

Let your bonds work smarter

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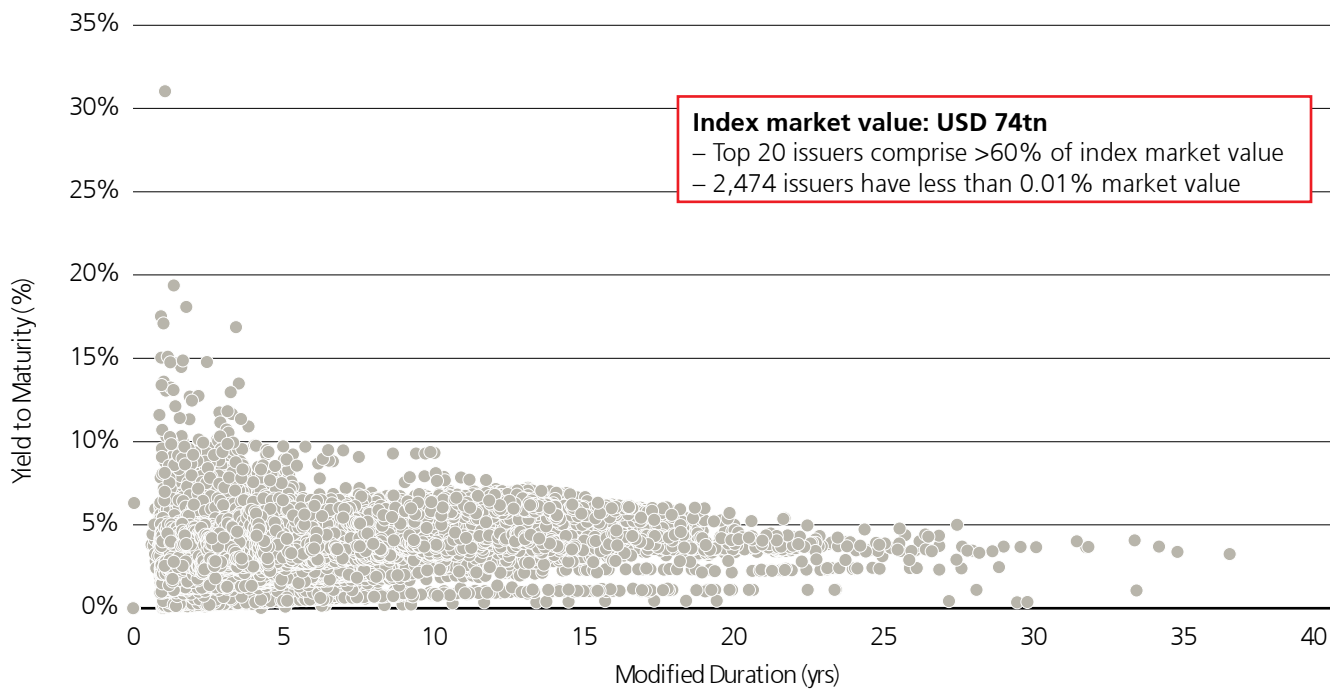


- Fixed-income markets are fragmented and inefficient, giving active managers scope to add value.
- Active bond managers can identify and mitigate both interest rate and credit risk in order to add value.
- In addition to security selection active bond managers can derive alpha by applying flexibility in duration, yield curve, sector and currency.
- Index replication in the bond market can be costlier and more challenging than in other markets due to transaction costs and liquidity.
- Higher risk sectors such as emerging market debt and high yield can offer idiosyncratic opportunities and an Unconstrained strategy can pursue the most attractive investment opportunities across market cycles.

Fixed income is often viewed as a stabilizing anchor of a portfolio. Yet in practice, bonds respond quickly to shifting rate regimes, credit cycles and geopolitical events. Treating fixed income as 'hold and forget' may leave certain opportunities for investors on the table. Studies have shown that active fixed income managers have historically been likely to outperform passive peers (Morningstar [Active vs. Passive Investing: Which Categories Are More Successful?](#)). The reason is simple: bond markets are complex, dynamic and full of inefficiencies that active managers may be well placed to capture.

The Case for Active Fixed Income

Bloomberg Global Aggregate index – Broad fixed income universe with over 30,000 bonds



Source: UBS Asset Management, Bloomberg. As of 30 September 2025. For illustrative purposes only.

