

## The Cyclical Nature of Active & Passive Investing

Recent performance has favored passive investing. But a look at the big picture shows how performance moves in cycles and reveals why active management isn't dead.



Reporters often prepare obituaries in advance for ailing celebrities so that when the end comes, they can publish instantaneously. Occasionally, someone hits “publish” prematurely, posting tributes for public figures who are very much alive.

In the same way, much ink has been hastily spilled recently in obituaries for active management. Most of the negativity has focused on the rise of passive investing, which has enjoyed strong performance in recent years. But simply because one style of investing has come into favor doesn't mean others are going the way of the dodo.

So why are so many pundits ready to write off active management? And what makes us so sure that investing actively is not only a viable but essential part of investor portfolios?

### Key Points

- The performance of active and passive management has been cyclical, with each style trading periods of outperformance.
- Market corrections are a regular and unavoidable part of market cycles.
- Active management has typically outperformed passive management during market corrections because active managers have captured more upside as the market recovers.

## What Have You Done For Me Lately?

Recency bias is the tendency to believe that recently observed patterns will continue into the future, and it's a powerful force that can influence investor decisions. But investors who only take recent performance into account are missing the forest for the trees. After all, yesterday's events shouldn't determine how tomorrow's investment decisions are made.

Morningstar Large Blend is the largest Morningstar category with \$9.55 trillion in net assets, and it constitutes 27% of the US mutual fund and ETF market.<sup>1</sup> We selected this category because it's widely believed to be the most efficient—the one in which active investing supposedly makes the least sense.

To represent active management, we removed all index funds and enhanced index funds. To represent passive management, we used the Morningstar S&P 500 Tracking category.

As shown in **FIGURE 1**, passive large-blend strategies outperformed active large-blend strategies for eight consecutive years through 2022 and again over the past three years. This helps to explain why passive large-blend strategies had inflows of \$353 billion in 2025, while more than \$375 billion in active large-blend strategies headed for the exits.<sup>1</sup>

But that only tells part of the story. A wider look at the chart reveals active and passive have traded the lead in performance over time like two evenly matched racehorses. From 2000 to 2009, active outperformed passive nine out of 10 times. During the 1990s, passive outperformed active five out of nine times. And over the course of the past 35 years, active outperformed 16 times while passive outperformed 19 times.

Therefore, the cyclical nature of active vs. passive investing definitely applies to the Morningstar Large Blend Category. The same holds true for other investment categories such as mid caps, small caps, and global/international equities. And just like performance, investor sentiment moves in cycles. If a certain style or asset class is doing well, investors are quick to extol its virtues and pour their money into it. It's no surprise, then, that passive investing is the new darling of many investors and much of the financial press. But just as a marathon isn't decided by the final 100 yards alone, we believe the dismissal of active management based on recent performance alone could be imprudent.

**FIGURE 1**  
**No Clear Winner in Active vs. Passive Large-Cap Funds**

■ Winner

	Active Large Blend Category (%)	S&P 500 Index Funds (%)
1991	32.64	29.66
1992	9.55	7.03
1993	12.35	9.43
1994	-0.68	0.88
1995	33.07	36.90
1996	20.76	22.48
1997	29.08	32.75
1998	21.93	28.19
1999	22.66	20.38
2000	-2.41	-9.42
2001	-10.08	-12.25
2002	-20.60	-22.40
2003	28.87	28.04
2004	11.32	10.41
2005	6.72	4.53
2006	14.30	15.31
2007	7.85	5.05
2008	-36.95	-37.18
2009	29.49	26.11
2010	14.54	14.63
2011	-0.69	1.68
2012	15.94	15.51
2013	32.89	31.84
2014	11.20	13.15
2015	0.05	0.95
2016	9.89	11.51
2017	21.20	21.37
2018	-6.22	-4.73
2019	29.56	31.00
2020	17.25	18.13
2021	26.17	28.10
2022	-16.88	-18.53
2023	23.02	25.88
2024	21.37	24.54
2025	15.44	17.40

As of 12/31/25. Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment. Active Large Blend is made up of funds from the Morningstar Large Blend category that are not index or enhanced index funds. S&P 500 Index Funds are represented by an equally weighted, annually rebalanced composite of Morningstar Large Blend index funds with a low historical tracking error to the S&P 500 Index. Data Sources: Morningstar and Hartford Funds, 2/26.

