

The compelling case for including active fixed income in defined contribution plans

Defined contribution (DC) plans continue to play a vital role in helping participants achieve their retirement income goals. By designing an investment menu aligned with participants' demographics, experience, and financial needs, plan sponsors can provide the right solutions, or portfolio building blocks, to give participants their best opportunity for long-term investment success. While equities tend to get plenty of attention given their potential to generate long-term growth, plan sponsors should also give due consideration to fixed income to ensure they are effectively addressing the unique needs of participants.

Fixed income is a powerful tool for managing overall portfolio risk, providing diversification benefits, and helping to cushion the impact of more volatile assets like equities. Investors may also turn to bonds for their reliable income stream generated through regular interest payments. In DC plan lineups, fixed income is often a key component of target-date funds (TDFs) and other balanced strategies.

Many plans also offer participants broad-based fixed income options, including the individual funds that help make up TDFs. Additionally, some offer fixed income selections in a supplemental tier, catering to participants seeking targeted exposure to specific investment styles, sectors, or risk profiles—for example, core-plus strategies, which incorporate segments of the fixed income market like high-yield bonds.



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Fixed income has become the largest global asset class by market capitalization, totaling more than \$145 trillion in 2024—nearly 15% larger than the \$127 trillion global equity market.¹ Over time, the fixed income market has not only grown in size but also matured, with notable improvements in credit quality, increased liquidity, reduced trading costs, and advancements in trading technology. These enhancements have widened the investable bond universe, enabling more cost-efficient and tailored solutions for participants.

At the same time, demographic shifts—such as an aging workforce and participants working longer than in the past—are increasing the relevance of fixed income. According to a recent research report, a record number of Americans are expected to reach the traditional retirement age of 65 in 2025.² As individuals approach retirement or extend their careers, their allocation to fixed income generally rises, underscoring its growing importance as part of a well-devised retirement plan.

The case for active fixed income

The case for active versus passive management has long been a topic of debate within the financial industry. When constructing a plan lineup, sponsors should thoughtfully evaluate the costs, benefits, and risks of each approach while being mindful of their fiduciary duties. Although low-cost index strategies remain widespread in DC plans, fixed income stands out as a particularly compelling area for active management, presenting opportunities to deliver additional value for those investors comfortable with active risk.³ In fact, we have seen active fixed income gain traction over the years and overtake passive assets in DC plans, making up more than half of the DC fixed income market as of 2024.⁴

This trend, however, does not extend to TDFs, which continue to be constructed primarily with passive strategies. This is largely because TDFs are designed for a broad participant base, where actionable personal data about the underlying

investor is limited. Across the mutual fund industry, the vast majority of fixed income cash flows have been directed toward broad-based Morningstar categories such as Intermediate Core, Intermediate Core-Plus, and Multisector Bond, with a preference for actively managed products.

In this space, skilled managers may be able to justify higher fees by capitalizing on opportunities arising from shifting interest rate and credit conditions—potentially delivering returns that exceed benchmark performance. Plan sponsors offering only passive fixed income options might consider active managers' ability to use their skills in duration and yield-curve positioning, as well as security selection, to potentially add value over the index. Some managers may also have the flexibility to explore opportunities across additional bond-market sectors, positioning the portfolio for any given market environment.

Moreover, bond markets are deeper, more complex, and less efficient than stock markets, and the economic interests of fixed income investors are generally more diverse than those who invest in equities (that is, mainly for capital appreciation). In the fixed income marketplace, for example, there are traditional investors who use bonds largely for capital preservation and income, institutional investors such as pension funds and insurance companies that are investing against a future liability stream, and central banks that use fixed income primarily to implement monetary policy. Together, these demand imbalances create a favorable opportunity set for active managers.

Over the past 20 years, the majority of actively managed fixed income funds have regularly outperformed their primary benchmarks on a rolling three-year basis, as illustrated in **Figure 1**. In comparison, active equity managers have generally struggled, with the majority underperforming their primary benchmarks over recent periods.

