
The Morningstar China Active/Passive Barometer

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Executive Summary

The Morningstar China Active/Passive Barometer is an annual report that measures the performance of onshore China-domiciled active funds against their passive peers in their respective Morningstar Categories. It spans nearly 2,790 unique funds that were alive at the start of the trailing one, three, five, or 10 years ended on Dec. 31, 2023.

The China Active/Passive Barometer applies a similar methodology as Morningstar's US and European Active/Passive Barometers. It uses several unique ways to measure active managers' success:

- ▶ It evaluates active funds against a composite of actual passive funds, not versus a costless index. In this way, the "benchmark" reflects the actual net-of-fee performance of passive funds.
- ▶ It considers how the average yuan invested in various types of active funds has fared versus the average yuan in the passive composite.
- ▶ It shows the distribution of surviving active funds' excess returns versus their average passive peer to help investors understand not just the odds of picking a successful manager but also the prospective payout or penalty.

All told, the Active/Passive Barometer is a useful measuring stick that can help investors calibrate the odds of succeeding with active funds in different areas based on recent trends and long-term history.

Key Takeaways

- ▶ The Chinese stock market in 2023 has continued its downward trend, leading to further structural divergence and ongoing challenges for active managers seeking excess returns. Fifty-eight percent of active funds across the three diversified stock-heavy fund groups managed to both survive and outperform their average passive peers in 2023. This witnessed a decline of 5 percentage points compared with 2022.
- ▶ In 2023, active managers of large-cap growth funds continued to lead the charge for active managers, with 61% to 82% outperforming their average passive peers over the trailing one, three, five, and 10 years ended December 2023. Although the success rates of this group have seen a slight drop from 2022, they have generally remained stable. The one-year success rate for active small/mid-caps has shown a modest improvement, climbing to 48% from 43%, but remains on the lower side. Conversely, active large-cap blend funds have experienced a big drop in their one-year success rate, falling to 49% from 63%.

- ▶ Chinese stock-pickers continued to struggle to add value in consumer sector funds, with success rates ranging between 27% and 46% in the one-, three-, and five-year periods ended December 2023. Active health sector funds remained at the top of the list in terms of success rate among the three sector fund groups, with the one-year success rate increasing to 67% from 62%. Active funds in the technology and communications sector struggled to outpace the passive peers over the trailing one and three years, with the one-year success rate dropping to 29% from 61% in 2022 and the three-year success rate falling to 40% from 85%.
- ▶ Almost all groups of the active funds we studied have shown higher survivorship rates compared with their passive peers within their respective groups.
- ▶ The majority of active managers across all diversified stock-heavy groups have generated positive and substantial excess returns over the long run. This also holds true in health sector funds and technology and communications funds, where excess returns among surviving active managers were also high and skewed positive over the past five years.
- ▶ Except for consumer sector funds, the average yuan invested in most active funds tended to outperform the average passive peers, in particular, in the mid- and long term.

The China Active/Passive Barometer focuses on evaluating China-domiciled, actively managed stock-heavy funds, since most passive strategies lie in the equity space in China. In this study, we analyzed diversified stock-heavy funds, which are funds with at least 70% of their assets investing in equities, relative to cohorts of similar peers, grouped by their respective investment styles. Specifically, large-blend stock-heavy funds include funds in the large-blend equity and aggressive allocation–large-blend categories; large-growth stock-heavy funds include those in the large-growth equity and aggressive allocation–large-growth categories; and small/mid-cap stock-heavy funds include those in the mid-growth equity, mid-blend equity, and aggressive allocation–small/mid-cap categories. It is worth noting that funds in these style groups share similar risk/return profiles.

We also look at funds specializing in the consumer, health, and technology and communications sectors. Consumer sector funds include funds in the sector equity consumer and the sector allocation consumer categories. Health sector funds include those in the sector equity health and the sector allocation health categories. Technology and communications sector funds include those in the sector equity technology and communications and the sector allocation technology and communications categories. Similarly, sector funds in the above categories typically invest more than 70% of their net assets in equities, and these sector groups also share similar risk/return characteristics.

