



Nasdaq for Asset Owners

# Asset Owner CIO Quarterly: Passive Investments in Retirement Portfolios

Q1 2025



## Introduction

Equities rallied to start 2025 on a continuation of enthusiasm around the mega cap tech and AI theme, amplified by expectations of supportive fiscal policies in the U.S., and easing financial conditions. However, the back-half of Q1 dispelled much of this narrative, particularly the theme of U.S. exceptionalism (at least for now). U.S. mega cap tech led the sell-off following their notable outperformance the last two years and given the AI-theme premium priced into valuations. Global trade and security policy came into significant flux and investors repositioned to reflect potential changes to the status quo with major U.S. equity indexes experiencing their worst quarterly drawdown since mid-2022. Then, on April 2nd, the U.S. announced broad-based tariffs which pushed the U.S.'s effective tariff rate on imported goods to over 20%—the highest tariff in over 100 years—which caused a sharp sell-off in global risk assets and a spike in recession concerns. A reprieve came April 9th as the U.S. announced a 90-day pause on higher reciprocal tariffs for everyone except China, whose tariffs now stand at 145%. The extreme policy swings have whiplashed global financial markets and left investors on edge as downside growth risks remain.

Given the lack of clarity, uncertainties and volatility are expected to persist in the near-term as risk assets are beholden to trade policy headlines. Heightened market volatility has colloquially been associated with greater opportunities for skilled active management. However, the unorthodox monetary policies deployed globally by central banks following the Global Financial Crisis suppressed the economic cycle and equity market volatility. This was followed by the massive outperformance by U.S. mega cap tech companies, particularly in 2023 to 2024. Both dynamics were suffocating headwinds for active management performance and, not coincidentally, were coupled with the markets becoming awash with passive flows—impacting not only the business models of traditional active management but also how institutional investors allocate capital. For example, over the last two years actively-managed U.S. large cap strategies endured -\$818bn in total net outflows while passive U.S. large caps added \$394bn in total net inflows based on Nasdaq eVestment asset flows data. In light of these macro factors, we review the current state of passive investment management from an asset owner's perspective using a dataset of \$13.7 trillion in retirement assets across mainly U.S. retirement plans and offer thoughts on how these forces may interact.

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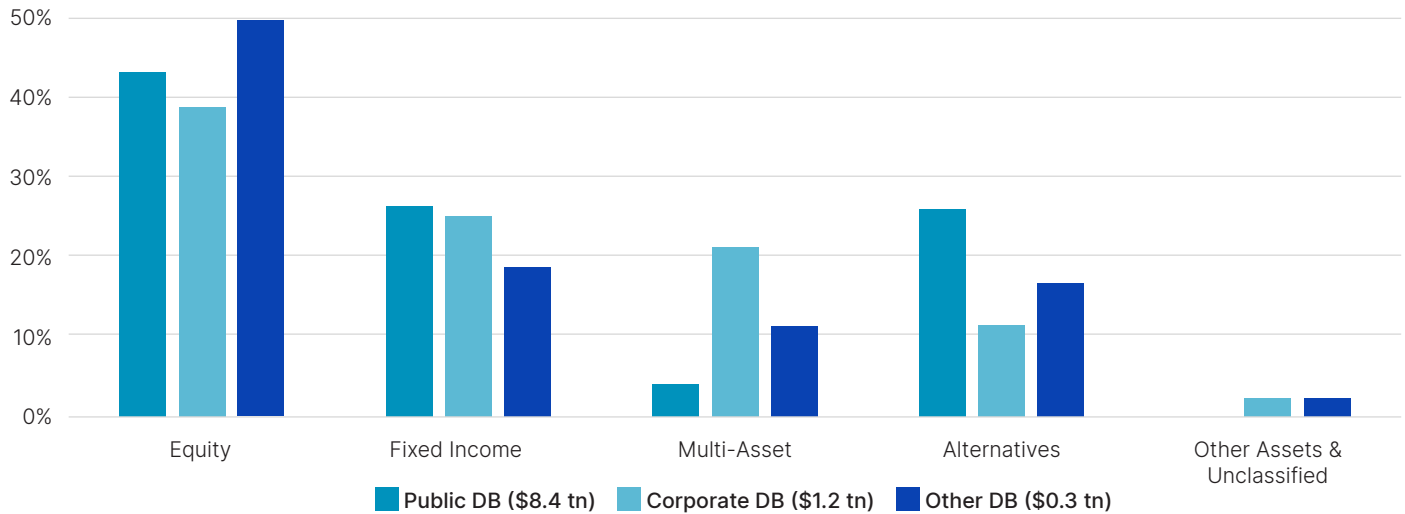
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# Passive Investments in Defined Benefit Plans

