

Why You Should Pay Attention to Active ETFs

Active ETFs offer investors better odds of success than traditional mutual funds.

Aug 27, 2025 | by Bryan Armour, CFA

Active exchange-traded funds are a hot story and one that I have frequently talked about during the past couple of years. I tend to focus on how active strategies fit into the ETF wrapper, but this month I am flipping the script and pondering the goals of active management and how ETFs can serve investors who prefer active management.

Active managers seek to outperform their benchmark. This can be a challenge because the collective investment by active managers is what sets the benchmark. For example, buying a security that active managers perceive as undervalued will drive its price higher, which would then be reflected in benchmark performance.

Nobel laureate William F. Sharpe wrote an article on this topic titled "The Arithmetic of Active Management" that was published in *The Financial Analysts Journal* in 1991. He posits that, in aggregate, active management is a zero-sum game where the gross return of the average actively invested dollar must equal the return of the average passively invested dollar. Passive management simply reflects the bets made by active managers. Active management's zero-sum game turns negative after fees.

A couple of major caveats exist. Sharpe would consider active management to be any active risk away from the market portfolio, regardless of whether the strategy tracks an index or not. And Sharpe's theory can't be applied to mutual funds and ETFs alone because they are not a closed system; investors can buy stocks directly or choose from other investing vehicles, like hedge funds, collective investment trusts, and so on. For this reason, supply/demand forces outside of mutual funds and ETFs can affect performance.

Despite these considerations, Sharpe's "arithmetic" remains a wonderful mental model for assessing actively managed ETFs. On average, investors should expect an active ETF's managers to earn the benchmark minus fees. Therefore, the fee sets the hurdle for outperformance.

Morningstar's Active/Passive Barometer illustrates the compounding effect of negative expected returns. Just 21% of the US active funds included in the report survived and beat their average passive peer over the decade through June 2025. Can active ETFs buck that trend in the next decade? I expect so, for a few reasons.

Active ETFs' Advantage Over Mutual Funds

ETFs have several advantages over mutual funds:

- » Greater tax efficiency
- » Lower fees
- » Insulation from buying and selling by other investors in the fund
- » Lower trading costs because of in-kind creations and redemptions

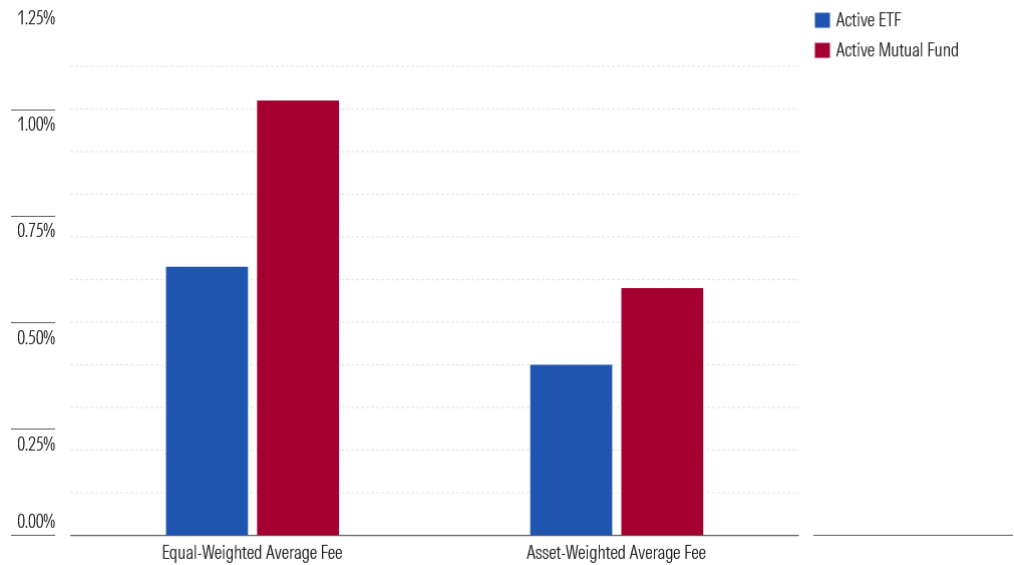
Tax efficiency won't affect pretax returns and thus success rates, but reduced trading costs should marginally improve them. The main pretax benefit of active ETFs versus mutual fund peers is their lower fees.

