MARKET INSIGHTS

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THE SECTORAL PERFORMANCE OF ACTIVE AND PASSIVE UCITS - IS A SIMPLE MEASURE ENOUGH?

INTRODUCTION

While past performance is not a guarantee of future returns, recent literature has shown that past top performers attract more inflows[1]. Over recent years, passive funds have been gaining in popularity as they have lower costs and often report higher average net returns than active funds[2]. However, the discourse on which group of funds performs better is more complex than it seems.

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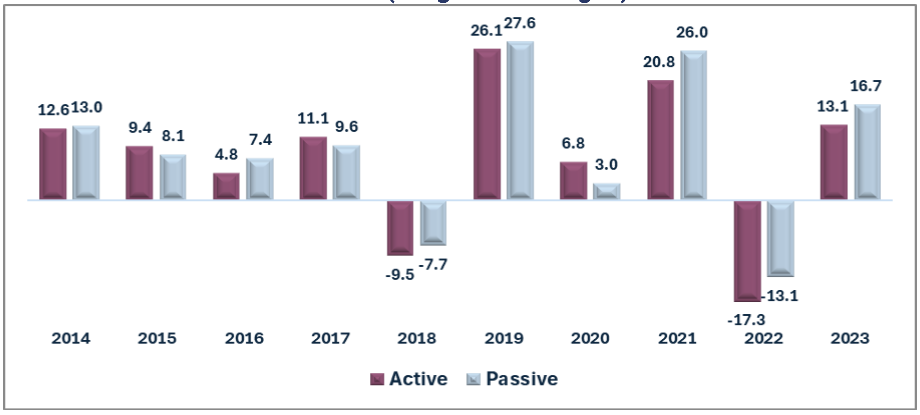
Historical fund performance is usually reported by showing a simple or weighted average of the gross or net performance of all the funds in a given category. This is often measured on a broad category of funds, such as all active or passive funds or the total universe of funds.
This approach does not take into account the diversity of funds in terms of issuers, types of securities, geographical exposure, currency and industrial sectors and, consequently the diversity of funds' performance.

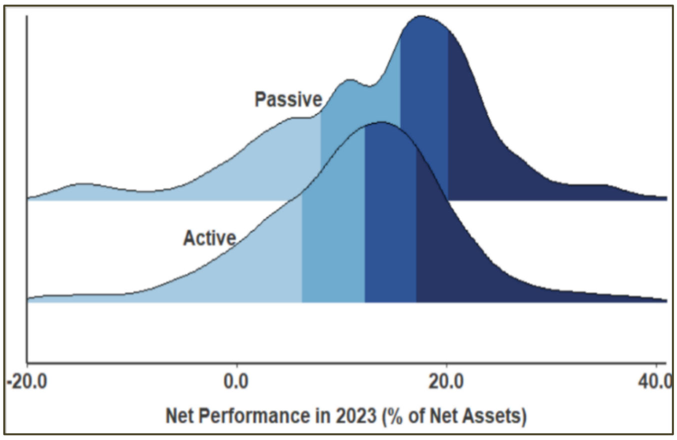
To illustrate, **Chart 1** shows the analysis of the average annual net returns of total active and passive UCITS during the last 10 years (2014-2023). In 2023, the average net performance[3] of active equity UCITS stood at 13.1%, while that of passive equity UCITS amounted to 16.7%, suggesting that passive UCITS performed better. In **Chart 2,** we report the distribution of average annual net returns of active and passive equity UCITS in 2023[4]. We notice that in 2023 many active funds performed as well as passives, and that many passive funds performed less well than actives. The observed returns depend on diverse fund characteristics, such as the industry sector or geographical exposure, regardless of whether a fund is active or passive.