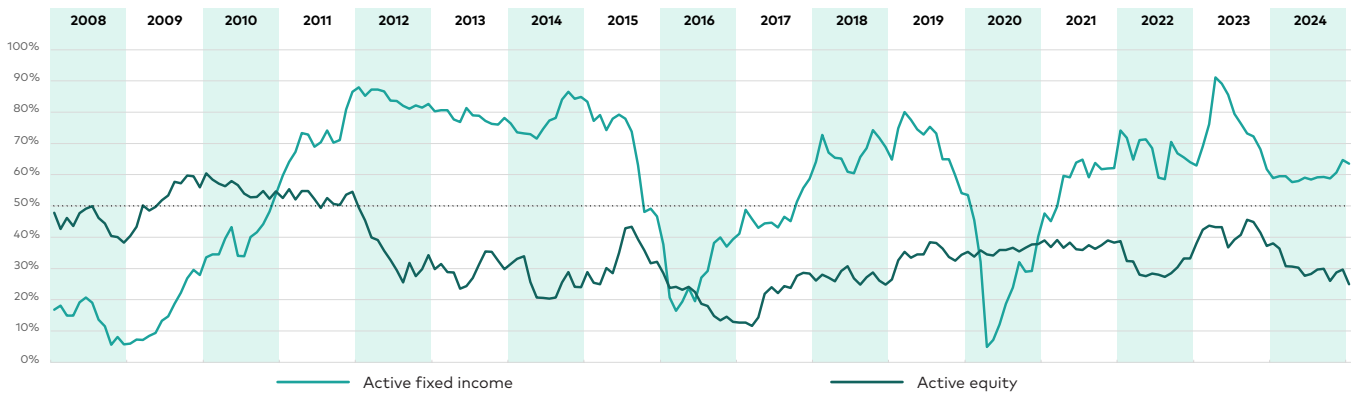
¹ [2025 Capital Markets Fact Book](#). SIFMA, July 2025.

² [Alliance for Lifetime Income Retirement Income Institute](#), 2025.

³ All investing is subject to risk. Index fund investing seeks to track a benchmark and thus provide relative-performance predictability compared with that of active fund investing regarding the expected return of the benchmark. The benchmark's realized positive and negative returns represent the risk of the market segment (systematic risk). Active fund investing's goal of outperforming a stated benchmark implies greater variability of realized returns around those of the benchmark and results in active (idiosyncratic) risk that should be accounted for alongside market (systematic) risk in any fund or portfolio risk assessment.

⁴ Vanguard calculations, using data from *Pensions & Investments*, as of December 2024.

FIGURE 1. Active fixed income funds have a solid record of outperforming their benchmarks
Percentage of active funds outperforming their primary benchmark over rolling 3-year periods