Results by Fund Groupings

Diversified Stock-Heavy Funds

- ▶ The Chinese A-share market's major indexes in 2023 continued to display sluggish movement, albeit less pronounced than in 2022. Value stocks performed better than growth stocks, as evidenced by the CSI 800 Relative Value Index only declining by 2.5% in 2023, while the CSI 800 Relative Growth Index recorded a decline of 16.6%. Small/mid-cap stocks exhibited more

resilience than large-cap stocks, as seen in the CSI 500 Index and CSI 1000 Index, which experienced declines of 7.4% and 6.3%, respectively, as opposed to the 11.4% decline of the CSI 300 Index, representing large-cap blue-chip stocks in China. When it comes to sectors, performance exhibited significant variation in 2023. Telecommunication, media, computer, and electronics sectors emerged as the top performers, showing strong growth in their SWS Sector Indices rising by 25.8%, 16.8%, 9.0%, and 7.3%, respectively. SWS Sector Indices for petrochemical, coal, home appliance, mechanical equipment, automobile, and textile & apparel sectors also saw increases last year, varying from 0.3% to 4.3%. However, sectors like electronic equipment, real estate, commerce & retail, and beauty & personal care didn't fare well, with declines in their SWS Sector Indices of more than 26% in 2023.

- ▶ Active large-cap blend managers in 2023 showed a diverging performance overall. Active funds that outperformed their passive peers tend to have a higher allocation to more resilient sectors, such as mechanical equipment, petrochemical, and textile & apparel. In contrast, they allocated less to lackluster sectors like electronic equipment, transportation, real estate, and food & beverage—sectors that received relatively higher weighting from underperforming active managers compared with those who outperformed. The disparity in sector allocations has resulted in a decrease in the one-year success rate, dropping to 49% from 63% in 2022. It is also important to note that three-year average returns for active and passive funds have experienced substantial decreases. This is mainly because the bullish market performance in 2020 was excluded from the statistical cycle, which is also true for the other groups.
- ▶ The success rate for large-cap growth in 2023 is 61%, dropped from 2022's 66% but still demonstrating overall stability. Most active managers continued to show their ability in making favorable sector calls throughout the year. This includes underweighting weaker sectors like electronic equipment and overweighting sectors with a relatively better track record but lower price volatility, such as automobile and mechanical equipment. Additionally, certain active fund managers also boosted the performance by adding coal investments in their portfolios.
- ▶ Active small/mid-cap managers have gone through a painful time over the past one and three years, despite their previous success over the five- and 10-year periods. Forty-eight percent of actively managed small/mid-cap funds were able to survive and outperform their passive peers in the one-year period. The performance of certain active fund managers was negatively impacted by misallocations in subsectors such as photovoltaic equipment and semiconductors. In contrast, most passive peers tracked the CSI 500 Index, benefiting from its diversified sector allocation. Additionally, certain passive funds tracking value style or dividend indexes demonstrated greater resilience in 2023.
- ▶ Active diversified stock-heavy funds continued to have higher survivorship rates relative to their passive rivals (see Exhibits 1, 3, and 5), and this is most prominent in the large-cap blend and small/mid-cap groups. The survivorship rates for active large-cap blend funds range between 82% and 96% in all the periods we studied. Meanwhile, 63% to 96% of passive peers survived during the same periods. In the case of small/mid-cap funds, the survivorship rate ranges between 94%

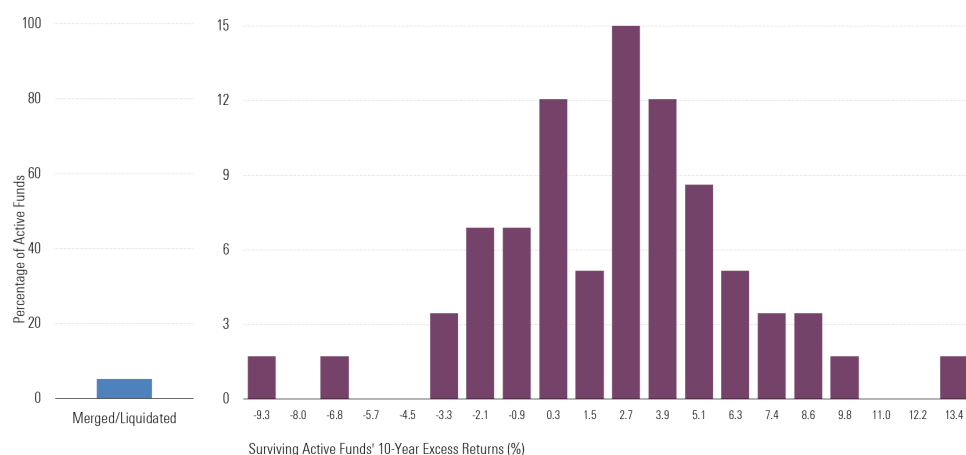
to 100%, contrasting with that of 75% to 92% for their passive peers. In an ever more competitive passive fund market with increasing product homogenization, the “survival of the fittest” is becoming more prominent. Poorly managed and underperforming products are being gradually phased out. Meanwhile, certain thematic passive funds were launched at market highs to capitalize on the hot market but were adversely affected by the market downturn and the volatile sectoral performance over the past two years, leading to a gradual decrease in size and eventual liquidation. Additionally, small and medium-size fund companies are relatively vulnerable to the intense competition and at a greater risk of their passive products being liquidated because of limited growth potential and lack of brand recognition.

