

Making the Most of Active Fixed-Income ETFs

Actively managed fixed-income ETFs offer many potential advantages for portfolio construction.



What You Need To Know

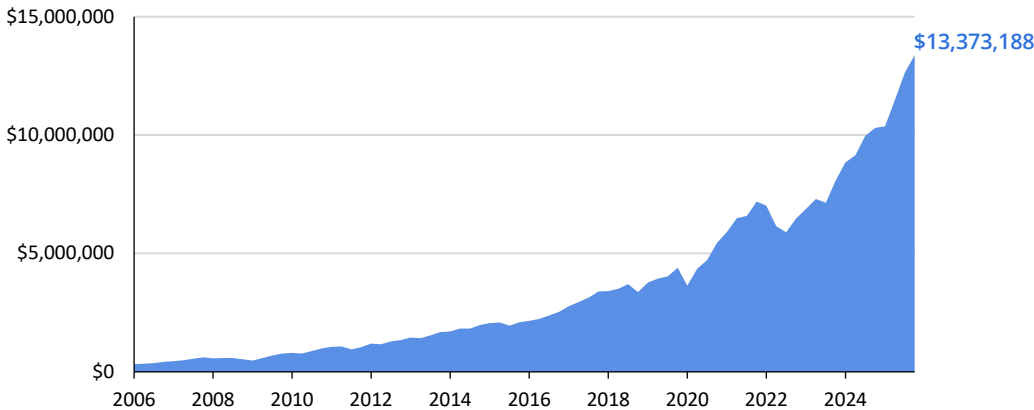
- Active fixed-income ETFs blend flexibility and versatility, combining active management with ETF transparency, liquidity, and potential tax efficiencies.
- Higher yields, increased volatility, and greater dispersion¹ across sectors may create more opportunities for active bond fund strategies as skilled fund managers seek to add value beyond what passive index tracking can capture.
- ETFs that passively track bond indices may leave meaningful gaps in portfolios, often excluding sectors such as high yield, municipal bonds, and asset-backed securities—allowing active fund managers to invest more broadly and potentially capitalize on mispricings or credit opportunities.
- Investors can deploy active fixed-income ETFs in multiple ways, including core/satellite portfolio construction, strategic model allocations, and tactical tilts (please see page 4 for additional information about these methods).
- ETFs are expected to continue their expansion into additional areas where active management has potential advantages—driven by innovation, increasing adoption in model portfolios, and emerging trends.

In a market that changes so much from day to day, it's easy to forget the bigger picture of how far we've come in terms of investment choices. In the past 30 years, ETFs have gone from being mostly passive vehicles tracking an index to an expansion into a wide variety of both active and passive strategies covering large swaths of the global markets. At the same time, the bond market has expanded and evolved, becoming increasingly global in nature and moving toward electronic and algorithmic trading. In this paper, we'll discuss how active fixed-income ETFs can help with navigating the current market environment, as well as some of the many ways to use these ETFs in investor portfolios.

Changing the Game

The proliferation of ETFs over the past few decades has been a game-changer for portfolio construction. Being able to view an ETF's daily holdings provides investors with precise information on what underlying investments look like. Continuous trading throughout the day on an exchange offers transparent pricing that reflects the value of the ETF's holdings in real time. With no minimum investment required, ETFs allow investors to fine-tune their portfolios and make tactical adjustments to underlying investments as market conditions and investment outlooks evolve. Finally, ETFs' in-kind creation and redemption mechanisms can reduce the amount of capital gains paid by investors, offering the potential for tax efficiencies that often don't exist for other investment vehicles. As ETFs have expanded to cover broad areas of the global markets, investors have gained more flexibility in what strategies they can access for their portfolios—and how they might seek attractive returns. As a result, ETFs have witnessed immense growth over the past 20 years.

FIGURE 1
ETF Total Assets (in millions)



As of 9/30/25. Data Source: Federal Reserve Bank of St. Louis, 6/26.

Why Active Fixed Income ETFs – And Why Now?