<sup>1</sup> As of 12/31/25. Data Source: Morningstar Direct, 2/26.

### Active or Passive? Yes.

Like the ocean tides, active and passive performance ebbs and flows. And as **FIGURE 2** demonstrates, their performance cycles are clearly defined. The chart compares the monthly rolling 3-year performance percentile rankings for active managers with that of passive managers ranked within the Morningstar Large Blend category.

**FIGURE 2** shows that while overall there is no clear winner over the past 35 years, there has been a clear winner in active vs. passive performance for multiple and sustained periods, followed by a trading of positions. Once again the recent outperformance of passive is evident and is preceded by 11 years of dominance by active management, and so on.

The story that **FIGURES 1 and 2** tell is clear. Just when it seems that active or passive has permanently pulled ahead, markets change, performance trends reverse, and the futility inherent in declaring a “winner” in active vs. passive is revealed anew.

#### Active Share: The True Measure for Active Managers

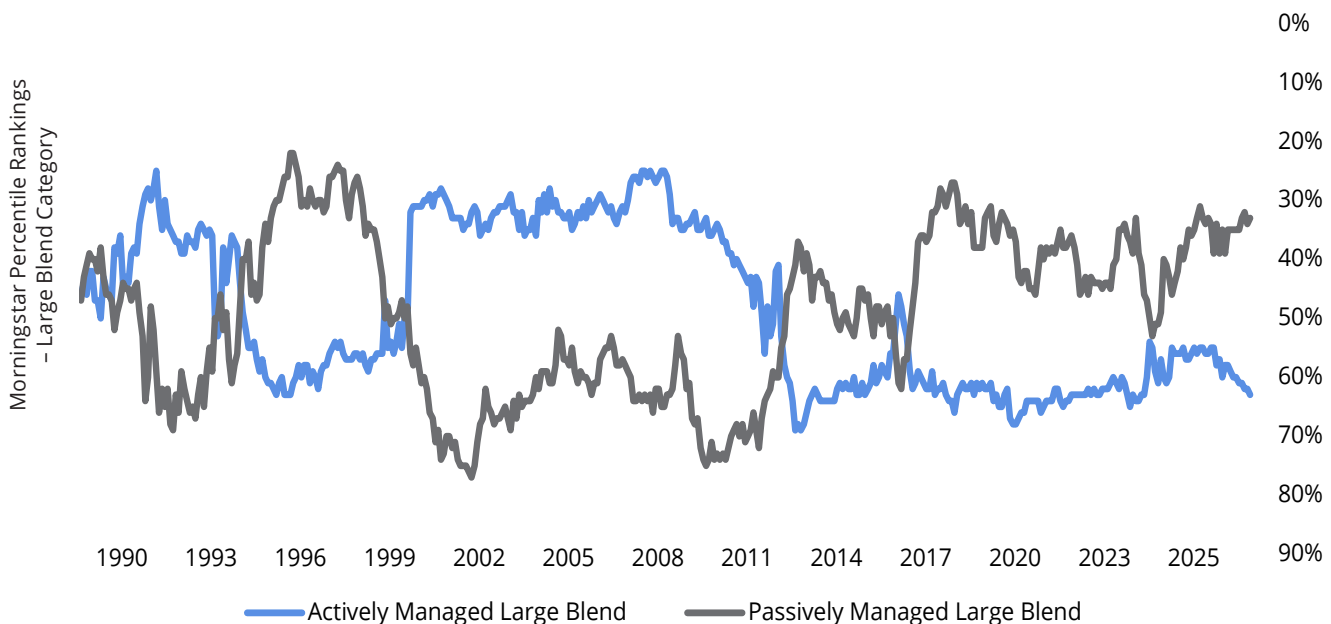
When it comes to active and passive, the debate isn’t as simple as an either/or choice. Many so-called active funds closely mirror the indices that serve as their benchmarks. These “closet indexers” offer no real value to active investors, and instead aim to slightly outperform the index by including a few different names. The problem, of course, is that this modest objective may not offer a real upside to justify the fees associated with active management.

Investors who are looking for a true active manager should examine the fund’s active share, or measure of the percentage of equity holdings in a manager’s portfolio that differ from the benchmark index. By examining active share, investors can get a clearer picture of how an active manager is adding value, instead of relying upon returns alone. It’s a metric you can use to help determine which funds are truly active or passive.

