T. Rowe Price

How to redeploy cash using actively managed ETFs

From the Field
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Key Insights

- There are three main types of exchange-traded funds (ETFs): Passive ETFs provide exposure to a market by replicating an index; factor or smart beta ETFs provide factor exposure by replicating a rules-based index, such as low volatility; and recently, active ETFs employ a portfolio manager who actively makes buy and sell decisions seeking to outperform a benchmark.
- Active ETFs are the fastest-growing type of ETF, and advisors increasingly are embracing them in their model portfolios.
- There are many ways to redeploy cash using T. Rowe Price active ETFs in the current market.

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Exchange-traded funds (ETFs), which were first launched in the U.S. in the 1990s and were mainly concentrated on tracking stock indices such as the S&P 500. Offering an attractive combination of decreased cost, increased tax efficiency, and greater convenience over many other traditional investment options, ETFs have proliferated and are now available across fixed income, commodities, and even cryptocurrency. As of June 30, 2024, investors held approximately USD 8.7 trillion in ETF assets spread across three distinct categories:

Passive

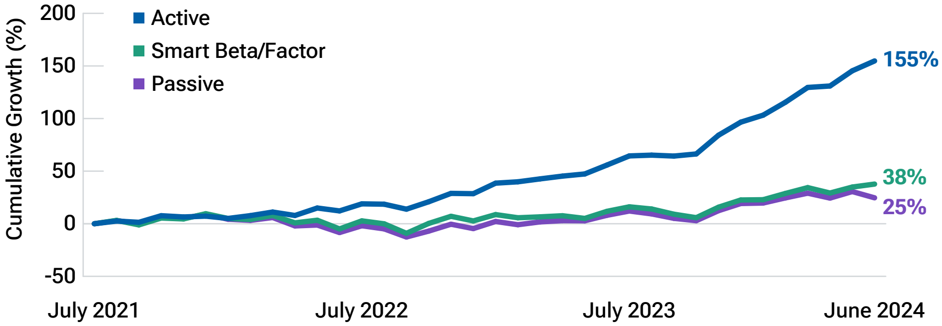
Passive ETFs typically track a market-capitalization-weighted index that seeks to duplicate the returns of a stated benchmark, less fees and expenses. These ETFs provide exposure to a particular market or segment of a market. Depending on the benchmark, they may provide diversification in a single holding. For example, an S&P 500 Index ETF would provide broad diversification across equities. On the other hand, a financials sector ETF could seek diversification specifically within the financials sector but would not offer broad market diversification.

Smart beta/factor

Smart beta or factor ETFs use rules-based indexes to gain exposure to certain factors, such as low volatility or momentum. Typically, these are single-factor ETFs, and, as a result, the diversification and performance of these ETFs may vary considerably as the specific factor's performance impacts results. For example, a low-volatility ETF may have fewer diversification benefits than a market cap ETF as all holdings share the same low volatility factor. These strategies may underperform for a time if the market favors another factor—quality, for example. Finally, factor ETFs are typically more expensive than passive ETFs.

ETF assets have shown robust growth over recent years, with active ETFs leading the way

(Fig. 1) ETF net asset growth by strategy type, July 31, 2021, to June 30, 2024



Source: Morningstar. Please see Additional Disclosure for more information.

Active

More recently, active ETFs have entered the marketplace. Active ETFs employ a portfolio manager who makes buy and sell decisions, actively constructing a portfolio in pursuit of benchmark outperformance. This outperformance could be based on performance or another metric, such as lower risk or better risk-adjusted returns. Fees are typically higher than passive ETFs but tend to remain attractive versus other investment vehicles.

Active ETFs show the fastest growth in a changing ETF landscape

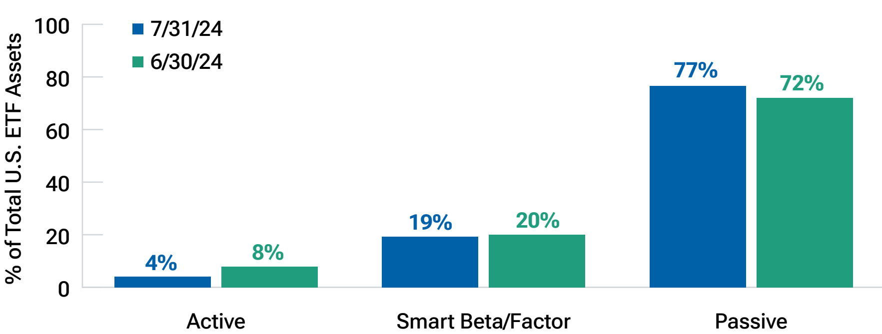
Looking at net asset growth rates in Figure 1, active ETFs grew at an impressive 155% from July 2021 through June 2024, followed by smart beta/factor ETFs (38%). Passive ETFs grew at a slower pace over the period (25%), although this slower growth rate was from a much larger asset base. Figure 2 shows the change in ETF assets by type over the same time period, suggesting that active ETFs took share from passive ETFs rather than from smart beta/factor.

More investment advisors are embracing active ETFs

In Figure 3, we looked at models in our proprietary client database of investment advisors. From June 2021 through June 2024, the chance of active ETFs being used grew from 15% to 36%, and smart beta/factor ETFs increased from 44% to 57%. Over the same period, the use of passive ETFs also grew, but at a lesser rate.