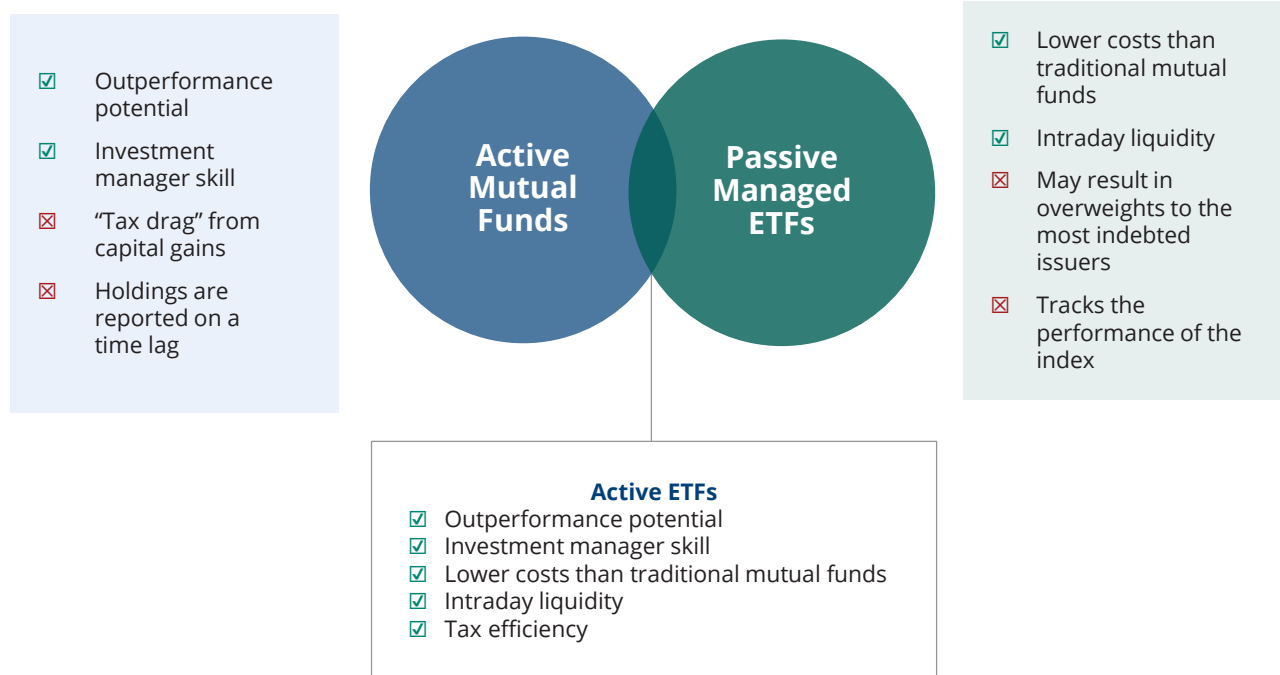
The past decade has been full of innovation and technological change, and nowhere more than in the fixed-income markets. Among the major changes that we've witnessed over the past several years:

- **Bonds are no longer boring.** Gone are the days when bonds were the yawn-inducing part of an investor's portfolio. US Federal Reserve (Fed) rate hikes in 2022 and ensuing geopolitical pressures have sparked a rise in volatility across markets while creating more dispersion among fixed-income market segments.
- **Yield has become a larger part of bond-fund returns.** Bond yields have continued to sit above their long-term averages, increasing the opportunity for bond investors to generate healthy returns from their investments.
- **Electronic trading is faster and more widespread.** Where bond purchases and sales used to be completed almost entirely through phone calls and broker-dealer relationships, the rise of electronic trading systems have allowed many of these trades to occur in a matter of seconds.

At the same time, financial professionals are looking for ways to adapt their business to an increasingly savvy clientele. Tending to a growing practice involves keeping up with the latest market trends and newest products, managing portfolios to meet clients' individual needs, scaling the business to appeal to newer clients, and servicing established relationships.

Actively managed fixed-income ETFs allow a financial professional to respond to the fast-paced bond markets in a way that potentially benefits their clients. They can fill a gap between traditional active mutual funds and passive ETFs by offering competitively priced, actively managed strategies in a tax-efficient structure.

FIGURE 2



Understanding the Potential Advantages of Active Fixed Income

Some investors may question why they need active management within a fixed-income portfolio when there are so many passive strategies available. A closer look at the bond market reveals an inherently complex structure that's difficult to capture fully by simply mimicking an index.

For example, the Bloomberg US Aggregate Bond Index² is known as a broad proxy for the US bond market, but the Index primarily includes Treasuries, corporate bonds, and mortgage-backed securities that have fixed rates and are rated investment-grade. Asset-backed securities, floating-rate notes, high yield, and municipal bonds are often left out entirely—and so are the opportunities that they present for return potential.

Active bond fund managers have more flexibility to invest beyond the index and seek additional value in the bond markets. If a bond is downgraded from investment grade, a passive core-bond strategy would need to sell the holding immediately, while a manager of an active bond strategy may choose to keep this bond as a portfolio holding if their research shows that the issuer is still creditworthy.

It's important to note that actively managed bond strategies are only as good as the knowledge and expertise behind them. Financial professionals must make sure that they select active bond strategies with adequate resources for research and execution, which can make a difference as the market changes.

Use Cases For Investors

There are an endless number of ways in which ETFs can be used in portfolios. Here are a few of the more common use cases:

Use Case #1: Core/Satellite Approach

A core-satellite approach to portfolio management involves investing the majority of assets in broad asset classes at a low cost, while using more specialized "satellite" investments to increase the potential for excess return³ by expressing particular investment views (ex: growth vs. value or preferences for certain asset classes or sectors), emphasizing certain trends such as AI automation, or enhancing diversification through allocations to commodities or real assets. Investors have an entire universe of ETFs to choose from—including broad asset-class coverage for a core portfolio and specialized areas of focus for the satellite portfolio—and can select a variety of investments while helping keep costs reasonable for their clients.

ETFs can also complement mutual funds or separately managed accounts⁴ (SMAs) in a model portfolio, offering a cost-effective allocation to specialized segments while maintaining an existing core allocation of mutual funds or SMAs. ETFs' lower minimum requirements can make it easier to introduce a new, smaller allocation to a satellite strategy or asset class.