#### The Active-Share Spectrum



**FIGURE 2**  
**Active and Passive Outperformance Trends Are Cyclical**  
 Monthly Rolling 3-Year Periods (1991–2025)



As of 12/31/25. Data Sources: Morningstar and Hartford Funds, 2/26.

## Home Runs: Part of the Cycle

Active/passive cyclicality is further demonstrated with high and low amounts of stock “home runs”—that is, a stock that outperforms the benchmark by 25% or more. Markets that feature large amounts of home runs signal dispersion in stock returns. High dispersion should benefit active managers who can single out the winners, whereas a low number of home runs indicates stocks are moving together, which typically benefits passive management.

In FIGURE 3, we’ve ranked the past 35 years from highest to lowest in terms of which stocks within the S&P 500 Index had the most home runs. The average number of home runs during this time period was 219. Sure enough, in years that feature a high number of home runs, active tended to outperform. And when there were fewer standouts, passive was the clear winner. It’s just another example of how the performance of active and passive management has remained faithful to cyclical trends.

**FIGURE 3**  
**Active Managers Have Generally Outperformed in High Dispersion Markets**

S&P 500 Index (1991–2025) ■ Active Outperforms

	Home Runs	% of HR	% Active Outperform
2001	322	63%	65%
2021	300	60%	28%
2000	305	59%	77%
2019	290	57%	35%
1992	269	53%	59%
2002	272	53%	62%
2004	264	52%	52%
2022	259	52%	61%
2010	253	50%	41%
2009	258	50%	61%
2005	243	48%	74%
2016	242	47%	30%
2011	232	46%	24%
2015	233	45%	38%
2014	231	45%	24%
1993	226	45%	65%
1994	227	44%	29%
2007	218	43%	69%
2018	216	42%	31%
2003	209	41%	41%
2020	213	41%	42%
1991	205	41%	64%
2013	198	39%	60%
2025	200	39%	32%
2024	199	39%	31%
2023	188	37%	30%
2012	182	36%	58%
2006	180	36%	39%
2008	184	35%	53%
2017	170	33%	47%
1997	155	30%	21%
1996	151	30%	33%
1999	135	26%	47%
1995	125	25%	18%
1998	114	22%	21%

As of 12/31/25. Data Sources: Factset, Morningstar, and Hartford Funds, 2/26.

## Active, Passive, and Market Cycles

So what does cyclicity in active and passive management performance mean for you as an investor? We believe it demonstrates the importance of maintaining perspective and minimizing the undue influence of fickle market sentiment as you navigate changing market cycles. Instead of letting recent performance enchant you into chasing returns, you should instead consider current market conditions and what the future could hold.

Despite a bear market in 2022, equities have generally risen for more than a decade (FIGURE 4). Not only that, the value of the S&P 500 Index has grown more than 911% since its low in March 2009.<sup>2</sup>

At the individual sector valuation level, the S&P 500 Index has a 20-year average price/earnings ratio (the ratio of

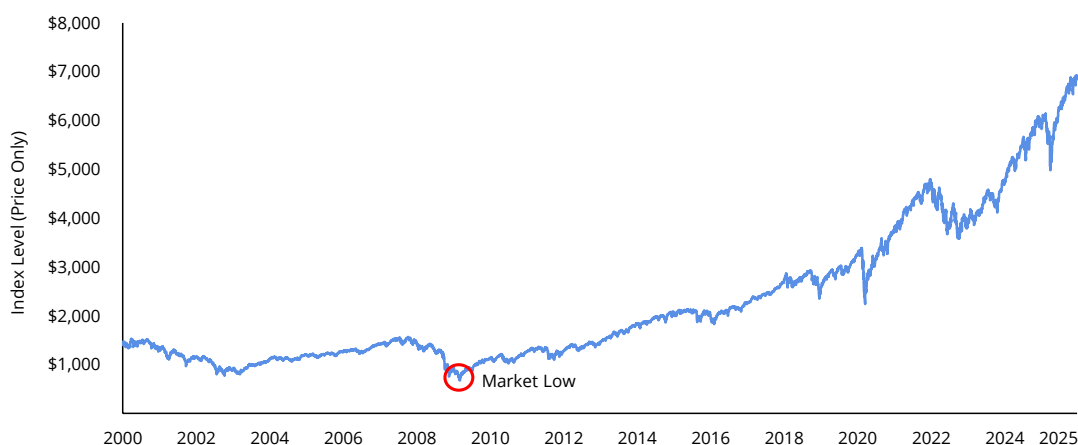
a stock's price to its earnings per share) of 17.2. As of December 31, 2025, the price/earnings ratio was 23.6.

