

# Manager versus Machine

Active and passive funds compared

December 2024

## Key findings

Our Manager versus Machine report looks at active funds in seven key equity sectors, and compares performance to the average passive fund in the same sectors, rather than a benchmark index. This provides a real world comparison, reflecting the practical investment choice that retail investors face between active and passive funds. While benchmark indices are of course widely used as comparators for active funds, investors can't buy an index; tracker funds are the nearest they can get.

- Only one third (33%) of active funds have outperformed a passive alternative over 10 years
- The shorter term performance figures are just as grim for active funds, where only 31% have outperformed in 2024 to date
- Active managers are struggling especially in Global and North America sectors, where market performance is being dominated by a small number of very large US tech firms
- But despite poor relative performance from active funds in these areas, absolute returns from Global and US funds have been swooningly positive
- Even in the UK, investors have enjoyed a 10.5% return from the typical tracker fund in the year to date
- Retail investors have withdrawn over £100 billion from active funds in the last three years
- Speculation around Capital Gains Tax ahead of the recent Budget added a bump to fund withdrawals in September and October
- Passive funds are cheap and simple but there is still a wide dispersion of return outcomes stemming from index selection and charges



Laith Khalaf, Head of Investment Analysis, AJ Bell

Laith Khalaf is Head of Investment Analysis at AJ Bell, and specialises in researching and writing about funds, markets and investing. He has over 20 years of industry experience, covering a wide range of roles across pensions and investments, analysing and providing commentary on key issues for both DIY investors and financial advisers.

## Active versus passive funds compared: déjà vu all over again

This year's Manager versus Machine report is déjà vu all over again. It's been another woeful year for active managers overall, and there are few crumbs of consolation to be had. In 2024 to date just 31% of active managers have outperformed a passive alternative in their sector. This compares to 36% in 2023. A year or two isn't a sufficient time frame over which to judge the merits of an active investment strategy, but the longer term figures offer no hiding place for the active management industry. Over ten years, just 33% of active managers have outperformed the passive machines, largely unchanged from 32% in last year's December report.

A lot of the damage to the aggregate performance of active managers is being done in the Global and North American sectors. Extracting these sectors from the data, the figures for active managers are improved, with 44% outperforming over 10 years. That's not too far shy of the 50% or so of active managers one might expect to outperform a passive alternative in normal conditions, before charges are factored into proceedings. However together the Global and North America sectors account for £317 billion of assets, so excluding them misses out an important chunk of retail investors' experience.

Table 1: % of active funds outperforming a passive alternative

IA sector	% funds outperforming			
	Year to date	5 years	10 years	2023*
Asia Pacific ex Japan	39%	47%	47%	39%
Europe ex UK	18%	14%	17%	25%
Global	38%	48%	52%	57%
Global Emerging Markets	46%	38%	52%	25%
Japan	37%	26%	23%	40%
North America	35%	26%	40%	44%
UK	31%	36%	42%	44%
<b>Total</b>	<b>31%</b>	<b>27%</b>	<b>33%</b>	<b>36%</b>
<b>Without US and Global</b>	39%	36%	44%	

Sources: AJ Bell, Morningstar total return in GBP to 30 November 2024. \*To 30 November 2023.

## US exceptionalism dominates returns

That experience will be boosted by the phenomenal returns harvested in these sectors, irrespective of whether investors have chosen active or passive strategies. The typical Global active fund has returned 163.0% over ten years, and that rises to 217.0% for the average passive fund. The average North American active fund has returned 273.6% over ten years, and that rises to 312.9% for the average passive fund. Returns from the S&P 500 have been so strong that it has been better to be invested in a third quartile active fund in the North America sector than a first quartile fund in any of the other six equity sectors in our analysis (see Table 2). Successful investing over the last ten years has been less about whether you're invested in a tracker fund, a good active fund, or a bad active fund, and more about whether you chose to back the US stock market, and to what extent.

In Europe, Japan and Global Emerging Markets sectors, the proportion of active funds outperforming over ten years is close to, or above, the magic 50% mark which provides some respectability to the endeavours of active managers. It shows there can be value harvested by active investors, if they pick funds in the top half of performers, which doesn't take a huge tilt of the table by sorting some of the wheat from the chaff. It also demonstrates the fortunes of active managers are dictated by the particular conditions of the markets they are working in, and performance isn't simply a referendum on stock selection skill alone.