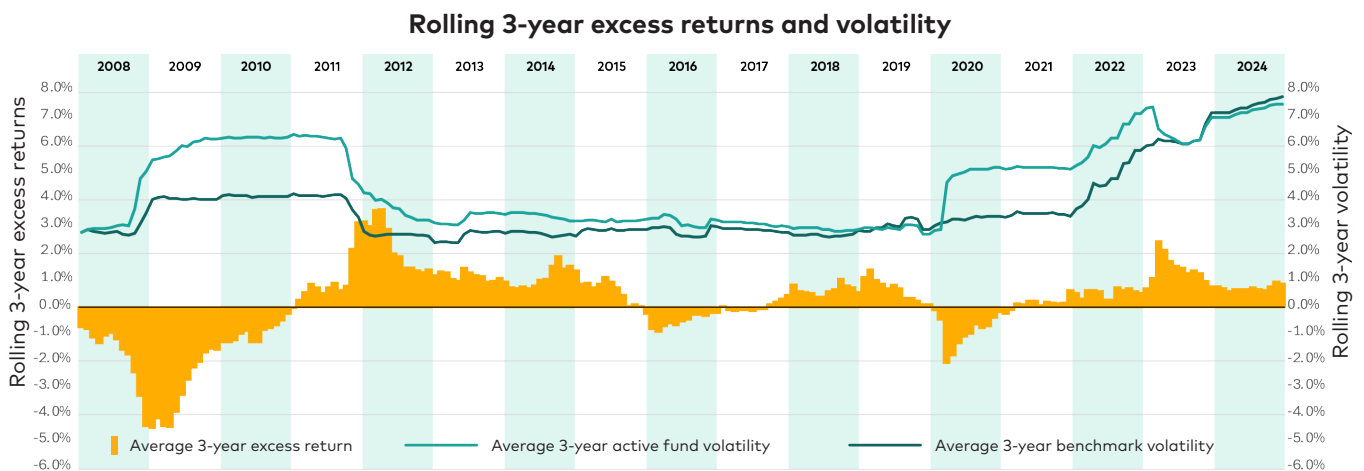


Notes: This chart displays the percentage of active fixed income funds and active equity funds with annualized total returns in excess of their primary prospectus benchmark over rolling three-year horizons for the 20-year period starting January 1, 2005, and ending December 31, 2024. A fund's prospectus benchmark may not fully reflect the fund's current investment strategy or risk profile and may be selected for reasons that differ from the fund's actual objectives. All returns are in U.S. dollars. See the Appendix for fund inclusion criteria. **Past performance is no guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.**

Sources: Vanguard calculations, based on data from Morningstar.

Additionally, the active fixed income funds included in our analysis have frequently generated positive excess returns relative to their benchmark while simultaneously maintaining a risk profile resembling that of the broad U.S. bond market (**Figure 2**). In other words, with the right manager, active bond investors may be able to generate higher returns than those offered by the benchmark or comparable index funds while assuming a level of volatility similar to that of the respective benchmark. Although periods of underperformance are inevitable for active fixed income strategies, the magnitude of such underperformance has historically been less than that of active equity funds, highlighting the comparatively lower return volatility in fixed income markets.⁵

FIGURE 2. Active bond funds have delivered excess returns with risk similar to that of the broad bond market



Notes: This chart displays the annualized excess returns of active fixed income funds relative to their primary prospectus benchmark, as well as their total return volatility as measured by standard deviation, over rolling three-year horizons for the 20-year period starting January 1, 2005, and ending December 31, 2024. A fund's prospectus benchmark may not fully reflect the fund's current investment strategy or risk profile and may be selected for reasons that differ from the fund's actual objectives. Broad U.S. bond market volatility is represented by the Bloomberg U.S. Aggregate Bond Index. All returns are in U.S. dollars. See the Appendix for fund inclusion criteria. **Past performance is no guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.**

Sources: Vanguard calculations, based on data from Morningstar.

Active fixed income at Vanguard

Today, Vanguard manages \$2.5 trillion in fixed income assets—a figure that may not surprise many investors.⁶ What might, however, is that more than \$1 trillion of those assets are actively managed.⁷ Our approach to active fixed income, backed by 40-plus years of experience, is centered on our team, process, and unique client ownership structure.⁸ Our team is composed of more than 200 experts worldwide who specialize in all publicly traded fixed income sectors. This breadth and depth allow us to mine for the best ideas, share them across the full franchise, and determine which of those ideas are best for each fund.

While our philosophy has been in place for many years, before the 2008 global financial crisis, Vanguard's Fixed Income Group focused on the high-quality, segmented portions of the fixed income market—reflecting our core expertise and the needs of many of our investors at the time. Over the last 10 to 15 years, however, fixed income markets and investor preferences have evolved. Recognizing the need to compete and establish ourselves as a world-class fixed income manager, we evolved as well.

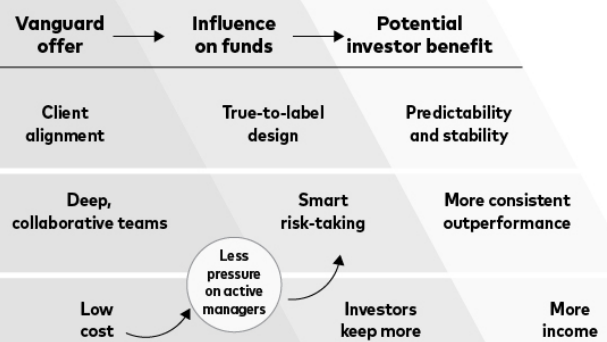
Over the last decade, we have made substantial investments in talent, not only developing internal capabilities but also, perhaps more importantly, bringing in external expertise. This has enabled us to build out teams across structured products, high-yield bonds, emerging markets, global credit, and rates and allowed us to expand our focus and enhance the diversity of our offerings, including the categories of core, core-plus, and multisector income. These strategies leverage our emerging markets, global credit, and U.S. high-yield capabilities and are widely used across the DC landscape.

