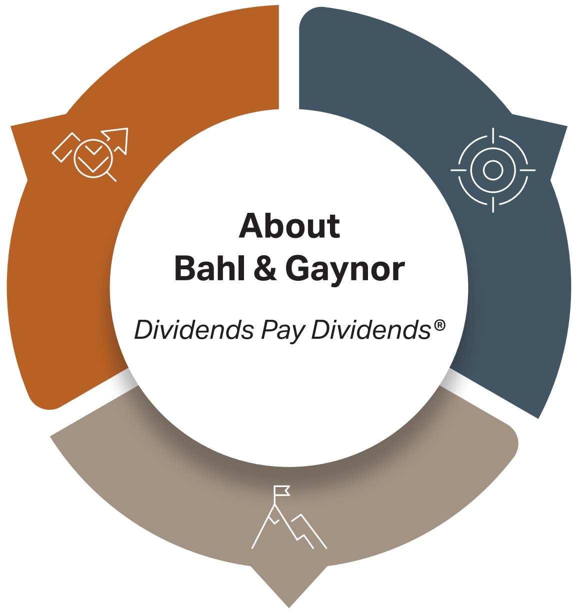


Source: Morningstar. 2024 YTD active ETF launches as of November 15, 2024. 2024 YTD active ETF asset flows as of October 31, 2024. Alpert, Gabe. "Will Active ETFs Outnumber Passive ETFs?" Morningstar, November 19, 2024, www.morningstar.com/funds/will-active-etfs-outnumber-passive-etfs

> "Given the notable growth and expansion in active ETFs, these vehicles have now become a powerful part of the investment opportunity set for investors and their advisors, alongside mutual funds, separately managed accounts and index-based ETFs."
>
> — Bob Groenke, Chief Executive Officer

Experienced investors striving to deliver the best for our clients

- Independent investment manager
- Founded in 1990
- 100% employee owned
- $51.9 billion in assts under management/assets under advisement[3]
- Highly experienced investment team with decades of collective experience



Disciplined dividend-focused process

- Specialized high-conviction, high-quality dividend growth investing
- Strict focus on protecting wealth while growing income and capital appreciation over the long term
- Driven by in-depth fundamental analysis

Proven long-term performance

- Diverse suite of strategies emphasizing risk mitigation and long-term capital appreciation and dividend growth
- Selection of separately managed accounts, mutual funds and ETFs
- Well-established results built on consistency and providing predictable, growing streams of cash flow independent of interest-rate cycles or credit spreads

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[1] Source: "ETFs 2026: The next big leap," PWC, accessed January 13, 2025, https://www.pwc.com/gx/en/industries/financial-services/publications/etf-2026-the-next-big-leap.html.

[2] Source: Alpert, Gabe. "Will Active ETFs Outnumber Passive ETFs?" Morningstar, November 19, 2024, www.morningstar.com/funds/will-active-etfs-outnumber-passive-etfs. % of All U.S.-Listed ETF launches calculated by dividing total active ETF launches by all ETF launches, active and index.

[3] Bahl & Gaynor regulatory assets under management were $20.1B and SMA platform assets under advisement were $31.8B as of 12/31/2024. Bahl & Gaynor identifies assets under management as assets over which the firm has discretion (including high net worth and institutional accounts and certain platform assets). Assets under advisement include model-only platform assets over which the firm does not have discretion.

Definition: **Alpha** is a measure of risk-adjusted return expected from a portfolio above the benchmark return at any point in time.

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