The following analysis includes \$13.7 trillion<sup>1,2</sup> in retirement assets across both defined benefit (DB) and defined contribution (DC) plans with much, but not all, of the data coming from U.S. participants. We first look at DB plans, whose asset allocations we present in figure 1.

Figure 1: Defined Benefit Asset Allocations



Source: Nasdaq eVestment Market Lens and Peer Benchmarking

There are significant differences in asset allocations based on the type of investor institution.

- Public equities make up 38.3% of corporate DBs’ externally managed assets versus 48.8% for non-corporate and non-public fund DBs – these include retirement plans for foundations, endowments, Taft-Hartley plans, and other institutions.
- Corporate and public defined benefit plans held roughly the same exposure in public fixed income, 25.2% and 26.4%, respectively. Fixed income allocations for “Other” DBs came in noticeably lower at 19.0%.
- Corporate DBs utilized multi-asset solutions to a much greater degree than other institution types.
- And, as an extension, corporate DBs invested the least in alternatives with a 12.0% allocation.<sup>3</sup> Across alternatives, we find the largest allocations for private equity, followed by real assets including real estate, then hedge funds and private debt which were held in roughly equal weight.

1 The aggregate asset allocations are constructed bottom-up from manager rosters collected via public disclosures, Freedom of Information Act (FOIA) requests, and regulatory filings. We focus solely on externally managed investments and exclude direct security and property holdings. The most recent data points available are collected for each plan, dated between year-end 2023 and year-end 2024, then standardized for this report. DB and DC plans which do not provide sufficient investment details are excluded (roughly \$12 trillion in additional assets).

2 Certain defined benefit entries may include DC assets dependent on how entity ownership is structured, i.e.: master trusts. Our analysis removes these entries where sufficient information is provided, but they may impact asset class totals.

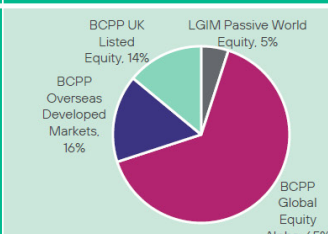
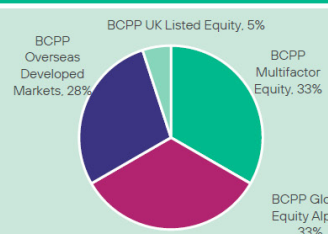
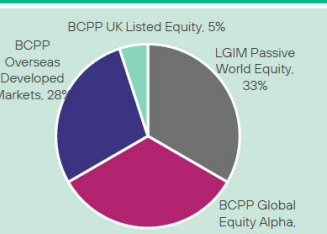
3 “Alternatives” include hedge funds, private equity, private debt, real estate, and real assets investments. Our data analysis likely has a bias against the classification of alternatives and as such the figures provided should be interpreted as an approximate floor.



With the broader picture in hand, we take a closer look at retirement plans' public equity and fixed income holdings which comprise roughly 68% of DB plan assets (\$6.8 trillion). We identify \$2.2 trillion in passive equity and \$0.7 trillion in passive fixed income assets<sup>4</sup>.