Returns from European and Japanese funds have been robust in absolute terms, but they still pale in significance compared to Global and US funds. This won't be lost on those investors who hold funds from different regions in their portfolios and are able to see this performance discrepancy first hand, perhaps simply by logging onto an app on their phone. This could well lead them to ditching funds from lesser performing sectors, even if those funds should be judged against appropriate regional benchmarks, because it's hard to ignore the stark comparator of other funds in your portfolio when it's staring you in the face every time you check your valuation. Similarly when investing fresh monies, it's natural for investors to reward the funds that have served them best to date. It's easy to see how a self-reinforcing cycle asserts itself, with more money flowing into better performing areas and driving up share prices.

Table 2: 10 year total returns for active and passive funds

IA Sector	10 year fund performance %			
	Active 25th percentile	Active average	Active 75th percentile	Average passive
Asia Pacific ex Japan	119.2	96.3	77.1	105.8
Europe ex UK	130.2	110.8	96.4	112.5
Global	206.5	163.0	126.4	217.0
Global Emerging Markets	85.0	64.6	50.5	64.2
Japan	149.2	124.4	108.2	122.6
North America	310.8	273.6	209.4	312.9
UK	92.1	73.3	59.8	78.6

Sources: AJ Bell, Morningstar total return in GBP to 30 November 2024.

US stock market exceptionalism has been especially evident in 2024, with the typical US tracker fund returning 27.6%, and helping to propel the average Global tracker fund to a return of 20.7%. Outside the US, it's been a positive year for equity markets on the whole, apart from in Europe where a typical tracker has returned just 2.4% in pounds and pence, thanks in part to a stiff depreciation in the Euro. The UK may look pedestrian by comparison with the US, but a 10.5% return from the typical UK tracker in the first 11 months of 2024 is nothing to be sniffed at, and double what the most competitive cash rates have been offering.

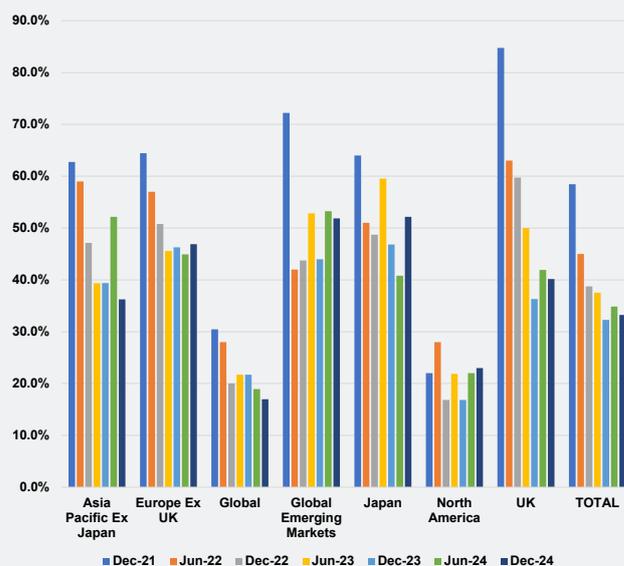
**Table 3: Year to date total returns for active and passive funds**

IA Sector	YTD fund performance %			
	Active 25th percentile	Active average	Active 75th percentile	Average passive
Asia Pacific ex Japan	135.9	108.0	93.8	103.4
Europe ex UK	149.0	119.6	104.9	123.7
Global	215.8	173.0	132.8	226.6
Global Emerging Markets	98.4	75.6	58.2	73.3
Japan	150.8	122.4	101.5	129.4
North America	326.2	278.1	211.9	329.1
UK	88.6	72.7	56.5	75.8

Sources: AJ Bell and Morningstar, total return to 30 June 2024.

Looking back at previous iterations of our Manager versus Machine report, it's clear the proportion of active managers beating a passive alternative has shown significant variation over time and across sectors (see Chart 1). It also looks clear that the Global and North America sectors have always been bringing up the rear when it comes to active fund performance against passive comparators. These two sectors go hand in hand because the US stock market now makes up such a large part of the global indices, like the MSCI World Index, used as benchmarks by active and passive funds alike.

**Chart 1: Previous Manager versus Machine results**



Sources: AJ Bell, Morningstar.



