Morningstar's Australia Active/Passive Barometer

Skill, survival, and structure: a case for selectivity in active management

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Introduction

The Morningstar Active/Passive Barometer measures the performance of active funds against passive peers in their respective Morningstar Categories. The study spans more than 800 open-end strategies (including open-end funds and exchange-traded funds) domiciled in Australia across nine categories. The Active/Passive Barometer evaluates the efficacy of active funds against a composite of passive fund performance within the corresponding category across trailing three-, five-, and 10-year periods ending June 30, 2026. For the purposes of this study, passive funds include all index-tracking, rules-based, and nondiscretionary investment approaches, including strategic-beta strategies, some of which may embody differentiated investment views in their design.

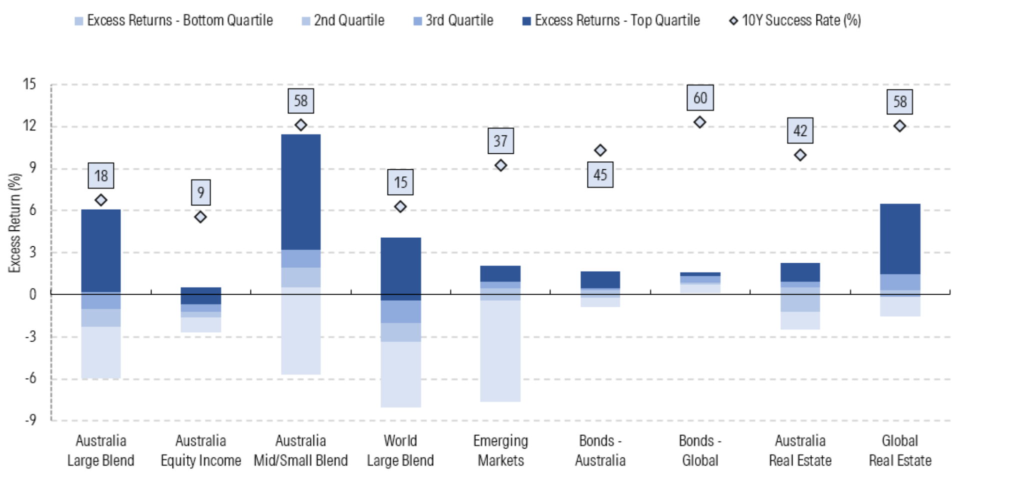
The study gauges how the average dollar invested in active funds has fared versus the average dollar in passive funds within the specified categories across various time frames.

The distribution of active funds' excess returns[1] versus their average passive peer indicates not just the odds of picking a successful manager but also the prospective payout or penalty.

Key Takeaways

- Passive strategies outperformed active peers across most segments over the past year, leading to a decline in trailing 10-year success rates[2] across much of the study. Even so, top-quartile active managers in seven of the nine categories delivered positive excess returns over the decade, demonstrating that opportunities for outperformance remain available, albeit increasingly concentrated among a select group of managers.

Exhibit 1 Active Strategy Excess Returns—Manager Selection Remains the Decisive Differentiator



Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

1, 2 Please refer to the "Approach" section on Page 2.

- Exhibit 1 demonstrates that the proportion of surviving active funds with positive excess returns may differ from the overall success rate. For example, in the emerging-markets category, more than half the surviving active strategies outperformed the passive benchmark over the trailing 10-year period, yet only 37% of active funds both survived and outperformed over the full horizon.

- Australia mid/small-blend exemplifies a category where active management has enjoyed a durable advantage across multiple market environments supported by persistent market inefficiencies. Active managers have often been able to add value through a disciplined application of basic quality and valuation filters.

- By contrast, the relative merits of active and passive investing in other categories can shift materially as market regimes evolve. The Australian and global bonds categories illustrate this dynamic well. During much of the 2010s, declining interest rates favored passive portfolios with longer-duration benchmark exposures. However, the higher-rate and more volatile environment of recent years has flipped the script.

- More recently, the equity-income category demonstrated how quickly leadership can reverse. Dividend-oriented passive strategies significantly outperformed active peers over the past year, resulting in a sharp deterioration in active manager outcomes and contributing to weaker success rates across even the longer-term evaluation periods. These examples underscore that while some active-passive outcomes are driven by enduring structural characteristics of the underlying market, others remain heavily influenced by prevailing market conditions and can change significantly over time.

- Lastly, the results reinforce that long-term success in active management requires managers to both outperform and endure. In this respect, passive strategies retain a notable advantage, consistently exhibiting higher survivorship rates than active peers.