- ▶ Most surviving active managers across all diversified actively managed stock-heavy groups that we examined have generated positive and significant excess returns over the past 10 years ended December 2023 (see Exhibits 2, 4, and 6). However, there were fewer funds in the small/mid-cap group with a 10-year track record.
- ▶ The average yuan in actively managed diversified stock-heavy funds has tended to outperform the average yuan invested in passively managed equity funds across large-cap blend, large-cap growth, and small/mid-cap fund groups (except for the one-year period for small/mid-cap funds). Similarly, the average active fund has tended to outperform its average passive peer.
- ▶ Investors have generally failed to choose above-average active diversified stock-heavy funds. Across the three groups in this study, aside from the one-year period for large-cap blend funds, active funds’ equal-weighted returns consistently outperformed their asset-weighted returns over the look-back periods ended December 2023.

Exhibit 1 China Large-Blend Stock-Heavy Funds (Year-End 2023)

	Active Funds		Passive Funds		Asset-Weighted Performance		Equal-Weighted Performance		Active Success Rate(%)
	#at Beginning of Period	Survivorship Rate (%)	#at Beginning of Period	Survivorship Rate (%)	Active (%)	Passive (%)	Active (%)	Passive (%)	
Trailing Total Return									
1-Year	219	96.3	213	95.8	-7.8	-9.1	-9.2	-9.6	48.9
3-Year	185	84.9	174	81.6	-4.8	-10.3	-4.3	-8.4	60.9
5-Year	165	81.8	137	70.8	10.3	3.7	12.4	6.2	72.6
10-Year	58	94.8	80	62.5	8.8	5.9	9.5	6.1	75.9

Source: Morningstar Direct. Data and calculations as of Dec. 31, 2023.

Exhibit 2 Mortality and Distribution of 10-Year Annualized Excess Returns for Surviving Active China Large-Blend Stock-Heavy Funds (%)

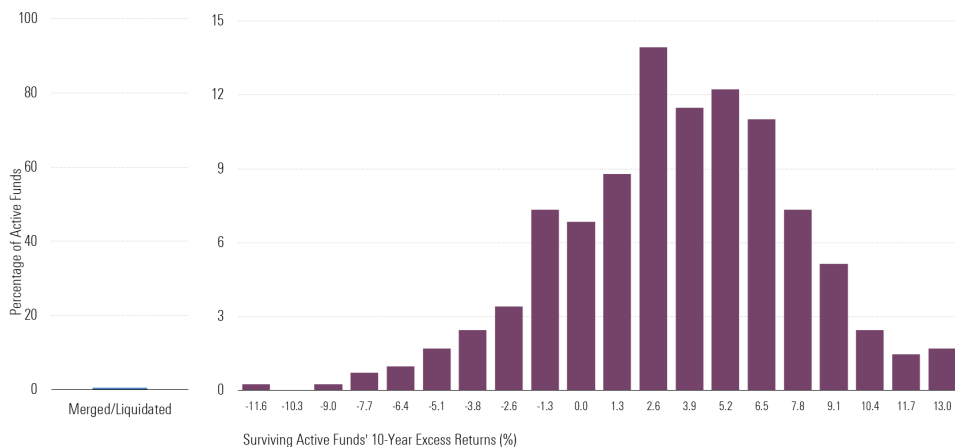
Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 3 China Large-Growth Stock-Heavy Funds (Year-End 2023)