## Magnificent seven ride again

The US has always been a difficult nut to crack for active managers, because the stocks within the S&P 500 are heavily poured over by so many pairs of analytical eyeballs across the globe that it's hard to bring an information edge to bear. This headwind has now been amplified by the success of the Magnificent Seven technology stocks, and their heavy concentration within the benchmark index, and by extension, in tracker funds. At the beginning of this year, an active manager running a US fund would have had to hold 28% in the Magnificent Seven stocks, and 7% in each of Apple and Microsoft, to simply match the exposure of an S&P 500 tracker. Over the course of this year, this concentration has increased to 33% for Magnificent Seven companies, including three individual stock positions above 6% (Apple, Microsoft, Nvidia).

These are punchy positions for an active manager to adopt, unless their own fundamental research leads them to precisely the same conclusion as the market. Not only would this seem too much of a coincidence by half, it would undermine the rationale for active management at its root. Any active US manager who did happen to invest in all of the Magnificent Seven stocks in equal proportion to their weight in the index would find themselves underperforming the market, and their passive peers, on that portion of their portfolio once charges have been deducted. That would put a huge burden on the remaining two thirds of their portfolio to deliver outperformance, while also prompting fund investors to consider disinvesting and putting a third of the proceeds into a tracker fund, with the remaining two thirds in a 'proper' active fund to achieve a similar, cheaper alternative.

## A new low for global active funds

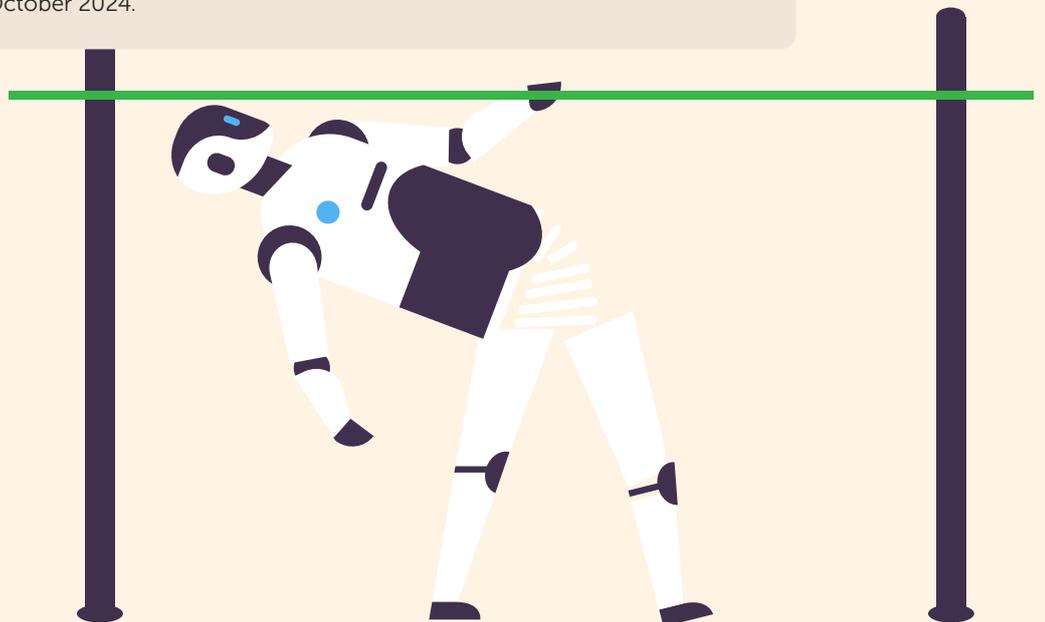
The exceptional performance of the S&P 500, driven by a small clutch of large technology companies, has also skewed the global stock market benchmarks towards the US, which has had a knock-on effect on the relative performance of active managers plying their trade in the Global sector. Just 17% of active managers in this sector have beaten a passive alternative over the last 10 years. This is the lowest reading we have seen for this sector since our Manager versus Machine Report was launched in 2021. Like their peers in the North America sector, Global managers face the same issues presented by the concentration of performance and size in the US portion of their portfolios, but they also face an adjacent quandary over the dominance of the global stock market by the S&P 500.