Use Case #2: Strategic Asset Allocation in Model Portfolios

Adoption of model portfolios has gained momentum as today's financial professionals strive to balance winning new business with nurturing existing client relationships and managing investment portfolios. Model portfolios offer investors a diversified portfolio within a single account; additionally, they can help financial professionals streamline investment decision-making and allow for ongoing portfolio management and monitoring.

Over time, model portfolios have undergone rapid transformation, expanding from a selection of mutual funds to a hybrid of mutual funds and ETFs. As ETFs have expanded their reach into specialized strategies and asset classes, ETF-only model portfolios have gained in popularity and usage. Financial professionals are now able to use ETFs to cover a wider variety of asset classes within their model-portfolio allocations.

Use Case #3: Tactical Adjustments in Model Portfolios

In many cases, an investor may want to make a finer adjustment to a portfolio's asset allocation in order to express a specific viewpoint and potentially generate excess returns. Think of it as a painter using a broad brush to paint the sky and background, and then using a small brush to add details within the landscape. With so many ETF strategies to choose from, investors can quickly make these changes to enhance the long-term strategic asset allocation that's already in place. Retail investors benefit from these active, customized viewpoints while taking advantage of ETFs' lower costs and efficiencies.

What's on the Horizon for ETFs

ETFs have sparked many changes in the investment industry, and there may be even more to come in the years ahead. ETFs are predicted to continue their path of rapid growth, with assets under management more than doubling to \$25 trillion by 2030, according to Citigroup.⁵ Active ETF strategies are expected to drive a large portion of that growth due to their flexibility and cost-effectiveness.



Active bond fund managers have the flexibility to invest beyond the index and seek additional value.

ETF strategies will likely continue to expand into more complex and esoteric areas of the market, as outcome- and derivatives-based strategies become more widespread. Areas of expected growth for ETF strategies include private credit, private equity, and other alternative investment strategies.

Finally, tokenization⁶ is transforming how investments are made, as more investors look at how to invest their digital assets (such as cryptocurrency) in seamless ways, as opposed to converting digital currency into fiat currency before making an investment. ETFs may establish digital clones for this purpose, or they may become on-chain ETFs that operate exclusively on blockchain networks. Technology and regulatory developments should be observed closely as these trends edge nearer to viability.

Questions to Ask

It can be overwhelming when evaluating the vast expanse of active fixed-income ETFs offered today. Here are some questions investors may want to ask as they assess different strategies for suitability and fit:

- Where is active management expected to add the most value in the current bond-market environment?
- What specific role is this ETF designed to play in a portfolio (core, income enhancer, diversifier, opportunistic)?
- How does this ETF complement other components of the portfolio, such as traditional mutual funds or passive ETFs?
- What decisions does the ETF's manager actively control (sector allocation, duration⁷, credit quality, security selection) and what's their core expertise?
- Is the strategy opportunistic or benchmark-aware?
- What are the primary sources of risk (ex: credit, duration, liquidity)?
- Does the ETF focus on income generation alone or does it aim for total return, encompassing both price appreciation and income generation?
- Are there tax considerations that make certain strategies more attractive for certain investors?

In today's market, active fixed-income ETFs can help investors access a broader variety of investment choices. At the same time, ETFs can be used by financial professionals to help grow their businesses and serve their clients as they handle an unprecedented amount of information and an ever-evolving market environment. Active fixed-income ETFs help deliver the expertise of a skilled manager in an affordable and tax-efficient way, providing benefits for both financial professionals and their clients as they invest for the future.



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¹ Dispersion measures the variation of returns within a group of assets.

² The Bloomberg US Aggregate Bond Index is composed of securities that covers the US investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. Indices are unmanaged and not available for direct investment.

³ Excess return is return generated by an investment strategy that exceeds the return of the strategy's benchmark.

⁴ A separately managed account is a portfolio of securities owned by a single client that is professionally managed separately from other portfolios.

⁵ Citigroup, "Sizing the ETF Opportunity: Active ETFs Move to Center Stage," April 10, 2026.

⁶ Tokenization refers to the process of converting ownership of assets into digital tokens using blockchain technology.

⁷ Duration is a measure of the sensitivity of an investment's price to nominal interest-rate movement.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. •

Investments in high-yield ("junk") bonds are considered speculative, involve heightened credit risk and greater risk of price volatility, illiquidity, and default than investment grade bonds. • Municipal securities may be adversely impacted by state/local, political, economic, or market conditions. Investors may be subject to the federal alternative minimum tax as well as state and local income taxes. Capital gains, if any, are taxable. • Mortgage-related and asset-backed securities' risks include credit, interest-rate, prepayment, and extension risk. • Foreign investments may be more volatile and less liquid than US investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. • Different investment styles may go in and out of favor, which may cause a fund to underperform the broader stock market.

Investors should carefully consider a fund's investment objectives, risks, charges, and expenses. This and other important information is contained in a fund's full prospectus and summary prospectus, which can be obtained by visiting hartfordfunds.com. Please read it carefully before investing.

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