	Active Funds		Passive Funds		Asset-Weighted Performance		Equal-Weighted Performance		Active Success Rate(%)
	#at Beginning of Period	Survivorship Rate (%)	#at Beginning of Period	Survivorship Rate (%)	Active (%)	Passive (%)	Active (%)	Passive (%)	
Trailing Total Return									
1-Year	1125	98.7	152	96.7	-16.4	-18.5	-13.9	-16.2	61.0
3-Year	1075	97.5	96	89.6	-11.1	-13.3	-9.0	-12.6	68.0
5-Year	876	98.2	61	93.4	10.6	8.3	12.8	7.9	76.9
10-Year	409	99.5	31	87.1	6.8	3.6	8.9	4.2	82.4

Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 4 Mortality and Distribution of 10-Year Annualized Excess Returns for Surviving Active China Large-Growth Stock-Heavy Funds (%)



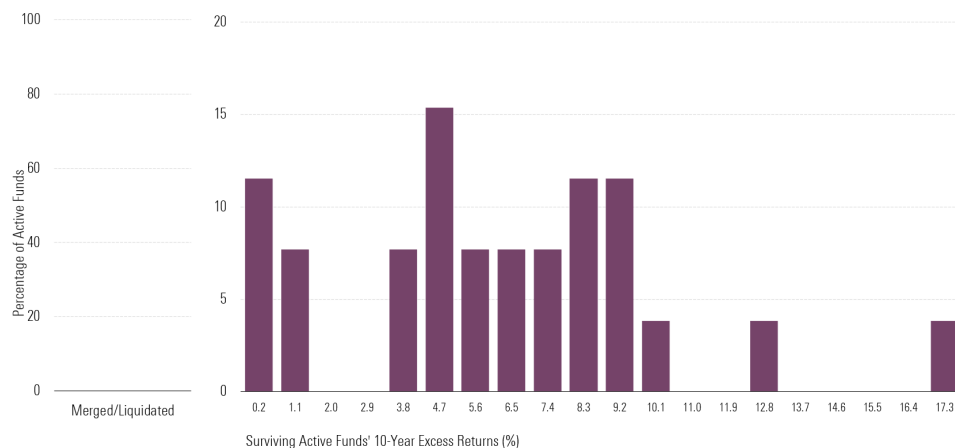
Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 5 China Small/Mid-Cap Stock-Heavy Funds (Year-End 2023)

	Active Funds		Passive Funds		Asset-Weighted Performance		Equal-Weighted Performance		Active Success Rate(%)
	#at Beginning of Period	Survivorship Rate (%)	#at Beginning of Period	Survivorship Rate (%)	Active (%)	Passive (%)	Active (%)	Passive (%)	
Trailing Total Return									
1-Year	111	98.2	92	92.4	-6.5	-5.5	-4.5	-4.5	47.7
3-Year	100	94.0	78	78.2	0.0	-3.0	0.4	-2.1	56.0
5-Year	83	95.2	47	83.0	14.3	7.4	16.5	7.8	91.6
10-Year	26	100.0	20	75.0	10.2	4.8	11.7	4.3	100.0

Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 6 Mortality and Distribution of 10-Year Annualized Excess Returns for Surviving Active China Small/Mid-Cap Stock-Heavy Funds (%)



Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 7 Year-Over-Year Success Rates (%) of China Active Stock-Heavy Funds

		2021	2022	2023
Large-Blend Funds	1-Year	66.9	63.3	48.9
	3-Year	71.9	70.0	60.9
	5-Year	69.3	74.6	72.6
	10-Year	72.5	82.7	75.9
Large-Growth Funds	1-Year	52.4	65.8	61.0
	3-Year	69.4	69.4	68.0
	5-Year	84.7	83.2	76.9
	10-Year	84.9	82.5	82.4
Small/Mid-Cap Funds	1-Year	73.0	42.9	47.7
	3-Year	94.1	87.0	56.0
	5-Year	94.9	95.5	91.6
	10-Year	88.0	90.0	100.0

Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Sector Funds

- ▶ Active managers in the consumer sector group continued to have a difficult time adding value for investors. In 2023, the performance of the SWS Beauty & Personal Care Sector Index was the worst among all the SWS Sector Indices, leading to a drag down in the performance of a few active managers because of their higher allocation to this sector. Moreover, most active fund managers have shown a preference for higher allocations in pharmaceuticals & biotechnology and light manufacturing, which limited their ability to generate excess returns. In contrast, the home appliance and automobile sectors stood out with their SWS Sector Indices, rising by 3.8% and 3.3%, respectively. This paved the way for thematic passive funds that focused on these sectors, offering relatively attractive returns.
- ▶ Actively managed health sector funds have consistently shown higher success rates compared with other sector groups (see Exhibits 8, 10, and 12). As of Dec. 31, 2023, 67% to 93% of active health sector funds survived and outperformed the average of passive funds during the periods studied, with the success rate slightly increasing over the trailing one year. In 2023, despite the ongoing downturn in health sector, the chemical pharmaceutical achieved a positive performance and was favored by active managers with extra weights. In addition to this, active managers also made a wise decision to reduce their exposure to the struggling health services subsector. Apart from the efficient allocation among subsectors, the meticulous stock selection has been instrumental in boosting the overall equal-weighted returns and success rates for active funds.
- ▶ The one-year success rate of active funds in technology and communications sector plummeted to 29% in 2023 from 61% in 2022. This decline can be partly attributed to poor decision-making by most active fund managers in terms of segmental allocations. They missed out on opportunities to generate extra excess returns in subsectors like consumer electronics, optics & photonics, and film & cinema, while making excessive investments in underperforming semiconductor and software development subsectors. On the flip side, the passive peers that track the thematic indexes, particularly those in niche themes, such as gaming, 5G connectivity, and artificial intelligence, achieved impressive returns in 2023. This can be attributed to the

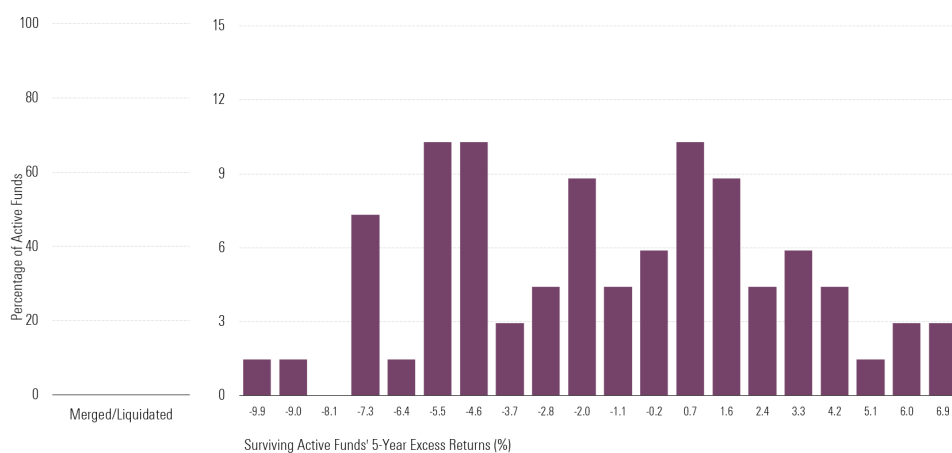
strong performance in these burgeoning fields. The passive funds in this group stood out as the only subgroup to achieve a positive equal-weighted return in the last year.

- ▶ Active funds in the consumer sector and the health sector groups had higher survivorship rates relative to their passive peers. During the one-, three-, and five-year periods ended Dec. 31, 2023, 99% to 100% of active consumer sector funds survived, while the odds of survival were 93% to 99% for their passive peers during the same periods. For actively managed health sector funds, the survivorship rates ranged between 99% to 100% for all the trailing periods we examined but 92% to 99% for passive funds in the group. The technology and communications sector's active funds exhibited survivorship rates between 94% and 99%, slightly trailing the 99% to 100% range demonstrated by passive peers. This is attributed to the liquidation of several mini active funds, which succumbed to a track record of poor performance in recent years.
- ▶ Most surviving active managers in health as well as technology and communications sector groups had delivered significant excess returns for investors over the past five years ended December 2023, and the distributions of excess returns for surviving active funds were mostly positive (see Exhibits 11 and 13). This indicates that the reward of choosing a winner tended to be greater than the performance penalty for poor manager selection. On the contrary, only 46% of active managers in the consumer sector group survived and outperformed their passive peers over the five-year trailing period ended Dec. 31, 2023, and the likelihood and performance penalty for picking an underperforming manager in this group tends to be greater than the probability and reward for finding a winner. It is worth mentioning that the three sector groups had a relatively limited number of passive funds with a track record of five years.
- ▶ For health sector funds and technology and communications sector funds, the average yuan invested in active funds mostly fared better when compared with their passive counterparts. It is noteworthy that the one-year asset-weighted return of passively managed funds in the technology and communications sector has significantly lagged the equal-weighted return for the same period. This is primarily due to the passive funds tracking the SSE STAR 50 Index, which have been adversely affected by the index's lackluster performance in 2023. This effect is further exacerbated by the considerable asset sizes of these funds. As for the consumer sector, active funds underperformed their passive peers, as observed in both equal-weighted and asset-weighted measures.
- ▶ In 2023, the China Securities Regulatory Commission led a pivotal initiative to reduce mutual fund fees across the Chinese market. Phase 1 of this was concluded by the year's end, concentrating on the reduction of management and custodian fees for active equity funds. This effort has not only elevated the net returns for investors in active funds but also stimulates a broader industry trend toward fee reduction, including within passive funds. Given that this is an industrywide initiative and the insignificant fee differences among active funds in China, our study did not examine active funds' success rates based on fee levels. ■■