FIGURE 5 illustrates that 10 out of 11 sectors in the S&P 500 Index are trading at a premium relative to their 20-year historical average. Active managers have the flexibility to consider valuations when choosing stocks, while passive investments can't use valuations as a consideration.

While bull markets can last quite some time, they're not immune to occasional corrections (as measured by a loss of 10% or greater) to help keep them healthy. Like speed limits on highways, market corrections are a necessary evil in investing, but not one to be feared. They keep markets from becoming overinflated and prevent valuations from reaching heights that lead to damaging crashes. They can also provide opportunities for active management.

**FIGURE 4**  
**Equity Prices Have Generally Risen Over the Past Decade**

S&P 500 Index Price Only (2000–2025)



As of 12/31/25. Data Sources: Ned Davis, Morningstar, and Hartford Funds, 2/26.

**FIGURE 5**  
**Nearly All Sectors Are Trading at a Premium to Their Historical Averages**

S&P 500 Sectors	20-Yr Avg P/E	Current P/E	% Change
Communication Services	12.8	11.6	-9%
Consumer Discretionary	18.6	23.9	29%
Consumer Staples	19.1	22.2	16%
Energy	15.9	16.8	6%
Financials	14.8	17.8	21%
Healthcare	16.0	19.6	23%
Industrials	18.1	24.4	35%
Information Technology	19.4	29.9	54%
Materials	15.8	21.4	35%
Real Estate	27.6	30.9	12%
Utilities	17.1	19.5	14%
<b>Total</b>	<b>17.2</b>	<b>23.6</b>	<b>38%</b>

Current P/E ratio is as of 12/31/25. Data Source: FactSet, 2/26.

<sup>2</sup> Data Sources: Ned Davis Research and Morningstar, 2/26.

## Active Management Has Fared Better During Corrections

When corrections occur, you may not want to be exclusively invested in passive. Instead, you may want to consider investing in actively managed funds.

There have been 27 market corrections over the last 35 years. **FIGURE 6** shows that during those corrections, active outperformed passive 21 times, with an average rate of outperformance of 1.05%. Again, we compared active to passive by removing index and enhanced index funds from the Morningstar Large Blend Category to represent active, and used the S&P 500 Tracking Index category to represent passive.

By allowing investors to respond to ever-changing markets, active management empowers investors to maximize opportunity as conditions demand. But if you're invested in an index fund, you could be exposed to significant downside due to single-sector performance. For example, during the collapse of the dot-com bubble in 2000, active management outperformed passive significantly, -2.41% to -9.42%.<sup>3</sup> Much of the blame for passive's underperformance during that period can be laid at the feet of a single sector.

As **FIGURE 7** shows, the technology sector made up 28% of the S&P 500 Index at that time. The sector (as represented by the S&P 500 Information Technology Index) crashed hard, to the tune of a 38.72% decline in 2000.

Meanwhile, the average active manager was underweight technology relative to the index (23% vs. 28%), which helped limit the damage done to their portfolios when the tech bubble burst. Active managers with a positive return during this time were more underweight to technology with a 12.3% average weighting, and those with a negative return hewed closer to the index with a 32.8% average weighting.<sup>4</sup>

When bull markets inevitably turn, passive managers could be left holding stocks and sectors with poor fundamentals and inflated valuations. Meanwhile, active managers have the ability to help mitigate risk by reducing exposures to expensive areas that will be hit hardest, and conversely, increase exposure as sectors or asset classes recover to capture upside as the new market cycle begins.