Approach

There are two key metrics we use for determining the efficacy of active funds:

1. Excess Return: The difference between the average return of an active fund and the average return for a passive fund in a particular category over the specified period.
2. Success Rate: The percentage of active funds available at the start of a measurement period that survived and outperformed the passive composite by the end of the period.

2026 Methodology Update

Success rates now reflect both survival and outperformance of funds available at the start of the measurement period. In the previous editions, success rates were calculated only among funds that survived through the evaluation period. Consequently, success rates will generally be lower under the revised methodology and are not directly comparable with figures reported in prior years.

Results by Category

Australia Large Blend

- The Australia large-blend category remains the largest category within the study. Active managers continued to face a difficult environment, with only a minority of funds successfully outperforming passive alternatives after fees and surviving over the full measurement period.
- While the category's one-year success rate improved relative to the trailing 10-year result, longer-term outcomes remain less favorable. An important factor in the lower long-term success rate has been fund closures, as a meaningful proportion of active funds failed to survive the full period under review. This underscores the challenge active managers face not only in generating excess returns but also in delivering durable outcomes over time.

Exhibit 2 Category: Australia Large Blend

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	3.3	4.3	-0.9	36.3	93.4
3Y	8.3	10.2	-1.9	26.4	82.2
5Y	6.1	7.4	-1.3	22.9	74.3
10Y	8.2	9.1	-1.0	18.3	66.1

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

Australia Equity Income

- Despite investment mandates across the peer group sharing a common focus on income generation and dividend-paying companies, outcomes between active and passive strategies diverged sharply over the 12 months to June 2026.
- Dividend-oriented passive indexes delivered exceptionally strong returns, resulting in widespread underperformance among active managers and materially weakening success rates across multiple evaluation periods. The disparity was further amplified by a small number of severely underperforming active strategies, which weighed heavily on average category returns. The sharp divergence over the past year had a significant effect on longer-term outcomes, driving the category's 10-year success rate down from 52% as of June 2025 to 9% as of June 2026.
- The recent environment strongly favored the rules-based dividend screens employed by passive strategies, while active managers struggled to translate their broader opportunity set and portfolio flexibility into superior long-term outcomes.

Exhibit 3 Category: Australia Equity Income

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	6.3	14.3	-8.1	5.0	100.0
3Y	8.7	12.5	-3.8	10.0	90.0
5Y	6.7	9.3	-2.6	11.1	88.9
10Y	7.4	8.6	-1.3	9.1	90.9

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

Australia Mid/Small Blend

- Active managers continued to demonstrate a clear advantage within the mid/small-blend category despite facing one of their most challenging periods relative to the broad market benchmark. The segment remains conducive to active management, supported by greater pricing inefficiencies, lower levels of research coverage, and a broader investment opportunity set than that available to passive strategies tracking narrowly defined indexes.
- Low fees remain a structural advantage for passive funds, particularly in a category where some active managers levy performance-based fees. Yet, active strategies have continued to deliver meaningfully stronger outcomes over longer horizons. Although relative returns came under pressure over the past year, active managers retained a high level of success, with long-term excess returns and success rates continuing to comfortably exceed those of passive alternatives.

Exhibit 4 Category: Australia Mid/Small Blend

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	8.2	9.6	-1.4	31.7	97.0
3Y	11.9	9.8	2.1	45.6	88.9
5Y	4.7	4.2	0.5	40.7	82.6
10Y	10.4	7.1	3.3	58.1	74.4

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

World Large Blend

- The dominance of US large-cap equities continued to shape outcomes in the world large-blend category. Strong returns from a narrow group of mega-cap technology stocks created a formidable hurdle for active managers, many of whom remained underweight the market's largest winners.
- While the category's one-year success rate improved relative to longer-term historical outcomes, the average active fund still underperformed the passive composite benchmark by a considerable margin. The results highlight the ongoing difficulty of overcoming benchmark concentration risk, even during periods when macroeconomic uncertainty and market volatility might ordinarily be expected to create opportunities for active stock selection.

Exhibit 5 Category: World Large Blend

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	8.6	14.2	-5.6	35.6	93.1
3Y	12.6	16.3	-3.6	28.1	80.4
5Y	8.9	11.7	-2.8	23.2	68.8
10Y	12.1	13.5	-1.4	14.6	65.6

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

Emerging-Markets Equity

- The emerging-markets category continues to exhibit one of the widest ranges of outcomes among active managers. The breadth of the opportunity set, varying country and sector exposures, and diverse investment styles employed by managers contribute to significant performance dispersion across the peer group.