Risk management beyond the benchmark

Fixed income indices are typically weighted by the amount of debt outstanding. Issuers who borrow the most have the largest representation reflecting issuance trends, which is not optimal for portfolio construction as it can lead to over-allocations to higher-levered issuers or countries with high levels of debt outstanding. As a result, they are structurally overweight the most indebted issuers and embed duration or credit risks that may not align with an investor's objectives. Active management can take into account these biases and build portfolios that focus on deliberate rather than inherited sources of return.

Flexibility to navigate dynamic conditions

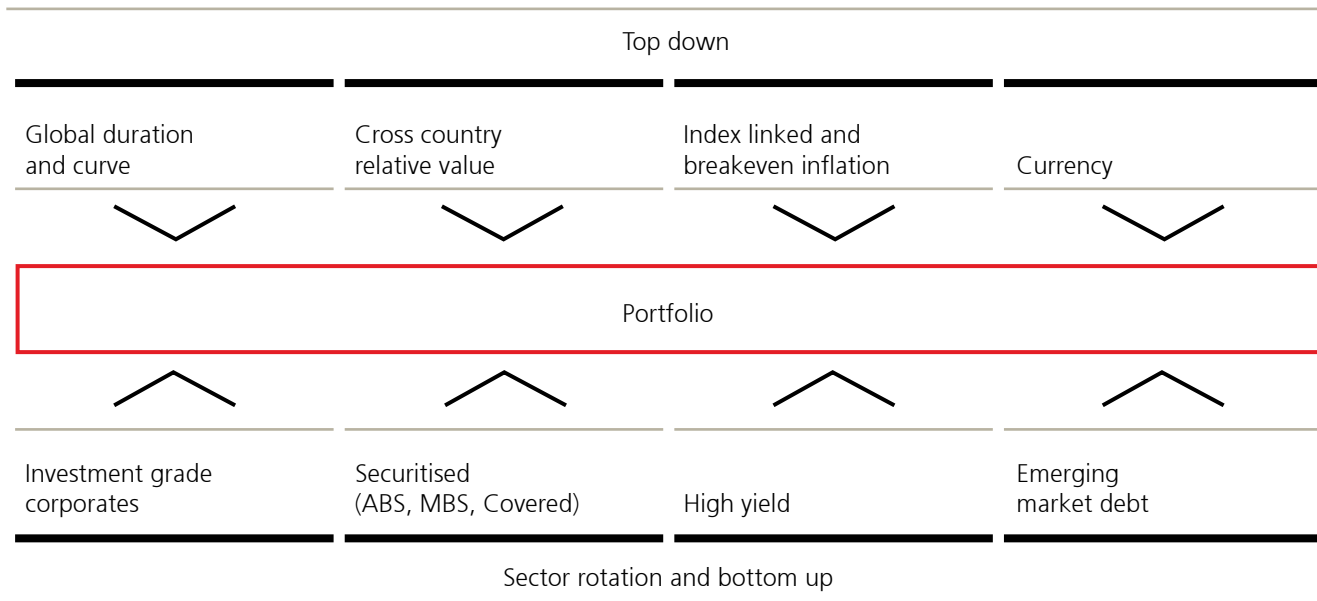
Interest-rate cycles, such as events post pandemic, and credit environments can change rapidly while varying in time across markets or sectors. Active managers have the opportunity to adjust duration, reposition along the yield curve or rotate between sectors as business cycles evolve. Past periods such as the European sovereign debt crisis, Taper Tantrum or Quantitative Easing programs were in fact alpha generation opportunities for active managers who could position their portfolios to take advantage of dislocations in the market. Similarly, by seeking to avoid stressed and distressed companies and sectors, active managers may sidestep drawdowns and potentially generate strong risk-adjusted returns. Passive strategies remain tied to a benchmark through every rate move, spread widening or sector dislocation. When markets turn, flexibility matters – and in fixed income, flexibility is often the difference between cushioning volatility and absorbing it.

A market built for active insight

Unlike equities, which trade in relatively transparent and centralized markets, fixed income is fragmented and diverse. Indices often contain thousands of individual securities, many of which are illiquid or newly issued. Passive strategies therefore rely heavily on sampling and inherited exposures – holding bonds because they exist in the index, not necessarily because they offer value.