Exhibit 8 China Consumer Sector Funds (Year-End 2023)

	Active Funds		Passive Funds		Asset-Weighted Performance		Equal-Weighted Performance		Active Success Rate(%)
	#at Beginning of Period	Survivorship Rate (%)	#at Beginning of Period	Survivorship Rate (%)	Active (%)	Passive (%)	Active (%)	Passive (%)	
Trailing Total Return									
1-Year	128	99.2	69	98.6	-17.6	-16.2	-15.4	-13.0	27.3
3-Year	91	98.9	26	96.2	-14.1	-10.9	-11.6	-10.5	37.4
5-Year	68	100.0	15	93.3	11.9	19.0	13.4	13.7	45.6

Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 9 Mortality and Distribution of Five-Year Annualized Excess Returns for Surviving Active China Consumer Sector Funds (%)

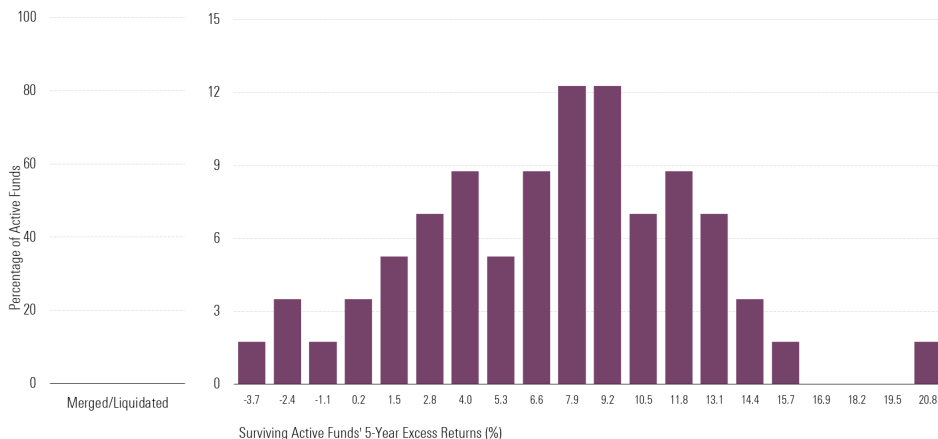
Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 10 China Health Sector Funds (Year-End 2023)

	Active Funds		Passive Funds		Asset-Weighted Performance		Equal-Weighted Performance		Active Success Rate(%)
	#at Beginning of Period	Survivorship Rate (%)	#at Beginning of Period	Survivorship Rate (%)	Active (%)	Passive (%)	Active (%)	Passive (%)	
Trailing Total Return									
1-Year	123	100.0	88	98.9	-13.7	-15.9	-9.6	-13.2	66.7
3-Year	76	98.7	32	93.8	-14.5	-17.7	-10.4	-14.0	72.4
5-Year	57	100.0	24	91.7	12.5	3.9	14.9	6.6	93.0

Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 11 Mortality and Distribution of Five-Year Annualized Excess Returns for Surviving Active China Health Sector Funds (%)