As an active manager, the Fixed Income Group takes responsibility for driving excess returns across all market cycles, but we can deploy that risk more judiciously and leverage our expense-ratio advantage when needed. In other words, we won't take undue risk in pursuit of higher returns to compensate for fees. Managers of higher-priced products are forced to run portfolios with

higher tracking error on a more consistent basis to be able to make up those fees even if that is an inefficient allocation of risk.

Additionally, our funds stay true to their objective, seeking long-term outperformance while behaving like the asset classes they represent—with similar risk profiles. So clients know what to expect for the funds' performance across varying market environments. Deploying a diversified set of strategies across these products provides the team with more opportunities to generate outperformance while maintaining strong risk-adjusted returns.

The Vanguard active fixed income story



We've been managing active fixed income for more than 40 years. With \$2.5 trillion in fixed income assets under management (as of December 31, 2024), we're one of the world's largest fixed income managers. Vanguard's mutual, investor-owned* structure allows us to pass along economies of scale, which helps us offer some of the most competitive fees around.

Our investment decision-making process is built on team collaboration to reduce sector biases and optimize portfolio exposures. Macro analysis is essential to the process, but we focus on adding value through a diverse set of repeatable and scalable strategies rather than relying on concentrated risk positions. Such strategies include a focus on security selection and sector allocation, with less emphasis on macro calls and outright duration bets.

*Vanguard is owned by its funds, which are owned by Vanguard's fund shareholder clients.

⁶ As of December 31, 2024.

⁷ As of December 31, 2024.

⁸ Vanguard is owned by its funds, which are owned by Vanguard's fund shareholder clients.

Conclusion

Plan sponsors should thoughtfully consider the evolving role of fixed income within a plan lineup, particularly in light of shifting bond market dynamics and changing participant demographics. While both passive and active strategies are widely leveraged across the DC landscape, active bond funds have steadily attracted assets over the years and may offer an edge over passive strategies due to the structural characteristics of fixed income markets. Historically, active bond funds have demonstrated a strong record of benchmark outperformance while maintaining a risk profile comparable to that of the broader bond market.

Vanguard has expanded its own active fixed income capabilities over time, with teams leveraging their expertise across a broad range of strategies, providing investors with diversified exposure across market sectors and credit qualities. In an upcoming research note, we will take a closer look at two of these sectors—emerging markets bonds and U.S. high-yield corporate—which are key components of our product suite and can play a meaningful role in investor portfolios.

Appendix

Fund inclusion criteria

For the performance analyses discussed in this paper, open-end and exchange-traded funds are included if they are available for sale in the United States, report sufficient data, and are classified by Morningstar in the following categories:

U.S. fixed income fund categories	U.S. equity fund categories
Intermediate Core Bond	Large Blend
Intermediate Core-Plus Bond	Large Growth
Multisector Bond	Large Value
	Mid-Cap Blend
	Mid-Cap Growth
	Mid-Cap Value
	Small Blend
	Small Growth
	Small Value

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Important information

For more information about Vanguard funds, visit vanguard.com to obtain a prospectus or, if available, a summary prospectus. Investment objectives, risks, charges, expenses, and other important information are contained in the prospectus; read and consider it carefully before investing.

Diversification does not ensure a profit or protect against a loss. Investments in target-date funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the workforce. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in target-date funds is not guaranteed at any time, including on or after the target date.

Bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments.

High-yield bonds generally have medium- and lower-range credit quality ratings and are therefore subject to a higher level of credit risk than bonds with higher credit quality ratings.

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All investing is subject to risk, including the possible loss of the money you invest. There is no guarantee that any particular asset allocation or mix of funds will meet your investment objectives or provide you with a given level of income.

The Vanguard logo consists of the word "Vanguard" in a bold, red, serif font. The letter "V" is significantly larger and more prominent than the other letters.

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