



What Are Actively Managed ETFs?

Active ETFs combine professional oversight with enhanced flexibility.

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Exchange-traded funds, or ETFs, have long been one of the most popular investment vehicles for both retail and accredited investors. Passive ETFs, which are funds that track a specific index, like the S&P 500, have traditionally been the preferred way to invest in a diversified equity portfolio.

But investment preferences are changing: Actively-managed ETFs, which are overseen directly by portfolio managers who make proactive holding decisions, have gained ground in recent years. According to the wealth management research firm Cerulli Associates, assets in active ETFs more than quintupled between 2020 and 2024, rising from \$171 billion to \$866 billion.

These active products combine the flexibility of ETFs with the strategic oversight of professional fund managers who have tailored insights into specific market sectors and securities, structural advantages, asset allocation, and tax-aware frameworks.

How Do Actively-Managed ETFs Differ from Passive ETFs?

Passive ETFs have for decades been a popular investment strategy due to their ability to replicate an index's performance at a low cost. It simply mirrors the composition and performance of an index such as the Nasdaq 100. Because there's no day-to-day trading or research involved, passive ETFs tend to have lower fees and less turnover.

But actively-managed ETFs have become more popular, proving to be even more beneficial for certain investors by fusing alpha-seeking features of other active strategies with the tax-efficient ETF wrapper.

An actively managed ETF is an exchange-traded fund in which a professional portfolio manager or management team makes ongoing investment decisions. Instead of tracking a fixed index, the manager chooses which securities to buy and sell in an effort to outperform a benchmark or achieve a specific investment goal.

Managers analyze market conditions, company fundamentals, and macroeconomic trends to adjust holdings. The difference is that these ETFs still trade intraday on exchanges, providing liquidity and transparency that traditional mutual funds don't offer.

What Investment Strategies Do Fund Managers Use in Actively Managed ETFs?

The strategies behind active ETFs vary widely depending on the fund's objectives. Some managers seek long-term capital appreciation by

identifying undervalued companies or emerging market opportunities. Others focus on income generation, investing in dividend-paying stocks or fixed-income instruments. And some try to ride the wave of current trends, such as artificial intelligence.

A key benefit of actively-managed ETFs is adaptability: If market conditions suddenly change, the ETF's holdings can be rebalanced to increase returns or protect against downside risk. This requires active management by a seasoned professional, who may employ a series of methodologies as part of their approach:

- **Fundamental analysis:** Evaluation of company balance sheets, earnings, and growth prospects to find securities trading below intrinsic value.
- **Quantitative models:** The use of data-driven algorithms to select securities based on factors like momentum, volatility, or valuation ratios.
- **Sector rotation:** Shifts in exposure between sectors—such as technology, healthcare, or energy—based on economic and market cycles.
- **Risk management:** Active managers may use hedging or tactical cash positions during volatile periods.

What Are the Potential Advantages of Investing in Actively Managed ETFs?

Beyond the well-known tax benefits of the ETF investment wrapper, active ETFs have distinct benefits beyond those attained in a passive vehicle, including:

- **Potential for Outperformance:** Active ETFs are guided by human decision-making, and therefore have the potential to beat market benchmarks.
- **Professional Oversight:** Investors gain access to institutional-grade research, portfolio construction, and risk management without needing to pick individual securities themselves.
- **Intraday Liquidity:** Active ETFs can be bought or sold throughout the trading day at market prices (unlike mutual funds, which settle only once daily, and private funds, where capital can be locked up indefinitely).
- **Low-Cost:** Active ETFs share the same low-cost benefit as passive ETFs that track an index, which normally charge a fee that is a fraction of an actively managed mutual fund.

For Whom Are Actively Managed ETFs Best Suited?

Actively managed ETFs can fit a range of investor profiles, but they're particularly well-suited for those who feel more comfortable with professional management, prefer enhanced liquidity and tax advantages, have conviction that their managers can identify pricing opportunities, and are seeking higher returns than that of a passive index.

For many investors, active ETFs serve as a complement to passive holdings. For example, an investor might keep broad, low-cost index ETFs as a portfolio core, while using active ETFs for satellite exposure to sectors like technology, international markets, or fixed income.

Actively managed ETFs blend the best of two worlds: the strategic expertise of active management with the liquidity, transparency, and cost efficiency of ETFs. They offer a compelling middle ground for investors seeking more flexibility than passive funds but less complexity than individual stock selection.

When chosen thoughtfully, actively managed ETFs can add opportunity and versatility to a well-diversified portfolio.

Definitions (as used by Twin Oak):

- 1. Cost-effective ETFs:** As defined compared to hedge funds, which commonly charge a 2% management fee as well as 20% of the profits.
- 2. Institutional Grade:** Investment strategies generally only accessible in private fund formats to accredited investors.
- 3. Tax Alpha:** The amount of a gross return lost to the tax drag of an investment vehicle through realized taxable events.
- 4. Low Cost:** Defined on a case-by-case basis but generally refers to solutions that are cheaper than private funds (2% management fees and 20% carry).

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- 1. New fund risk:** The Fund is a newly organized, management investment company with no operating history.
- 2. Non-diversification risk:** More of the Fund's assets may be invested in the securities of a single issuer than could be invested in the securities of a single issuer by a diversified investment company. This may make the value of the Shares more susceptible to certain risks than shares of a diversified investment company. The Fund has a greater potential to realize losses upon the occurrence of adverse events affecting a particular issuer.
- 3. Counterparty Risk:** Some of the Fund's derivatives contracts are privately negotiated in the over-the-counter market. A counterparty defaulting on its payment obligations to the Fund will cause the value of an investment in the Fund to decrease.
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