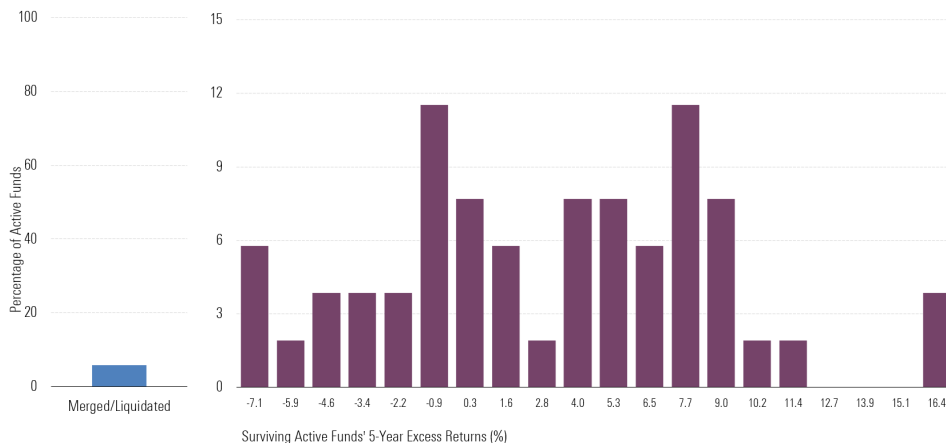
Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 12 China Technology and Communications Sector Funds (Year-End 2023)

	Active Funds		Passive Funds		Asset-Weighted Performance		Equal-Weighted Performance		Active Success Rate(%)
	#at Beginning of Period	Survivorship Rate (%)	#at Beginning of Period	Survivorship Rate (%)	Active (%)	Passive (%)	Active (%)	Passive (%)	
Trailing Total Return									
1-Year	93	98.9	184	98.9	-5.9	-4.1	-2.8	3.7	29.0
3-Year	70	97.1	71	100.0	-10.6	-10.7	-7.6	-7.2	40.0
5-Year	52	94.2	29	100.0	10.8	9.7	13.6	9.4	69.2

Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 13 Mortality and Distribution of Five-Year Annualized Excess Returns for Surviving Active China Technology and Communications Sector Funds (%)



Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Exhibit 14 Year-Over-Year Success Rates (%) of China Active Sector Funds

		2021	2022	2023
Consumer Sector Funds	1-Year	44.9	35.9	27.3
	3-Year	58.6	27.8	37.4
	5-Year	36.8	52.0	45.6
Health Sector Funds	1-Year	83.3	61.8	66.7
	3-Year	94.8	90.8	72.4
	5-Year	94.9	98.0	93.0
Technology and Communications Sector Funds	1-Year	51.6	61.4	29.0
	3-Year	88.0	84.6	40.0
	5-Year	93.8	88.9	69.2

Source: Morningstar Direct. Data and Calculations as of Dec. 31, 2023.

Appendix—Methodology

Data Source

Morningstar's China open-end and exchange-traded funds database.

Universe

All ETFs and open-end mutual funds (excluding funds of funds and money market funds) in each Morningstar Category that existed at the beginning of the relevant period (including funds that did not survive to the end of the period) defined the eligible universe. To be included, a fund's inception date must precede the start of the period and the obsolete date cannot predate the start of the period. In addition, each must have asset data for at least one share class in the quarter prior to the start of the sample period (the beginning of the trailing one-, three-, five-, or 10-year period) to facilitate asset-weighting.

Survivorship

To calculate survivorship, we divide the number of distinct funds (based on unique fund ID at the beginning of the period) 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-, or 10-year period). We treated a China onshore-fund's transformation with a significant strategy change as a liquidation, since such funds will not track the prior performance record and will adopt a whole new strategy. In this case, fund transformation date will be regarded as the end date of this fund.

Asset-Weighted Returns

We calculate the asset-weighted returns for each cohort using each share class' quarterly assets and returns since funds' assets are disclosed quarterly in China. When a fund becomes obsolete, its historical data remains in the sample. Funds that incept or migrate into the category after the start of the period are not included.

Equal-Weighted Returns

To come up with a single return figure for funds with multiple share classes, we first calculate the asset-weighted average of all the fund's share classes. We then take the simple equal-weighted average of the quarterly returns for each fund in the group and compound those returns over the sample period. As before, 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.

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 magnitude of outperformance in defining success—a fund that just barely beat the passive alternative counts as much as a fund that significantly outperformed.

As in the equal-weighted return calculation, we calculate the asset-weighted average of all the fund's share classes to come up with a single return figure for funds with multiple share classes. 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).

Excess Returns

We measure surviving active funds' excess returns relative to the equal-weighted average passive fund return in each group.

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