

FEATURED INSIGHT

When the Market Outgrows the Index

DAVID VICK, CFA | MARCH 2025

KEY TAKEAWAYS

- Recent fixed income volatility highlights the limitations of the Bloomberg U.S. Aggregate Bond Index (commonly referred to as “the Agg”), a key index
- Nearly half of the opportunities available in fixed income aren’t represented in the Agg
- Actively managed ETFs are a potent way to diversify a fixed income portfolio

It’s been nearly 40 years since the Agg became the industry’s fixed income standard benchmark for the broad, high-quality bond market in the U.S. But in today’s market, does it really reflect all the opportunities that are available to investors?

With nearly 14,000 individual issues worth more than \$29 trillion in market value, the Agg includes a wide range of securities across multiple sectors, including Treasury and other government-related bonds, corporate bonds, and securitized issues. As with all indexes, however, there are rules that guide the construction of the index, limiting the number and types of securities that are included.

Traditional fixed income portfolios are tethered to the Agg and typically primarily hold securities that are also included in the index. But those traditional strategies miss out on opportunities available in the roughly 47% of the U.S. fixed income markets that aren’t included in the Agg.

This is a significant constraint amid the volatility that is taking hold as markets wrestle with stubborn inflation, tariffs imposed by the Trump administration on trading partners, and global polarization. Unlike previous cycles, though, today’s investors have more choices to position their fixed-income portfolios outside of the Agg, including active ETFs.



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It's a Big World

The big issue is that the Agg only includes bonds that are rated investment grade, publicly registered, have a fixed rate coupon, at least a year of maturity remaining, are denominated in U.S. dollars, and meet certain minimum size requirements. These rules exclude large segments of the market, including floating rate issues (which is the vast majority of the asset-backed securities markets, including collateralized loan obligations (CLOs)), inflation-protected issues (TIPS), unrated and below investment grade issues (high yield and bank loans), short term instruments (money market securities), and bonds issued in any currency other than USD.

In total, these excluded sectors in the U.S. alone account for an estimated \$26 trillion, and more than \$110 trillion globally. Clearly there is a whole universe of bonds not included in the Agg. (See Figure 1.)

Figure 1: Investment Universe

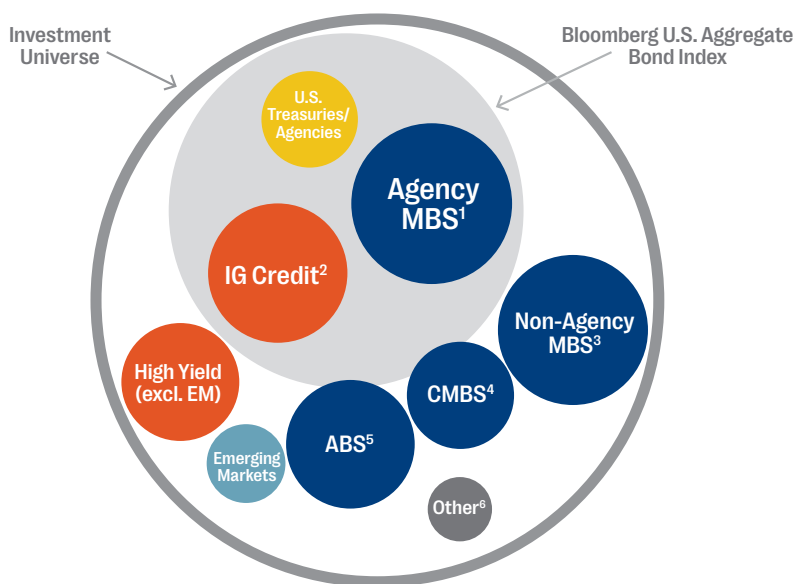


Diagram not to scale and intended only to illustrate potential areas of investment.