The case for passive management has been discussed ad nauseum – competitive fees and scale benefits for institutions with larger mandates, the double layered difficulty in producing alpha and in sourcing those managers who do provide alpha. More poignant to the current market environment is institutional investors' interest in alternatives to market capitalization-weighted products. DB plans' passive equity assets are largely held in products tied to market capitalization-weighted indexes, accounting for \$2.0 trillion of the \$2.2 trillion total. However, factor-based strategies ranging from Russell 1000 Growth index to multi-factor equity products held total DB assets of \$73.8 billion (3.3%); sector-focused and thematic equity AUM measured \$48.7 billion (2.2%). Despite the current size disparity, institutional investors are more frequently considering factor-based and thematic products for their investment mix as shown in the excerpt below, sourced from an investment consultant's proposal to a UK public pension.

Figure 2: Market Cap vs. Multi-Factor Approach

	Current	Step 1a – Today's proposal	Step 1b – Alternative proposal for today
Allocation			
Active / Passive split	95% / 5%	67% / 33% (inc. Multi Factor)	67% / 33%
Pooled	95% (+5% pool aligned)	c.100%	c.67% (+ c.33% pool aligned)
UK / North America / EM vs market cap	+22% / -24% / -1%	+9% / -16% / 0%	+9% / -16% / -3%
Blended target return vs benchmark*	c. +1.6% p.a.	c. +1.2% p.a.	c. +1.0% p.a.
Modelled volatility**	20.9% p.a. (highest of portfolios shown)	c.2% reduction vs current	c.2% reduction vs current
Estimated management fees	23bps	14bps	13bps

Source: Nasdaq eVestment Market Lens, excerpt from U.K. public pension equity proposal

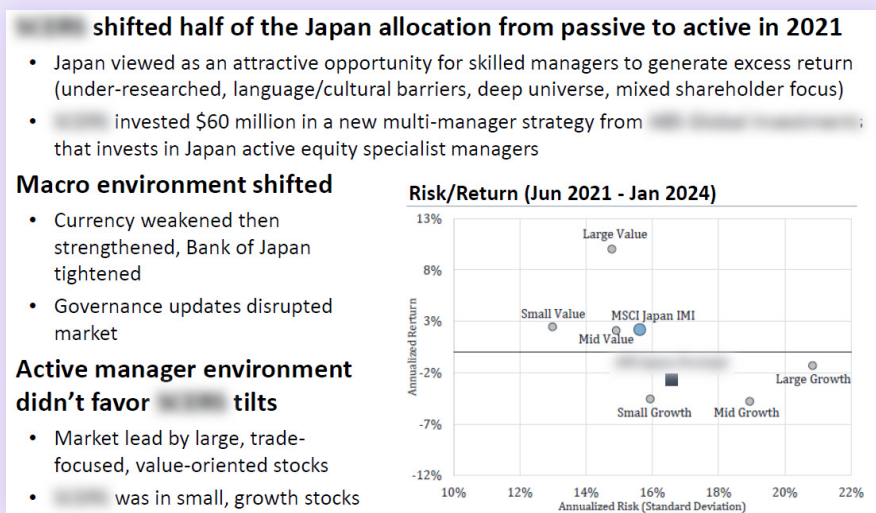
In this example, underperformance of the active portfolio was the precipitator for change. However, the key considerations in the transition into a multi-factor strategy included reducing the current concentration toward U.S. and growth names in market cap-weighted indexes and the relative size of the active portfolio. Perhaps in contraposition to the aforementioned concentration, we note the proposed reduction in domestic (U.K.) equity exposure and increase in international equity exposure. For many investors that have already embraced non-market cap-weighted passive options or have strategic allocation targets at the regional level, recent U.S. equity outperformance has been a primary motivator in considering "top-ups" to their passive market cap-weighted investments.

Relatedly, there are adherents to passive allocation as an equities default with active management utilized for particular sleeves, either strategically or tactically. Below is an equity portfolio review from a DB plan which utilizes an active carve-out approach along geographic lines. The plan had chosen to strategically allocate to active Japan equity managers, but underperformed over a 2.5 year period due to the portfolio's tilts toward small cap and growth stocks.