1. Average Annual Net Returns of Total Equity UCITS (weighted averages)



Source: EFAMA's calculation on Morningstar data

2. Distribution of Annual Net Returns of Equity UCITS in 2023



Source: EFAMA's calculation on Morningstar data

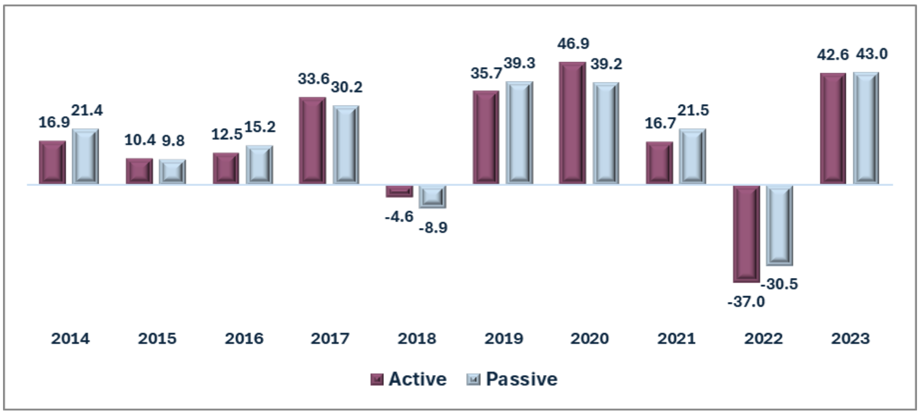
In this report we analyse the performance heterogeneity of funds across different industry sectors of equity UCITS to understand whether a simple average measure of performance of a broader group of funds can be a reliable point of reference. For this purpose, we split the universe of active and passive[5] equity UCITS into different industry sectors, a strategy known as sector investing[6], and we then study the differences in returns compared to their performance in total.

NET PERFORMANCE OF SECTOR EQUITY UCITS

The charts below compare the annual net returns of active and passive equity funds that primarily invest in four key industry sectors -technology, financials, healthcare, and energy- from 2014 to 2023.

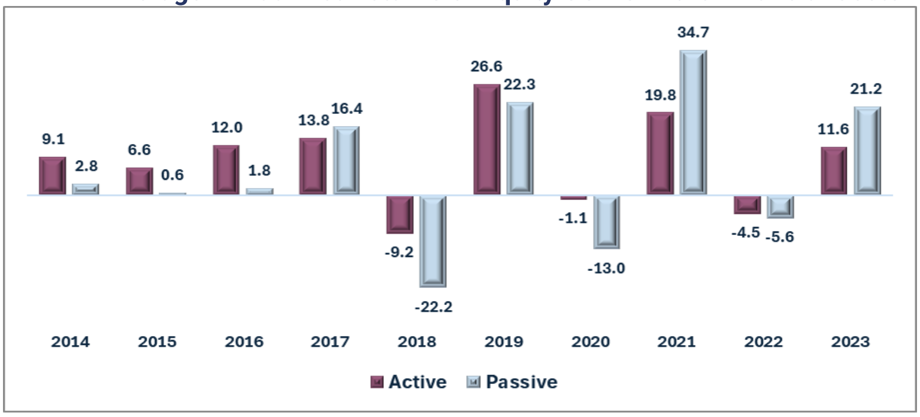
In the technology sector, passive UCITS outperformed active UCITS in 6 out of 10 years, in the financial sector this was the case for 3 out of 10 years, while in the healthcare and energy sectors, passive and active funds each outperformed in 5 out of 10 years. The net returns for these sector-specific funds also vary significantly from the average returns of the broader universe of active and passive equity funds shown in **Chart 2**.