1 Agency Mortgage-Backed Securities.

2 Investment-Grade Credit.

3 Non-Agency Mortgage-Backed Securities.

4 Commercial Mortgage-Backed Securities.

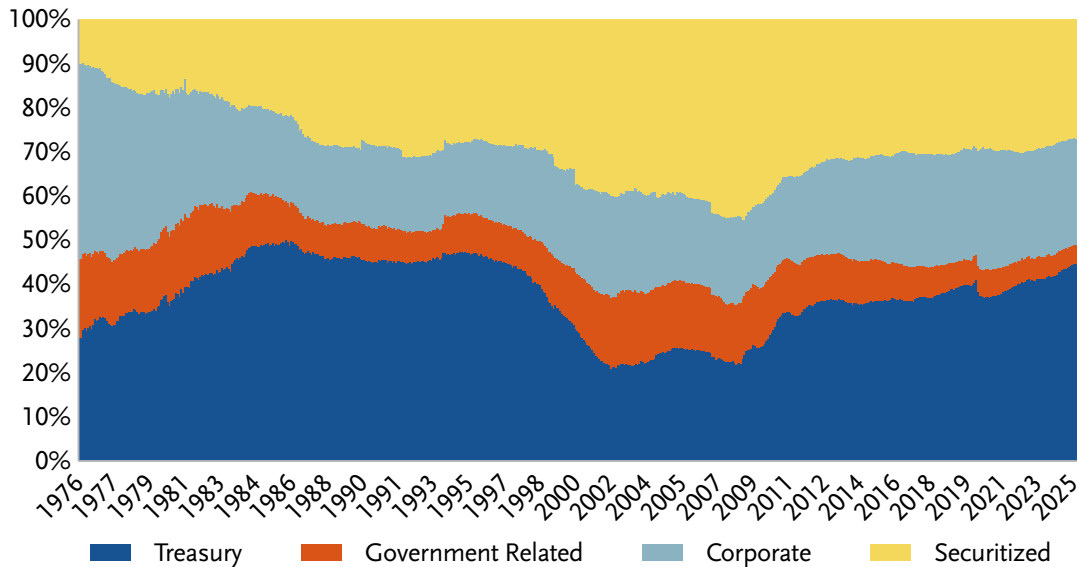
5 Asset-Backed Securities.

6 Other may include preferred shares, convertible bonds, municipal bonds, and other types of debt instruments permitted under the prospectus.

Not only are there a host of sectors not included in the Agg, but the ones that *are* included have changed over time due to long-term issuance patterns. In particular, U.S. Treasury bonds make up almost 45% of the index, while other government-related sectors add another 4%. Corporate bonds comprise 24%, while securitized issues (mortgage and asset-backed securities) make up the remaining 27%.

Given high current deficits, Treasury issuance has been robust, causing the percentage of Treasuries in the Agg to steadily move higher. (See Figure 2.) We expect that to continue as the U.S. budget deficit grows.

Figure 2. Historical Sector Weights of the Agg



Source: Bloomberg as of February 28, 2025

Additionally, the potential upside from the Agg is limited because nearly half of the Agg is comprised of these Treasuries. In essence, that means investors may be leaving money on the table.

A New Day

Historically, many of these non-index sectors have been outside the reach of the average investor, requiring special expertise and sophisticated analytics to understand and price the different types of risks present in these securities. Today, however, actively managed ETFs provide an effective and efficient means by which any investor can benefit from the expertise of professional managers, tapping into the abundant opportunities potentially available in sectors outside of the Agg.

These ETFs can be targeted in nature, focusing on a particular sector that offers a specific risk/reward profile that may be attractive for certain investors. For example, a dedicated CLO ETF could be a solid high-quality income solution for some investors, while one that focuses on senior bank loans would be a better option for an investor with a higher risk tolerance who also wants a higher level of income.

Investors can also tap into a broader active ETF that is designed to navigate across the entire fixed income landscape, identifying opportunities across sectors and individual issues. Without any tether to the Agg and with the ability to invest more broadly across the universe, those ETFs can provide flexibility and the potential for attractive returns across a wide range of market environments.

This isn't the first time that a market outgrew an index. The Nasdaq Composite, for example, became more influential when the traditional companies contained in the Dow Jones Industrial Average didn't reflect the growing investor focus on technology.

The Agg could ultimately modify selection criteria to meet the market's expansion, but there's no telling if or when that will happen.

In the meantime, investors want more choices and more flexibility, both of which are especially important when markets are in flux, volatile headlines are driving significant uncertainty, and sentiment is shifting seemingly daily.

There's just no time to wait. ■

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