4 Note certain mandates could not be classified as either active or passive due to a lack of information.



Figure 3: Passive Core with Actively Managed Carve-out



Source: Nasdaq eVestment Market Lens, excerpt from U.S. public pension equity portfolio review

As a further consideration, managers investing in more liquid portions of the market, e.g.: U.S. large cap equities, have seen fees compress substantially. However, fees have tended to stay higher in segments of the market where names are less well covered or there exist natural barriers to entry, such as language. Therefore, in the areas where a case is more easily made for active management, we are likely to find less “fee alpha”—efficient markets at work. Shown below are fees for active U.S. large cap core strategies and for select passive products; for more on passive fees see our report, “[Uncovering Fee Savings for US Public Funds](#)”.

Figure 4: Active Managers vs. Select Passive U.S. Large Cap Products

	Active US Large Cap Core Managers	Vanguard S&P 500 Index	Invesco QQQ Trust	BlackRock Russell 1000 Index	DWS Group Passive US Equities
Benchmark	Various	S&P 500	Nasdaq-100	Russell 1000	MSCI US
AUM (YE'24, US\$ bn)	\$1,844	\$1,655	\$375	\$216	\$79
Mgmt. Fee / Expense Ratio	44 bps (Avg. Sep. Account Fee)	3 bps (VOO)	20 bps (QQQ)	15 bps (IWB)	7 bs (XD9U LN)

Source: Nasdaq eVestment Analytics, data as of 31-Mar-2025

Note: Assets under management and fee figures are reproduced as provided to Nasdaq eVestment and may include multiple product wrappers including separate accounts, commingled funds, mutual funds, and ETFs. The passive products listed above may offer vehicles with lower or higher fees.



Turning to passive fixed income, its value proposition has key differences relative to passive equities. Firstly, long-only fixed income fees are generally quite low, and while passive fees do tend to be even lower, fee recapture is less impactful. Secondly, active fixed income managers have tended to outperform their benchmarks. In the core fixed income space, studies point to outperformance as a byproduct of additional credit risk exposure taken on by active managers.<sup>5</sup> We will not attempt to draw a line between alpha and factor exposure here. Nonetheless, the additional credit risk has produced results in active managers' favor over the relatively short life of passive fixed income as an alternative. Lastly, fixed income as an asset class introduces liquidity and index construction issues which exist to lesser degrees than in the equity space. This produces portfolio construction concerns and client education considerations.

Figure 5: Rationales for Active Core Plus Fixed Income

**Q&A**

- **Question: Would moving to an all active “risk-reducing” bond portfolio increase portfolio downside risk?**
  - **Answer:** Yes. The vast majority of core-plus bond managers are consistently underweight Treasuries relative to the Bloomberg Barclays Aggregate Bond Index in favor of higher-yielding spread sectors. These spread-sector investments will almost certainly underperform Treasuries in an equity market sell-off.
- **Question: Why would we want to increase risk within our “risk-reducing” bond portfolio?**
  - **Answer:** Two primary reasons:
    - 1) As the U.S. Government has issued more and more debt, U.S. Treasuries have become a larger and larger part of the Bloomberg Barclays Aggregate Bond Index. Today, U.S. Treasuries represent nearly 40% of the Index, and their aggregate yield-to-maturity is less than 1%. (I.e., is negative in real terms.) We believe being able to underweight the Index's exposure to Treasuries is very likely to be additive to the DB Plans' long-term returns.
    - 2) [REDACTED] has a long history with actively managed core-plus bond mandates. Over that history, these mandates have consistently added about 1% over the BB Aggregate Bond Index, net of fees. We believe it is reasonable to expect this level of outperformance to continue, albeit with the occasional drawdown associated with risk-market corrections. We believe this level of “reward” to be worth the additional risk, particularly in today's historically low-yield environment

Source: Nasdaq eVestment Market Lens, excerpt from U.S. public pension fixed income portfolio review

Despite the comparatively tougher sell, institutional AUM in passive fixed income has risen to \$1.7 trillion—and in contrast to the above example, U.S. core bond mandates account for roughly one-third of the total.<sup>6</sup> The rise in portfolio trading for fixed income has also been a key value driver for allocators to passive fixed income, and for the broader financial ecosystem, increasing liquidity for corporate bond portfolios.<sup>7</sup> In the institutional space, we have also seen a proliferation in duration-focused strategies, but asset gathering for credit and global and non-U.S. fixed income has been noticeably slower.

