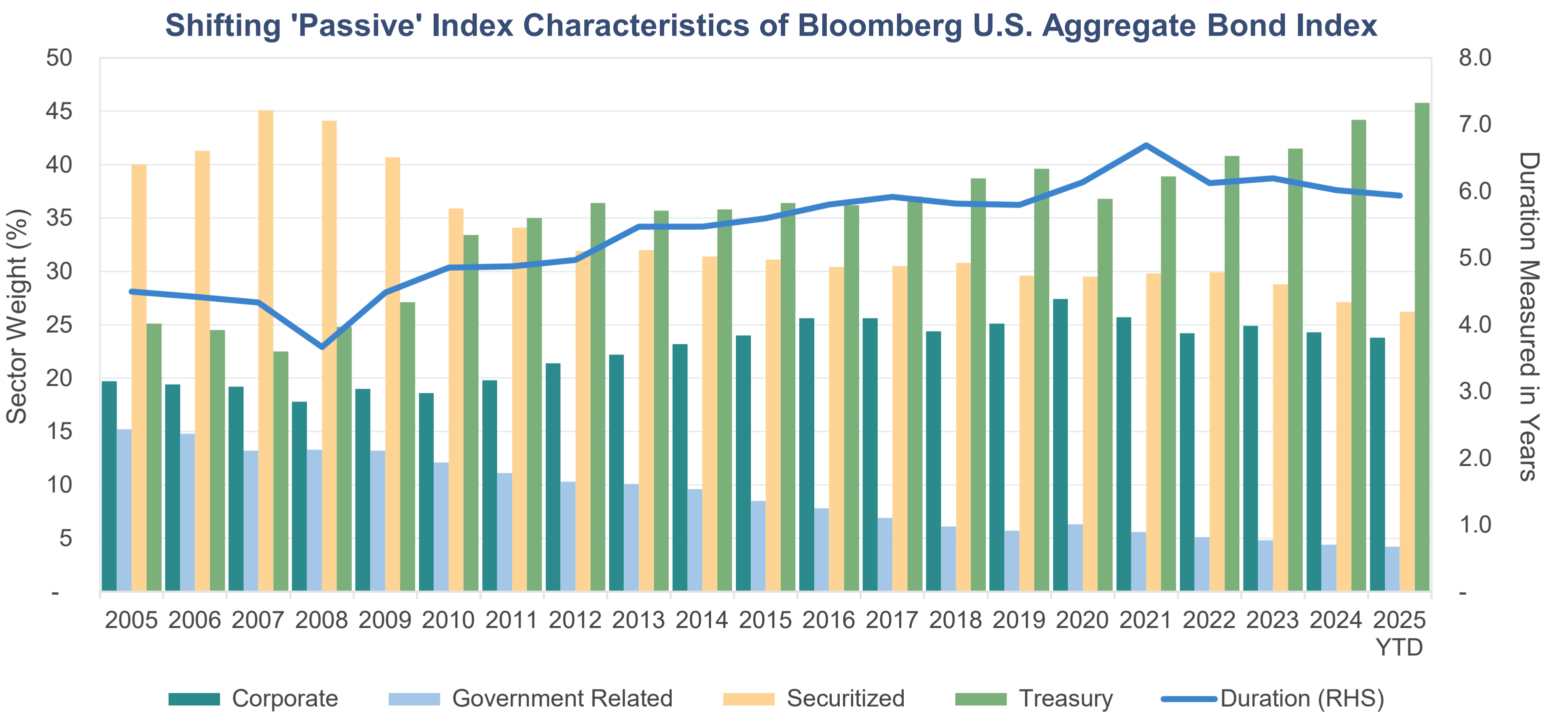
The Sterling Capital VAULT

Passive Investing is NOT Static Investing

The proliferation of benchmark tracking funds in the investment world has led to one large misnomer: passive investing. While definitions vary, the most common form of passive investing is purchasing a fund that mimics an underlying index and holding for longer time horizons. It is easy to see how the word passive can become conflated with static or stable allocations. However, if the asset itself changes materially over time, how passive is it really?

To illustrate the point, look no further than one of the largest and most commonly used benchmarks in the fixed income space - the Bloomberg U.S. Aggregate Bond Index. Consider a scenario in which an investor purchased an exchange-traded fund (ETF) that simply mimics the characteristics of this index (i.e., a passively managed ETF) in 2005, this ETF is the investor's only holding, and for 20 years the investor does not adjust their holdings. Does the risk profile of the investor's portfolio change over time?

On the surface, our investor has maintained 100% passive exposure to the U.S. fixed income market. While the passive allocation has been constant, the market index it tracks has been anything but. Since it is a rules-based index, any bond that meets the inclusion criteria is added to the universe, and as sector issuance ebbs and flows, the asset allocation mix and characteristics of the index reflect those changes over time. Comparing the index changes over the holding period highlights just how much the "passive" investments have shifted.



Without touching anything, the asset allocation mix of the underlying holdings changed meaningfully over the years. The portfolio's drift is not contained to just asset allocation as the characteristics of the index it mimics have also changed over time. In simplistic terms, a bond or portfolio's duration is a measurement of price sensitivity to changes in interest rates. In 2005, the option adjusted duration of the Bloomberg U.S. Aggregate Bond Index was 4.16. By 2025, the duration lengthened substantially to 6.06, making the portfolio more sensitive to interest rate moves, again without the account lifting a finger!

Passive investing may seem simple, but it carries hidden risks. As market conditions change, a passive fund's risk profile can shift without investors realizing it, leading to unintended exposures. Active management, by contrast, continuously monitors and adjusts to mitigate these risks. In fixed income, where risk is inherently asymmetric, understanding risk exposures on a standalone basis and in relation to other holdings is critical to avoid unintended risks and ultimately protect the end investor.

RHS: right-hand side. Chart and textual data is as of 11.30.2025. Sources: Bloomberg L.P.; Sterling Capital Management Analytics. The views expressed represent the opinions of Sterling Capital Management. Any type of investing involves risk and there are no guarantees these methods will be successful. This information must be read in conjunction with the definitions and disclosures on the last page.

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The Bloomberg U.S. Aggregate Bond Index is an unmanaged index composed of securities that are SEC-registered, taxable, and USD-denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. It is not possible to invest in the Bloomberg U.S. Aggregate Bond Index, which is unmanaged and does not incur fees and charges.

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Technical Terms: the technical term below is sourced from Corporate Finance Institute.

An Exchange-Traded Fund (ETF) is an investment fund that holds assets such as stocks, commodities, bonds, or foreign currency. An ETF is traded like a stock throughout the trading day at fluctuating prices.

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