- Even as active managers maintained a respectable success rate relative to passive alternatives, average category returns were weighed down by a subset of particularly weak-performing funds. As a result, the average active fund compared less favorably with the passive benchmark than success-rate statistics alone might suggest. Performance dispersion remains a defining feature of the category, with a substantial gap separating the highest- and lowest-performing active strategies.
- Prudent manager selection remains the primary determinant of investor outcomes in this category, given the significant dispersion in performance across active strategies.

Exhibit 6 Category: Emerging-Markets Equity

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	27.5	34.1	-6.7	41.3	89.1
3Y	16.6	20.3	-3.7	30.4	76.1
5Y	6.8	8.8	-2.1	23.7	71.1
10Y	9.5	10.0	-0.5	36.7	63.3

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

Bonds—Australia

- Active fixed-income managers continue to hold an advantage in the Australia bond category, with success rates and excess returns remaining broadly supportive of active management over longer evaluation periods. The ability to actively manage duration exposure, vary allocations between government bonds and credit, and selectively allocate within corporate credit has continued to differentiate active strategies from passive alternatives.
- Active managers have generally benefited from their flexibility to adjust portfolio positioning in response to changing market conditions, while passive portfolios remain constrained by benchmark composition. However, the category has also experienced a decline in fund survivorship, with several active strategies being discontinued over the past year.
- Given the modest impact it has on category success rates, it serves as a reminder that investors face not only performance risk but also the risk of strategy closures and mergers when allocating to active strategies.

Exhibit 7 Category: Bonds—Australia

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	2.2	1.1	1.1	85.2	96.2
3Y	4.3	4.1	0.2	47.9	77.1
5Y	0.9	0.2	0.7	55.3	78.7
10Y	1.9	1.6	0.3	44.7	65.8

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

Bonds—Global

- Active managers in the global bonds category have continued to distinguish themselves from passive alternatives, with surviving funds continuing to record a 100% success rate against the passive composite over both the five- and 10-year periods. The category has been particularly supportive of active management, as managers have demonstrated skill in navigating interest rate cycles through dynamic duration positioning while enhancing returns through sector selection and selective exposure to higher-yielding credit securities.

- Although the strongest active managers have continued to deliver compelling outcomes, overall success rates remain constrained by historically low survivorship within the category. Encouragingly, survivorship trends have improved materially in recent years, resulting in a more stable active opportunity set. Nevertheless, the category highlights that successful active investing depends not only on manager skill but also on selecting strategies with the durability to remain available throughout the investment horizon.

Exhibit 8 Category: Bonds—Global

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	3.2	1.6	1.6	90.6	100.0
3Y	3.8	2.5	1.3	76.7	86.7
5Y	-0.0	-1.3	1.3	71.4	75.0
10Y	1.3	0.5	0.8	60.0	60.0

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

Australia Real Estate

- Despite the concentrated nature of the Australian real estate market, active managers have continued to face challenges in differentiating themselves from passive alternatives. While performance was heavily influenced by a small number of large index constituents, many active strategies remain relatively close to benchmark weights, limiting opportunities to generate meaningful excess returns through stock selection.
- The constrained opportunity set has contributed to a relatively narrow dispersion of returns among active funds, as only a handful of managers have been willing to take sizable active positions away from the index. Consequently, average active returns have remained heavily influenced by the performance of the largest listed REITs, reducing the scope for active management to differentiate and add value despite the apparent inefficiencies of a concentrated market.
- As in prior years, survivorship effects remain an important consideration when interpreting category statistics, with fund closures and mergers among underperforming active strategies weighing on aggregate return outcomes.

Exhibit 9 Category: Australia Real Estate

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	-2.5	-1.8	-0.7	46.2	100.0
3Y	9.7	10.6	-0.9	48.3	82.8
5Y	5.1	5.0	0.1	41.9	71.0
10Y	5.1	5.3	-0.2	42.4	63.6

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

Global Real Estate

- The global real estate category delivered a notably stronger outcome for active managers over the 12 months to June 2026, with many strategies benefiting from an expanding opportunity set and greater dispersion across property subsectors. Even as long-term success rates remain finely balanced, recent results demonstrate the potential for active managers to add value through stock selection and portfolio positioning.