The US stock market now makes up around 70% of global benchmark indices like the MSCI World, and by extension, the tracker funds that follow them. This is a high concentration in a single region, and one which historically active managers have balked at copying, though over the last 10 years they have increased their exposure to the US significantly. A decade ago, the average Global active fund held 46% of its portfolio in the US, compared to 57% from the average passive fund. Global active funds on average now hold 59% of their portfolio in the US, but that compares to 69% from the average passive fund, so they are still underweight the US stock market to the tune of around 10% (see Chart 2). Given the extreme performance differential between the US and other regions detailed in Table 2, being underweight the S&P 500 goes a long way to explaining why so few active managers have outperformed the passive machines in the Global sector. Consequently, it seems pretty inevitable that until there is a reversal of the dominant performance of the US stock market and the big tech stocks within it, this report will continue to paint a bleak picture of the fortunes of active managers in the Global and US sectors.

Chart 2: Active managers in the IA Global sector are underweight the US



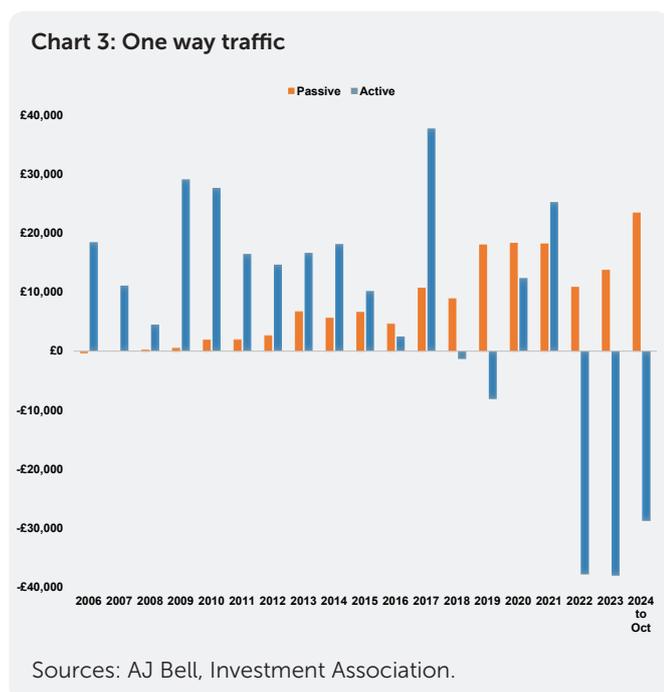
Sources: AJ Bell, Morningstar to October 2024.



## The critical condition of active management

Active managers aren't just suffering in terms of performance relative to their passive peers, they're losing the battle for flows too. The last three years have witnessed an unprecedented rout for active managers in terms of fund flows (see Chart 3). Since the beginning of 2022, £105 billion has been withdrawn from active funds and £48 billion has been invested in passive funds, based on AJ Bell analysis of Investment Association data. The exodus from active funds shows only the most minimal signs of abating, with 2024 outflows on course to come in just below those of last year's record-breaking outflows.

Investors are drawn to passive funds because of their simplicity, and their low cost, not solely their performance. But if we lived in a world where trackers were cheap and cheerful, but tended to deliver worse outcomes, the traffic from active to passive wouldn't be quite so one way. It's possible to point to a reinforcing market cycle at play here. Superior passive performance leads to money flowing out of active funds and into trackers. Liquidations of active portfolios dent the stocks held by active managers and the proceeds flowing into passive funds put upward pressure on the stocks held in tracker portfolios. This will in turn tend to improve the relative performance of passive funds, and the cycle begins afresh.



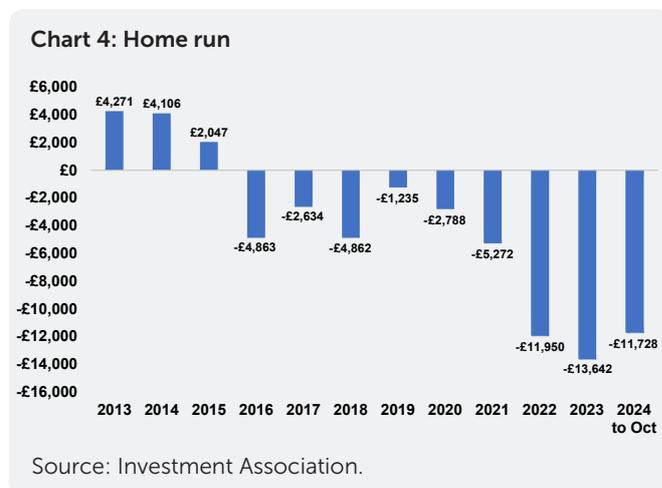
Despite the inflows into passive funds, over the last three years there has still been a £56 billion net withdrawal from open-ended funds in total (numbers don't add due to rounding). This reminds us that active funds aren't just competing with open-ended passive funds, they're competing with investment trusts (where wide discounts tell us demand is also weak), ETFs (which are seeing record global flows), Bitcoin (now held by seven million adults in the UK, according to the FCA), expenditure (the cost of living crisis dented the propensity to save and invest), mortgages (which are now really worth paying down) and last but not least, cash.