If active managers are expected to earn the market return minus fees, then lower fees are an easy win for investors. In other words, active managers of low-fee ETFs face a lower hurdle to beat their benchmark than higher-fee mutual fund peers.

The average active ETF faces a 40-basis-point lower hurdle to beat its benchmark compared with the average mutual fund. This alone is a reason to believe that the growth of active ETFs should have a meaningful impact on future Active/Passive Barometer success rates.

Investors tend to prefer cheaper funds, too. The fee paid by the average invested dollar drops to 0.40% for ETFs and 0.58% for mutual funds. From this perspective, ETFs' fee advantage over mutual funds shrinks, but the hurdle remains lower. Active ETFs should be more competitive than the average active mutual fund based on Sharpe's arithmetic.

In Investing, You Get What You Don't Pay For



Source: Morningstar's 2024 US Fund Fee Study. Data as of December 31, 2024.

High-Quality Strategies Are Jumping to ETFs

Active managers long held out on ETFs because of their daily transparency. Some companies went to great lengths to create nontransparent ETFs for this reason. But the benefit of opacity is unclear for investors. In fact, performance and manager skill are less predictable in these types of strategies. ETF investors are used to transparency, so nontransparent ETFs never took off.

Yet, active managers are now racing each other to launch ETFs. Over 1,100 active ETFs have been launched since the start of 2024. Active managers' change of heart on daily transparency largely comes down to revenue. Active ETFs are collecting inflows, while active mutual funds are bleeding outflows.

The expanding menu of active ETFs isn't full of great strategies, but there were a few newcomers worth celebrating.

Neuberger Berman Small-Mid Cap ETF NBSM

Neuberger Berman took the plunge with a concentrated small-cap strategy in ETF form after 30 years of managing this strategy as a separate account and operating a similar mutual fund strategy in Neuberger Berman Genesis. This team's resources and discipline create a strong foundation for building a portfolio of roughly 50 high-quality stocks. Investors

should keep an eye on capacity, given this concentrated portfolio of small and mid-caps, but the Genesis fund currently manages \$10 billion with about 100 stocks, so there's plenty of room to run for this \$200-million ETF.

Investors can expect lower risk than is typical of small-cap strategies, which could produce lagging performance in bull markets. That said, the Genesis fund had better risk-adjusted returns than category peers and its category index over the past decade. The ETF earns a Morningstar Medalist Rating of Silver, and we expect strong performance over the next full market cycle.

Jensen Quality Growth ETF JGRW

This is Jensen Investment Management's first ETF, marking the addition of another asset manager among the selective ranks of High Morningstar Parent ratings. This ETF follows the same strategy as the 32-year-old mutual fund of the same name. It mostly hunts in large caps and follows a bottom-up, high-conviction process that filters out companies without a decade straight of at least 15% return on invested capital. The team conducts fundamental research on those that pass through the screen, ultimately ending up with a couple dozen steady growers trading at reasonable prices.

Investors can expect high conviction and high active risk from this strategy, yet relatively steady performance. Its stable of high-quality firms has kept a lid on volatility over the history of its mutual fund sibling. Returns may lag during bull markets, but the mutual fund has outperformed the Morningstar US Large-Mid Cap Index and its average Morningstar Category peer in risk-adjusted terms over the past decade.

Oakmark U.S. Large Cap ETF OAKM

This ETF marks portfolio manager Bill Nygren and Oakmark's first. The ETF's management team is the same as the Gold-rated \$24 billion Oakmark Investor. This mutual fund has earned its keep by finding cheap stocks with strong managers, pushing the portfolio deep into value territory on the Morningstar Style Box. The ETF appears poised to follow in its footsteps, albeit with a bit leaner portfolio, given its large-cap-only mandate.

Oakmark U.S. Large Cap ETF investors can expect a bumpy but lucrative ride. Over the past decade, sibling strategy Oakmark Investor has had a 30% higher standard deviation than the Morningstar US Large-Mid Cap Broad Value Index, but not all volatility is bad. Oakmark Investor's return fell in the top 3 percentile among large-value funds during that time.