- Currency management remains a critical driver of investor outcomes within the category. The appreciation of the Australian dollar against the US dollar over the past year proved beneficial for currency-hedged strategies relative to their unhedged counterparts. Given the category's mix of hedged and unhedged funds, currency movements continue to influence aggregate results and complicate direct comparisons across managers.
- Structural changes within the listed real estate universe have also created opportunities for active management. The growing importance of data centers and other specialized real estate segments has altered index composition over time, requiring active managers to assess whether benchmark weights appropriately reflect underlying fundamentals. The ability to take differentiated positions relative to these evolving market dynamics has become an increasingly important contributor to excess returns.
- Notwithstanding the influence of short-term currency fluctuations, such effects are likely to be less significant over longer investment horizons. As higher interest rates continue to reshape the operating environment for listed property securities, active managers may be well-positioned to exploit the resulting opportunities and inefficiencies, supporting the case for active management within the category.

Exhibit 10 Category: Global Real Estate

Time Period	Active Funds Average Return (%)	Passive Funds Average Return (%)	Excess Return (%)	Active Funds Success Rate (%)	Active Funds Survivorship (%)
1Y	11.3	13.3	-2.0	53.3	96.7
3Y	8.5	8.8	-0.3	41.4	96.6
5Y	2.8	2.1	0.7	41.4	89.7
10Y	4.4	3.4	1.0	57.7	84.6

Source: Morningstar Direct. Data as of June 30, 2026. Returns are calculated net of fees and annualized for periods exceeding one year.

Note

- The distribution of fund returns within a category is not always symmetrical around the calculated average performance. Consequently, return outliers can skew average results such that average excess returns may not always align with the observed success rates.
- We use "beginning-of-period" categories for each fund (that is, the categorizations that would have been used by a potential investor at the time of the investment decision). Some funds may have subsequently migrated to other categories as fund attributes change or as the classification system evolves.
- The study mitigates survivorship bias by including the applicable returns for funds that closed before the end of the period. When a fund becomes obsolete, its historical data remains in the sample. Funds that incept or are moved into the category after the start of the period are not included.

Limitations

- Across all categories, the number of passive funds is far smaller than the number of active funds. The number of passive funds with long histories is quite limited. Thus, we have capped our longest trailing period at 10 years, where we have at least three passive strategies with continuous records in each of the nine categories.
- Owing to the limitations of data availability in Australia, the return for each strategy is measured using equal-weighted returns (instead of asset-weighted returns used in some other regions) for the share classes associated with it. As a result, the presence of funds that are listed on platforms and master trusts with higher total fees and lower assets may understate returns in some cases.
- Similarly, the calculated average returns are not asset-weighted; that is, the returns for all the funds are equally weighted. It is possible that the return of smaller funds may have an outsize impact. The presence of sufficiently large sample sizes should mitigate (but not eliminate) this effect.
- The passive strategies within a category can include niche indexes that may behave quite differently from each other and from the typical category index return characteristics. The availability of investable indexes within the category is a key input in the passive composite calculations.
  For instance, there are several passive funds tracking the popular S&P/ASX 200 index in the reasonably homogeneous Australia large-blend category. However, there is no universal "equity-income" index, and the active funds composing the Australia equity-income category can be spread across the market spectrum. This can lead to a wide dispersion of returns within the category, resulting in skewed success rates, especially in the short term.

Glossary

Equal-Weighted Returns

To calculate the return figure for strategies with multiple share classes, we take the simple average of the monthly returns for each share class in the group and compound those returns over the same period. When a fund becomes obsolete, its historical data remains in the sample. Funds that incept or are moved into the category after the start of the period are not included. The currency for the return calculations is the Australian dollar.

Survivorship

To calculate survivorship, we divide the number of distinct strategies that started and ended the period in question by the total number of funds that existed at the onset of the period in question (the beginning of the trailing one-, three-, five-, and 10-year periods).

Excess Return

The excess return is the difference between the average return of an active fund and the average return for a passive fund in a particular category over the specified period. This figure includes returns for strategies that may have merged or may have become obsolete after the start of the calculation period.

A positive (negative) number indicates that an investment divided equally across the active funds in a particular category outperformed (or underperformed) an equal investment divided equally across the comparable passive funds.

Success Rate

The success rate indicates what percentage of funds that started the sample period went on to survive and generate a return in excess of the equal-weighted average passive fund return over the period. This approach differs from the convention of using a single representative index to gauge success. We do not consider the magnitude of outperformance in defining success: A fund that just barely beat the benchmark alternative counts as much as a fund that significantly outperformed.

We calculate the equal-weighted returns of all the fund's share classes to come up with a single return figure for each active fund. We then rank the funds by their composite returns, count the number that rank higher than the equal-weighted average return for the passive funds in the category, and divide that number by the number of funds at the beginning of the period (using the same number from the denominator of the survivorship calculations).

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