5 AQR Capital Management LLC, “Active Fixed Income Illusions”, The Journal of Fixed Income, Spring 2020 Volume 29 Number 4

6 Source: Nasdaq eVestment Analytics

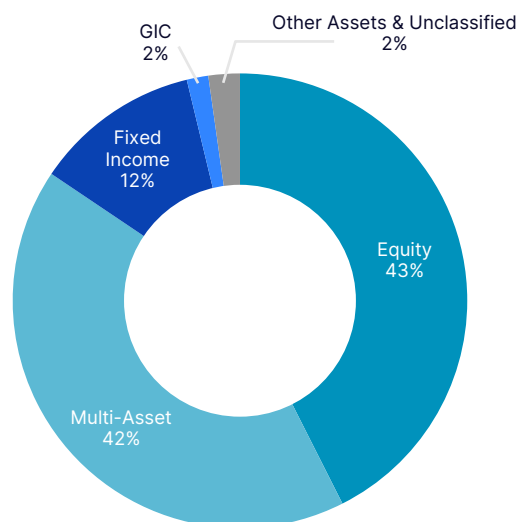
7 Robin Wigglesworth, “Portfolio trading is reshaping credit markets”, Financial Times, 19 November 2024, <https://www.ft.com/content/5e9f42b5-cb14-45fc-9804-279c28fd8418>



## Passive Investments in Defined Contribution Plans

Moving on to the DC space, we analyze \$3.6 trillion in assets sourced primarily from U.S. Department of Labor Form 5500 filings. The asset mix for DC participants lean more heavily toward multi-asset solutions. Across DC plans, we find nearly 34 products offered to participants on average, with much of this total driven by asset allocation strategies which cater to the gradient of retirement dates and risk tolerances.

Figure 6: Defined Contribution Aggregate Asset Mix (\$3.6 trillion)



Source: Nasdaq eVestment Market Lens

Public equities and fixed income account for 54.4% of the asset mix in our sample, or \$2.0 trillion. Actively managed products still outnumber passive products on DC shelves, for both equity and fixed income, by a wide margin. There are nearly 12 equity products offered to DC participants on average and only 31% of DC plans offer more passive equity options than actively managed ones. Despite this, we find that assets held favor passive equities with roughly half of all DC plans in our sample having more assets in passive equity products than in active. There are 5 fixed income products offered on average and 15% of plans providing more passive options than active. In contrast to equities, only 14% of DC fixed income AUM was held in passively managed products—which likely speaks to the aforementioned propensity of fixed income managers to outperform their benchmarks.

Among the 7,468 defined contribution plans in our sample, 93.7% offered a broad market cap-weighted passive equity product with AUM totaling \$796.7 billion. By contrast, 20.4% offered factor-based equity products (\$48.6 billion in AUM) of which the vast majority are “vanilla” growth and value index strategies. 17.1% of the plans in our sample offered thematic and sector-based equity products (\$8.9 billion). This segment was significantly more varied. REIT index products were the most common in this space, but thematics also abounded, including semiconductor, biotechnology, and clean energy exposure. Lastly, we note that a small fraction of our sample offered levered and/or inverse equity ETPs.

## Conclusion

We have witnessed a broad proliferation of passive investment products across retirement solutions with market cap-weighted equity offerings accruing the bulk of assets. However, we see whitespace in the growing but still nascent passive fixed income universe and across more tailored asset class exposures and solutions. For further adoption of passive investment products in retirement plans, investor education will remain a key challenge for both asset managers and index providers. Additionally, active equity and fixed income managers are facing challenges from not only passive offerings, but from liquid alternatives and private markets products; the insulation of the DC space from private capital strategies may also be coming to a close. We view competition in the retirement space as a force for good and look forward to reprising our analysis in the future, including a look at the role which passive investment products play in the insurance space.



## Get in touch

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