Competitive interest rates on cash have gone from close to zero to around 5% in the last three years. Importantly this sharp rise in the return on cash hasn't been accompanied by a market fall which would make equities more obviously attractive to own. UK consumers already had an unhealthy propensity to hold too much cash, even when interest rates meant they were getting a return below the rate of inflation. In 2021, the FCA identified 8.4 million people holding more than £10,000 in investible assets wholly or mainly in cash, and targeted a 20% reduction in that number as part of its strategy. But by 2023, this figure had risen to 11.8 million people.

Rachel Reeves can also take a bow for prompting a flurry of outflows from investment funds. In the lead up to the Budget, rumours of a capital gains tax raid were plentiful, and some appeared to have been sourced from within the Treasury. In mid-October the Prime Minister poured a splash of cold water on the possibility that capital gains tax rates could rise in line with income tax rates, but by then a stampede for the exit signs was already underway. In September and October, over £9 billion was withdrawn from investment funds by retail investors, as they scrambled to encash profits ahead of a possible capital gains tax raid (source for data: Investment Association).

It's reasonable to suppose that the surge in passive fund sales must end somewhere, but we may still be a long way from that point. Trackers currently make up 24% of funds run by Investment Association members. But in the US, the value of assets in passive funds overtook active funds for the first time last year, according to Morningstar. In other words, more than 50% of fund assets were invested passively. The index investing megatrend began in the United States, so it sets a meaningful roadmap of where the UK investment industry may end up. In other words, don't bet the house on an active revival anytime soon.

It's worth also reflecting on the particularly large flows coming out of funds investing in UK equities. Since 2016, £59 billion has been withdrawn from UK Equity funds, and 2024 has been another awful year for UK fund flows (see Chart 4). Despite outflows and weaker performance than global peers, UK funds still remain heavily over-represented in retail investors' portfolios, if you compare them with the global stock market, which people are increasingly doing. That means the unwinding of a historically high weighting to UK funds probably still has some road ahead.



## Passive performance requires scrutiny too

Passive funds are definitely enjoying an expansive moment in the sun, and for a lot of investors their low cost and simplicity makes them cheap and cheerful components for pensions and ISAs. But picking a passive fund is not something which can be done entirely without deliberation, and there are pitfalls to avoid.

The first thing to note is there is a fairly uniform reduction in charges which can be gleaned from stepping across the active and passive threshold on average, to the tune of around 0.75% per annum in the seven equity sectors analysed here (Table 4). However that masks some troubling pricing behaviour by a handful of passive funds, especially in the Global and UK sectors, where the most expensive passive funds come in at 0.57% and 1.02% respectively (See Table 5). In the UK this means the most expensive tracker fund is 20 times more expensive than the cheapest. It is possible, in theory if not in practice, to defend pricing differentials for active funds on the basis of the better outcomes investors can achieve by investing with a higher quality fund manager. But there can be no such argument launched for passive funds tracking the same index, where the return should be close to identical before fees are levied.

**Table 4: Active v passive charges**

	10 year fund performance %		
	Average passive %	Average active %	Difference %
Asia Pacific ex Japan	0.16	0.91	0.75
Europe ex UK	0.11	0.87	0.76
Global	0.14	0.90	0.76
Global Emerging Markets	0.24	1.01	0.77
Japan	0.15	0.90	0.75
North America	0.10	0.84	0.74
UK	0.14	0.84	0.70

Sources: AJ Bell, Morningstar to 30 November 2024.