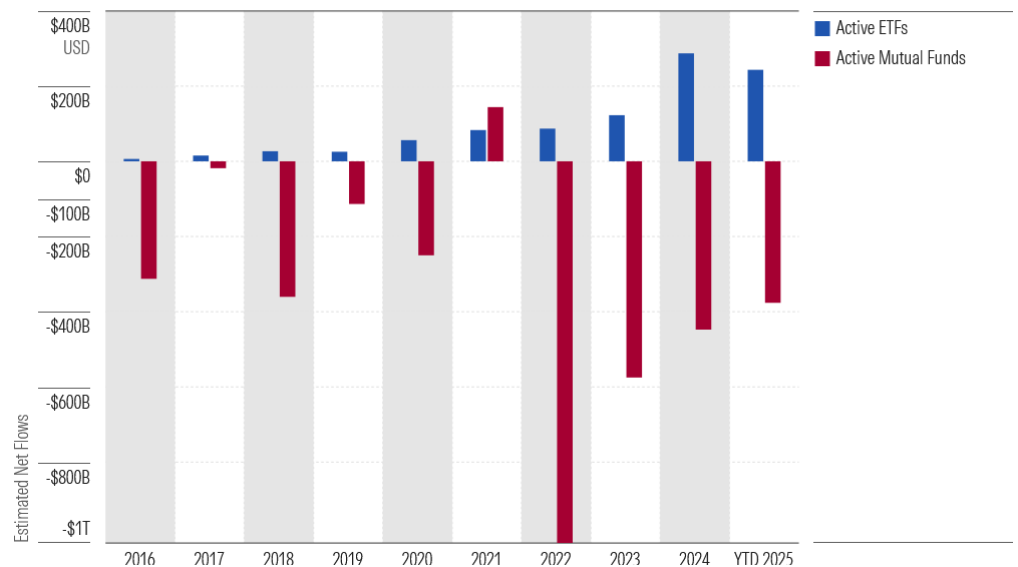
MFS

MFS launched the first mutual fund in the US over 100 years ago, but it was a late joiner to the ETF market, launching its first series of ETFs in December 2024. MFS joins Jensen as the two latest asset managers with High Parent ratings to join the ETF fray. MFS launched five ETFs, including growth, value, and international stock ETFs, as well as core-plus and municipal-bond ETFs. Each strategy is unique, but the equity ETF portfolios should rhyme with existing mutual funds by the same names. The equity mutual funds each receive Silver Medalist Ratings.

Each of the equity mutual funds has delivered strong performance and below-average volatility. A big part of this is the managers' focus on durable businesses with competitive advantages. Early analysis has shown the ETFs hold slightly more concentrated portfolios, so investors shouldn't expect the exact same performance as the mutual funds.

These newcomer ETFs pair strong track records with lower fees and greater tax efficiency. Active ETFs appear poised to put up a better fight against their average passive peer than their predecessors.

ETFs May Offer a Lifeline for Active Managers



Source: Morningstar Direct. Data as of July 31, 2025.

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Oakmark U.S. Large Cap ETF Average Annualized Total Returns (%) as of 3/31/26	3 Months	1 Year	Since Inception (12/03/24)
Net asset value (NAV)	-2.75	13.39	8.83
Market price	-2.80	13.50	8.85
S&P 500® Index	-4.33	17.80	7.31
Russell 1000 Value® Index	2.10	15.87	8.06

Gross expense ratio: 0.64%. Net expense ratio: 0.59%. Harris Associates, L.P. (the “Adviser”) has contractually undertaken to waive its management fee by 0.05% of the Fund’s average daily net assets. The undertaking lasts until 1/27/2027 and may not be terminated during its term without the consent of the Board of Trustees.

Periods less than one year are not annualized. Performance reflected net of fees. The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Total return includes change in share prices and, in each case, includes reinvestment of dividends and capital gain distributions. To obtain most recent month-end performance data, visit oakmark.com/OAKM.