**FIGURE 6**  
Active Management Has Taken Corrections in Stride

Date	Actively Managed Large Blend 12/31/25	S&P 500 Tracking 12/31/25	Difference
10/8/97-10/27/97	-9.35	-10.61	1.26
7/18/98-8/31/98	-19.68	-19.12	-0.55
9/24/98-10/8/98	-11.02	-9.77	-1.25
7/17/99-10/15/99	-11.28	-11.83	0.55
3/25/00-4/14/00	-10.90	-10.90	0.01
9/2/00-4/4/01	-21.50	-27.04	5.54
5/22/01-9/21/01	-24.70	-26.00	1.30
1/5/02-7/23/02	-28.51	-31.39	2.88
8/23/02-10/9/02	-18.15	-18.96	0.82
11/28/02-3/11/03	-13.41	-14.25	0.84
10/10/07-3/10/08	-16.46	-18.08	1.61
5/20/08-10/10/08	-36.19	-36.50	0.31
10/14/08-10/27/08	-15.92	-15.44	-0.48
11/5/08-11/20/08	-24.47	-24.98	0.52
1/7/09-3/9/09	-25.20	-27.21	2.01
4/24/10-7/2/10	-15.70	-15.70	0.01
4/30/11-10/3/11	-20.41	-18.79	-1.62
5/22/15-8/25/15	-11.64	-11.98	0.34
11/4/15-2/11/16	-13.63	-12.81	-0.82
1/27/18-2/8/18	-9.79	-10.10	0.31
9/21/18-12/24/18	-19.37	-19.45	0.08
2/20/20-3/23/20	-34.05	-33.81	-0.24
1/4/22-3/8/22	-12.49	-12.90	0.41
3/30/22-6/16/22	-19.38	-20.61	1.23
8/17/22-10/12/22	-15.51	-16.73	1.21
8/1/23-10/27/23	-9.78	-10.02	0.25
2/20/25-4/8/25	-18.15	-18.81	0.66

Average Outperformance	1.05%
Active Wins	21
Passive Wins	6

As of 12/31/25. All values are rounded to the nearest basis point, which is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument. Data Sources: Ned Davis Research, Morningstar, and Hartford Funds, 2/26.

<sup>3</sup> Data Sources: Ned Davis Research and Morningstar, 2/26.

<sup>4</sup> As of 12/31/25. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Data Sources: Morningstar and Hartford Funds, 2/26.

**FIGURE 7**  
**Index Funds: Individual Sectors Can Have Outsized Impact**  
 S&P 500 Index Sectors (1/1/00–12/31/00)

Sector	Average Weight (%)	Total Return (%)	Impact on Performance (%)
Communication Services	6.75	-38.82	-3.02
Consumer Discretionary	9.78	-23.61	-2.63
Consumer Staples	8.65	5.35	0.45
Energy	6.47	19.96	1.10
Financials	15.42	19.87	2.62
Healthcare	11.66	38.35	3.64
Industrials	8.84	3.24	0.15
Information Technology	28.34	-38.72	-11.35
Materials	2.00	-16.41	-0.38
Real Estate	0.10	-26.65	-0.03
Utilities	1.98	53.59	0.80
<b>Total</b>	<b>100</b>		

Data Source: FactSet, 2/26.

### Investment Implications:

This insight focused on active vs. passive investing in the Morningstar Large Blend category because it’s widely believed to be the most efficient category—the one that should invariably favor passive investing. Yet even this category shows the cyclical nature of active and passive performance. The same cyclical nature is present in other investment categories such as mid caps, small caps, and global/international equities.

Just as we think declaring active management dead is premature, we don’t contend that active management is the only suitable choice for investors. Far from it. We believe that the choice between active and passive management is not a zero-sum game, but that each has a place in investor portfolios based on the individual needs and wants of the investor. With that in mind, here are some conclusions to take away from this piece:

- The performance of active and passive management has been cyclical—each style has experienced extended periods of outperformance.
- When evaluating active and passive management, looking beyond recent performance and measuring active share is important.
- As we saw in 2025, market corrections are inevitable and a common occurrence in equity markets over time.
- Over the past 35 years, the market experienced 27 corrections, with active management outperforming passive management in 21 of them.
- During market corrections, the flexibility of active management allows for reducing exposure on the downside and ramping up exposure to capture alpha<sup>5</sup> in the early stages of recovery.

**Talk to your financial professional about the benefits of incorporating active management into your portfolio.**

<sup>5</sup> The measure of the performance of a portfolio after adjusting for risk. Alpha is the excess return of a portfolio over its benchmark.

**S&P 500 Index** is a market capitalization-weighted price index composed of 500 widely held common stocks.

Investing involves risk, including the possible loss of principal.

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