Active managers, by contrast, can be selective. Seeking to avoid issuers with deteriorating fundamentals, leaning into improving credits and managing sector exposures deliberately can add value. In markets where new issuance, corporate actions and policy shifts can redefine the landscape, selectivity can become a performance driver.

Drivers of active fixed income



Idiosyncratic opportunities: Where skill adds the most value

Some segments of fixed income can offer especially attractive opportunities for active managers. Emerging markets, high yield and unconstrained bond strategies, can capitalize on dispersion and outcomes that hinge on allocation and issuer-specific developments. Passive exposure treats these sectors as uniform while active managers can take advantage of their complexity.

Emerging Markets

Sectors in the bond market that offer higher return potential, but require an understanding of issuer specific fundamental risks, may offer experienced and skilled managers with deep research benches opportunities to leverage an information advantage. The emerging market debt universe is comprised of over 60 countries each with different political climates, macro-economic cycles and widely different trade landscapes. Additionally, the exposure of passive managers is hardwired to frontier countries which account for over 28% of the JPMorgan EMBI Global debt index. Liquidity can be challenging at times during market events or even due to limited dealer inventory of bonds from smaller, frontier issuers where trading can be thin and transaction costs elevated. Bottom-up analysis is critical within the EM sector not only to seek to mitigate default risk, but also to aim for upside return generation. Further, elections and geopolitics can have significant impacts on the performance of individual countries that can present unique opportunities to take active risk.

High Yield

Another high return potential sector in the bond market that also requires skilled insight into issuer specific risks is the high yield corporate market. Alpha generation in the high yield market is predominantly driven by credit selection. Passive funds do not employ issuer selection and therefore can include debt approaching or already trading at distressed levels. Historically defaults have been around 3% in the EUR high yield market and between 3.5%-4% for the USD high yield market, which, again, are hardwired into the portfolios of passive high yield managers. Active management seeks to distinguish companies with improving balance sheets from companies with weakening balance sheets, adjust exposure if liquidity tightens, and identify rising-star/fallen-angel candidates (companies that may see credit rating bumps or cuts, respectively) before credit events occur. Experienced high yield managers have demonstrated the ability to avoid defaults in their portfolios holdings over longer periods of time, while navigating the credit cycle. Typically, a seasoned credit research function is critical to issuer selection. As high yield markets can reprice quickly, selective risk-taking often can deliver better outcomes than generic broad market exposure.

Unconstrained Strategies

While high beta sectors in the bond market have compelling cases for active management, the most flexible approach to navigating all types of market cycles are unconstrained bond strategies that operate without the limits of traditional portfolios. Unconstrained fixed income investing seeks to exercise the freedom to pursue opportunities across a broad variety of global rates, credit and currencies. An unconstrained manager can seek to allocate with conviction where they see the risk-adjusted return potential as higher while aiming to sidestep areas that they feel lack compelling valuations, or potentially avoiding issuers or sectors that pose unattractive credit risks. In the current environment, influenced by policy shifts and evolving inflation outlooks, the ability to express high-conviction ideas across diverse sectors may present a meaningful source of return, while also serving as a diversifier in a broader asset allocation.

In an asset class defined by change, it pays to embrace active management

Fixed income is more than a defensive asset class. It is a market rich with complexity, dispersion and evolving risks and opportunities – one where informed decision making seeks to improve investor outcomes. Importantly, the fee gap between active and passive fixed income strategies has narrowed significantly. This is particularly true in markets such as high yield and emerging market debt where the cost of index replication (due to transaction costs and liquidity) remains high, which has led passive managers to

underperform their benchmarks on a net of fee basis. Perhaps a confluence of these cost-related factors is one of the reasons active funds have seen notably strong interest more recently with flows in Q3 2025 outpacing passive peers for the first time since 2021. In fixed income, dynamic and flexible approaches to bond markets, can help investment managers to navigate challenging economic environments and whipsaws in geopolitical dynamics. (Morningstar, European Fund Flows: A Sign of Life From Actively-Managed Funds).

A deep bench of seasoned portfolio managers and on-the-ground research analysts is vital to developing a nuanced view of the complex fixed income opportunity set. Active management, equipped with research depth, flexibility and prudent risk management, can help a fixed income allocation adapt to changing market and economic environments and potentially ‘work harder’ for investors.

In an asset class defined by change, it is compelling to embracing active management – instead of passively hugging a benchmark.

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