Risks

ETF General Risk: Exchange-Traded Funds (ETFs) trade like stocks, are subject to investment risk, and will fluctuate in market value. Unlike mutual funds, ETF shares are not individually redeemable directly with the Fund, and are bought and sold on the secondary market at market price, which may be higher or lower than the ETF’s net asset value (NAV). Transactions in shares of ETFs will result in brokerage commissions, which will reduce returns.

Active ETF: Unlike typical exchange-traded funds, there are no indexes that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objectives will depend on the effectiveness of the portfolio manager. There is no assurance that the investment process will consistently lead to successful investing.

Equity Securities Risk: Equity securities are volatile and can decline significantly in response to broad market and economic conditions.

Value Investing Risk: Value investing carries the risk that a security can continue to be undervalued by the market for long periods of time.

Concentration Risk: Concentrated investments in a particular region, sector, or industry may be more vulnerable to adverse changes in that industry or the market as a whole.

Understanding the risks: Investing involves risk; principal loss is possible. There is no guarantee the Fund’s investment objective will be achieved. The Fund is actively managed and does not seek to replicate a specific index. **Exchange-Traded Fund (ETFs)** are subject to additional risks that do not apply to conventional mutual funds, including the risks that the market price of ETF’s shares may trade at a premium or discount to its net asset value (NAV), an active secondary trading market may not develop or be maintained, or trading may be halted by the exchange in which they trade, which may impact an ETF’s ability to sell its shares. Unlike mutual funds, ETF shares are bought and sold at market price, which may be higher or lower than their NAV, and are not individually redeemed from the fund. Brokerage commissions will reduce returns. The Fund invests primarily in **large capitalization securities**, which may be unable to respond quickly to new competitive challenges or opportunities, attain the high growth rate of successful smaller companies, or be out of favor under certain market conditions. The Fund tends to be invested in a relatively **focused portfolio** of securities, thus the appreciation or depreciation of any one security held will have a greater impact on the Fund’s net asset value versus investing in a larger number of securities. **Common stocks** are subject to special risks. As a **new fund**, there is a limited operating history and there can be no assurance it will grow to an economically viable size, in which case it may cease operations and require investors to liquidate or transfer their investments. These and other risk considerations, such as market, sector or industry, large shareholder, and value style, are described in detail in the Fund’s prospectus.

Oakmark Fund Average Annual Total Returns (%) as of 3/31/26	3 Months	1 Year	3 Years	5 Years	10 Years
Investor Class OAKMX	-2.47	10.04	16.06	11.21	13.50
S&P 500® Index	-4.33	17.80	18.32	12.06	14.16
Russell 1000® Index	-4.18	17.74	18.14	11.34	13.97

The performance data shown represents past performance. Past performance is not a guarantee of future results. Total return and value will vary and you may have a gain or loss when shares are sold. Current performance may be lower or higher than quoted. Performance for periods less than one year is cumulative, not annualized. Returns include changes in share price and reinvestment of dividends and capital gains, if any. For the most recent performance information, please visit oakmark.com.

Gross expense ratio: 0.89%. Net expense ratio (Contractual): 0.89%. Contractual expiration date: 1/27/2026. Expense ratios are as of the Fund's most recent prospectus dated January 28, 2025, as amended and restated January 30, 2025, March 14, 2025 and May 19, 2025; actual expenses may vary. Returns for periods less than one year are not annualized. Since inception returns for the indexes are calculated based on the Investor Class inception date.

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Value Investing Risk: Value investing carries the risk that security can continue to be undervalued by the market for long periods of time.

Concentration Risk: Concentrated investments in a particular region, sector, or industry may be more vulnerable to adverse changes in that industry or the market as a whole.

Foreign Securities Risk: Foreign securities may involve heightened risk due to currency fluctuations. Additionally, they may be subject to greater political, economic, environmental, credit, and information risks. Foreign securities may be subject to higher volatility than US securities, due to varying degrees of regulation and limited liquidity.

Before investing in any Oakmark Fund, you should carefully consider the Fund's investment objectives, risks, management fees and other expenses. This and other important information are contained in a Fund's prospectus and summary prospectus. Please read the prospectus and summary prospectus carefully before investing. For more information, please call 1-800-OAKMARK (625-6275).

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