3. Average Annual Net Returns of Equity UCITS in the Technology Sector



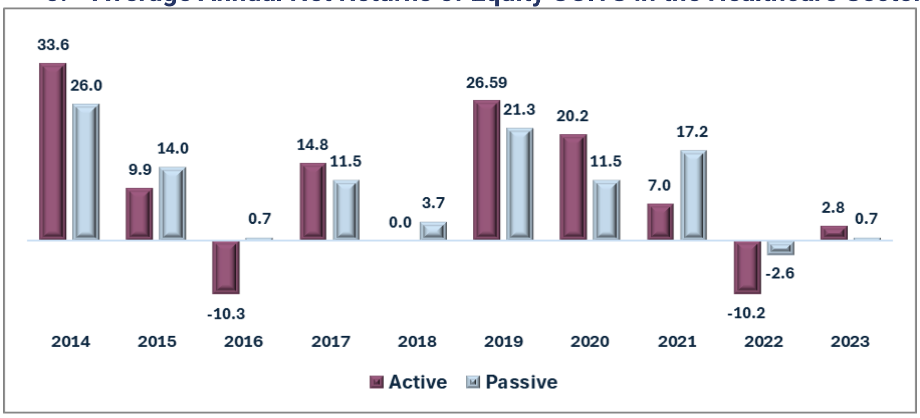
Source: EFAMA's calculation on Morningstar data

4. Average Annual Net Returns of Equity UCITS in the Financial Sector



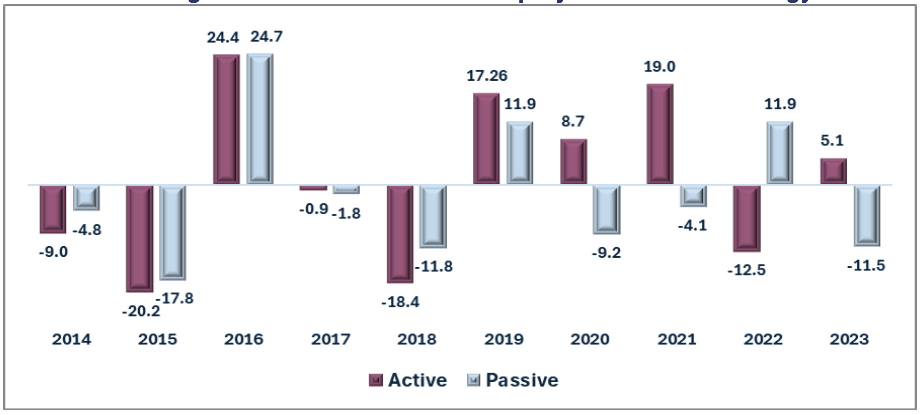
Source: EFAMA's calculation on Morningstar data

5. Average Annual Net Returns of Equity UCITS in the Healthcare Sector



Source: EFAMA's calculation on Morningstar data

6. Average Annual Net Returns of Equity UCITS in the Energy Sector



Source: EFAMA's calculation on Morningstar data

Since equity fund investors tend to have a long-term investment horizon, comparing annual returns is less meaningful than evaluating performance over an extended period. To address this, **Table 1** presents the annualized 10-year net returns (2014–2023) for active and passive equity UCITS.

The data confirms that, on average, passive funds outperformed active funds. However, sector-specific results reveal that passive funds in the technology and healthcare sectors outperformed their active counterparts. In contrast, active funds in the energy and financial sectors delivered better returns than passive funds. Additionally, there were notable differences in net returns across the four sector-focused equity funds.

Annualised 10-Year Net Returns of Equity UCITS (2014-2023)		
Sector	Active	Passive
Technology sector	12.7	13.4
Healthcare sector	8.5	10.0
Energy sector	1.1	-1.5
Financial sector	7.0	4.3
Total	7.0	8.3

Table 2 illustrates the implications for an investor who invested €1,000 at the end of 2013, highlighting the varying outcomes based on sector selection and fund type.