**Table 5: Range of passive charges**

	Passive funds ongoing charge %			
	Most expensive	Average	Least expensive	Range
Asia Pacific ex Japan	0.30	0.16	0.12	0.18
Europe ex UK	0.13	0.11	0.06	0.07
Global	0.57	0.14	0.12	0.45
Global Emerging Markets	0.39	0.24	0.19	0.20
Japan	0.29	0.15	0.08	0.21
North America	0.30	0.10	0.05	0.25
UK	1.02	0.14	0.05	0.97

Sources: AJ Bell, Morningstar to 30 November 2024.

Clearly passive fund charges will play a substantial role in determining the net return enjoyed by investors, as will the choice of sector. Over the last 10 years, the average fund tracking the US stock market has returned 312.9%, while the average fund tracking Global Emerging Markets has returned just 64.2%. No prizes for guessing which set

of investors will be happier. But even within sectors, there can be significant variation in passive fund performance, as witnessed by the 99.2% difference between the best performing and worst performing Global tracker fund, and the 35.8% difference between the best and worst performing UK tracker fund.

There are two key factors that determine the variation within sectors. One, as described above, is the annual charges, and this in fact explains almost all the performance gap between the best and worst performing trackers in the UK. But index selection also plays a key role. Within the Asia Pacific region, available indices place different weights on developed and developing Asia economies, leading to a dispersion of return outcomes. In the Global sector the MSCI World Index and FTSE World Index take the lion's share of passive benchmarking credits, but an S&P Global 100 tracker is another option for investors. This provides a more concentrated portfolio of the biggest companies in the global stock market, and given the prevailing trends, this has resulted in even bigger returns for investors over the last decade, turning £10,000 into £38,637, compared to £31,702 from the average Global passive fund (see Table 7). The gulf in performance passive investors can experience clearly demonstrates that even this simple route to investing does require some active choices to be made to maximise returns.

**Table 6: Passive fund performance %**

	10 year fund performance %			
	Max passive	Average passive	Min passive	Range
Asia Pacific ex Japan	121.9	105.8	91.4	30.6
Europe ex UK	114.4	112.5	110.5	3.9
Global	286.4	217.0	187.2	99.2
Global Emerging Markets	72.8	64.2	61.2	11.6
Japan	126.3	122.6	117.8	8.5
North America	316.9	312.9	298.0	18.9
UK	83.4	78.6	47.6	35.8

Sources: AJ Bell, Morningstar total return in GBP to 30 November 2024.

**Table 7: Passive fund performance £10k invested**

	10 year fund performance £10,000 invested			
	Max passive	Average passive	Min passive	Range
Asia Pacific ex Japan	£22,192	£20,575	£19,137	£3,055
Europe ex UK	£21,443	£21,249	£21,052	£391
Global	£38,637	£31,702	£28,718	£9,918
Global Emerging Markets	£17,276	£16,423	£16,119	£1,156
Japan	£22,627	£22,262	£21,779	£848
North America	£41,691	£41,287	£39,804	£1,887
UK	£18,341	£17,857	£14,762	£3,579

Sources: AJ Bell, Morningstar total return in GBP to 30 November 2024.

## Summary

It's been another year when the passive machines have ruled the roost. Active funds are not only suffering from weaker performance, money is pouring out of them and into passive vehicles, but also into cash and other investment vehicles. There are areas where investors may seek out active management that are not well served by passive funds, and which are not covered in this report. Examples include funds which seek to minimise volatility, provide income, or invest in smaller companies. However in the key battlegrounds such as the Global and North America sector, the long-term performance of active funds is looking very shaky indeed. Long running market trends undoubtedly play a large role in the active fund rout. The symbiosis between the outperformance of passive funds and the dominance of global markets by a relatively small number of large companies shows no sign of abating, and until it does, active management is likely to remain under the pump in terms of performance, and flows.

---

## Methodology

Our report analyses the performance and charges of over 1,000 open-ended funds across seven popular equity sectors which are identified as the primary share class, using the median average performance of passive funds as a hurdle for active managers to beat. When calculating the performance of the average passive fund we have excluded ESG and smart beta passive funds, which include an element of active selection at an index level. Over longer time periods, the performance data does contain some survivorship bias, because underperforming funds will have tended to be closed or merged. The report analyses historical fund data, and while past performance can provide an insight into long running trends, it is never an entirely reliable guide to the future. This report was published in December 2024.



### Notes to editors:

Past performance is not a reliable guide to the future and some investments need to be held for the long term. This content is intended for journalists only and should not be relied upon by individual investors.