The Value of EUR 1000 After 10 Years (2014-2023) Invested at the Beginning of 2014 in Equity UCITS		
Sector	Active	Passive
Technology sector	3,863	4,265
Healthcare sector	2,271	2,604
Energy sector	1,018	816
Financial sector	2,150	1,565
Total universe	1,972	2,227

RISK-ADJUSTED PERFORMANCE

Simply comparing returns without considering risk can be misleading, as higher returns often come with higher risk. To provide a more precise assessment of performance, it is important to evaluate the risk-adjusted returns of equity UCITS. This can be achieved by calculating the Sharpe Ratios[7], which measure how much excess return an investor earns for each additional unit of risk taken. A higher Sharpe Ratio indicates that a fund delivers better returns relative to its risk, while a low or negative Sharpe Ratio reflects poor risk-adjusted performance, even if the fund generates positive returns.

Table 3 presents the Sharpe Ratios of net returns for active and passive UCITS across the four sectors over 5-year and 10-year periods.

	Sharpe Ratio (5 years)		Sharpe Ratio (10 years)	
Sector	**Active**	**Passive**	**Active**	**Passive**
Technology	0.58	o.69	0.82	0.90
Healthcare	0.42	0.50	0.48	0.51
Energy	0.42	0.31	0.27	0.19
Financials	0.41	0.40	0.47	0.20

We find that even after accounting for the volatility during different time frames, the results remain similar and robust. Passive equity UCITS outperformed the active funds in two out of four sectors for both time frames, 5-years and 10-years, and vice versa. The risk-adjusted performance varies across the industry sectors, and is subject to other fund characteristics.

CONCLUDING REMARKS

This report explores the net performance differences between sectoral active and passive equity UCITS and compares the average sectoral performances to those of total active and passive equity UCITS.

We find that, while passive equity funds generally outperform active equity funds when comparing net returns across the entire universe of equity funds, this pattern does not hold consistently across all sectors.

Some active funds outperform passive funds and vice-versa depending on the industry sector, the year, and the time horizon, demonstrating that no single category consistently delivers superior performance. Similarly, when we take a 10-year investment perspective, passive UCITS do not outperform active ones in 2 out of the 4 sectors analysed, i.e. technology, financials, healthcare, and energy. Our results are proven robust even after accounting for the volatility of returns – in half of the cases, passive UCITS do not have higher risk-adjusted returns.

Given these variations, it is prudent for retail investors to seek professional advice before allocating their savings to specific types of equity funds.

It should be recognised, however, that past performance is no guarantee of future results and that one cannot easily predict in advance in which industry sector active equity UCITS will outperform their passive peers overall, nor recommend a specific active equity UCITS that will manage to do so over the client's investment horizon.

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[1] The Economic Times (2024). Mutual funds: Past performance not always guarantee future return; how to choose mutual funds to get best return.
[2] For example, in its last edition of the *Costs and performance of EU retail investment products report* for 2023, ESMA underlined that 'active equity funds once more underperformed, in net terms, passive non-ETF funds and ETFs'. This conclusion was made based on the comparison of average net returns calculated for active, passive funds and ETFs, without taking into consideration the diverse nature of these UCITS categories.
[3] Throughout this article the term 'net performance' will refer to the performance net of costs.
[4] The distribution chart is presented with a bell-shaped curve. The bigger the area below the curve the higher the number of funds that reported that specific net performance value. Different blue colors represent different quartiles (rectangular areas below the curve) where, from left to right, the first quartile comprises funds that reported the net performance values corresponding to 0-25% of the total range of values, the second quartile comprises net performances in the 25-50% range, the third quartile corresponds to to 50-75% and the last quartile to 75-100% range.
[5] The compositions of passive UCITS in these 4 sectors are dominated by ETFs. In the Energy and Financials sectors all passive funds are ETFs, while for the Technology and Healthcare sectors they represent 96% and 93% of the sector universes.
[6] Investing in different sectors is a strategy known as sector investing, which allows for portfolio diversification, returns optimization and portfolio adjustment in the case of changing business cycles or cyclical trends.
[7] The Sharpe ratio describes how much excess return you receive for each additional unit of risk you assume. A higher ratio implies a higher investment return compared to the amount of risk of the investment.

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EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the authoritative EFAMA Fact Book.

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