Active ETFs are taking market share from passive ETF offerings

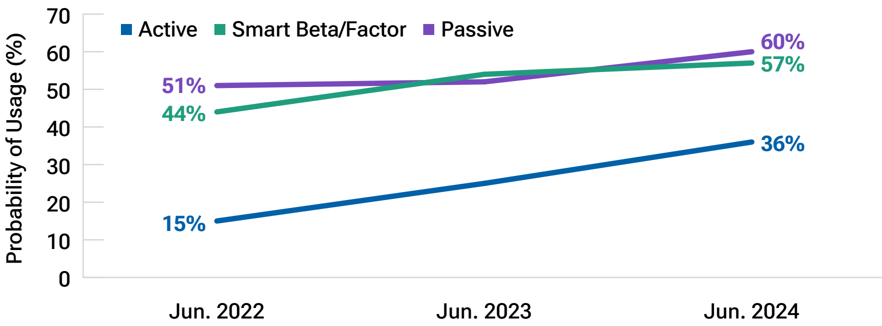
(Fig. 2) Percentage of total U.S.-domiciled ETF assets by type, July 31, 2021, to June 30, 2024



Source: Morningstar. Please see Additional Disclosure for more information.

The use of active ETFs in model portfolios has increased significantly

(Fig. 3) Chance of ETF usage in model portfolios by category, June 30, 2021, to June 30, 2024



Source: T. Rowe Price Client Investment Platform database.

Figure 4 shows the average allocation in these same models over the period. Allocations to active ETFs increased over the period alongside smart beta and passive.

How to redeploy cash in today's market using T. Rowe Price active ETFs

Fixed income

With all eyes on central bank policies, investors are looking to lock in higher rates while adding credit and duration. Investors looking to redeploy cash into fixed income could consider the following:

Ease into the market with the **Ultra Short-Term Bond ETF (TBUX)**.

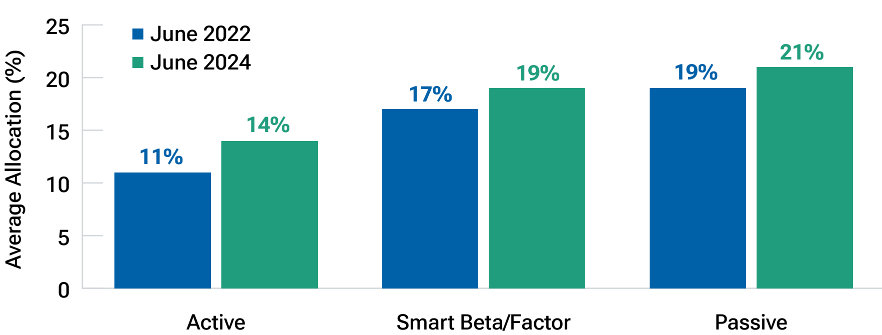
- For increased duration, redeploy cash to the **QM U.S. Bond ETF (TAGG)** for U.S. aggregate index-level duration and active management.
- Add both duration and credit with the **Total Return ETF (TOTR)**.
- Take advantage of higher yields via the **Floating Rate ETF (TFLR)** or **U.S. High Yield ETF (THYF)**.

Equity

As U.S. stocks face a broadening of performance rather than a rotation, consider the following options:

Average allocations to active ETFs in advisor model portfolios rose

(Fig. 4) Average allocation when used by type, June 30, 2021, to June 30, 2024



Source: T. Rowe Price Client Investment Platform database.

- Fewer interest rate cuts may favor value stocks such as the **Equity Income ETF[1] (TEQI)** or **Value ETF (TVAL)**.
- With small-caps trading at a major discount to larger companies, consider the **Small-Mid Cap ETF (TMSL).**
- Diversify away from Magnificent 7 stocks:
  - The **Capital Appreciation Equity ETF (TCAF)** allocates to a contrarian investment manager focused on finding good companies while mitigating long-term secular risks.
  - The **U.S. Equity Research ETF[1] (TSPA)** employs an actively managed, high-alpha portfolio run by over 30 analysts with mandatory benchmark sector exposure resulting in less concentration risk.
  - Embrace active management where valuations are higher with the **Blue Chip Growth ETF[1] (TCHP)** or **Growth Stock ETF[1] (TGRW)**.
- Seek to improve your portfolio's relative downside by adding to dividend growth stocks with the **Dividend Growth ETF[1] (TDVG)**.
- And with international stocks still offering good value relative to U.S. equities, consider the **International Equity ETF (TOUS)**.

T. Rowe Price Portfolio Construction Solutions can help

If you're preparing to redeploy cash into the market and are considering ETFs as an option in your model, we can help. Supported by the multi-asset experience and global resources of T. Rowe Price, our integrated suite of Portfolio Construction Solutions is designed to address your portfolio construction needs and help position your practice for success.

[1] **These ETFs are different from traditional ETFs.** Traditional ETFs tell the public what assets they hold each day. This ETF will not. **This may create additional risks for your investment.**

For example:

- You may have to pay more money to trade the ETF's shares. This ETF will provide less information to traders, who tend to charge more for trades when they have less information.
- The price you pay to buy ETF shares on an exchange may not match the value of the ETF's portfolio. The same is true when you sell shares. These price differences may be greater for this ETF compared to other ETFs because it provides less information to traders
- These additional risks may be even greater in bad or uncertain market conditions.
- The ETF will publish on its website each day a "Proxy Portfolio" designed to help trading in shares of the ETF. While the Proxy Portfolio includes some of the ETF's holdings, it is not the ETF's actual portfolio.

The differences between this ETF and other ETFs may also have advantages. By keeping certain information about the ETF secret, this ETF may face less risk that other traders can predict or copy its investment strategy. This may improve the ETF's performance. If other traders are able to copy or predict the ETF's investment strategy, however, this may hurt the ETF's performance.

For additional information regarding the unique attributes and risks of the ETF, see the prospectus.

Take your practice to the next level. Contact us.

We work with financial professionals to find practical solutions for critical investment and practice challenges. Used independently or in combination, each component of our integrated suite of Portfolio Construction Solutions provides access to T. Rowe Price's world-class multi-asset expertise and global investment resources to address your portfolio construction needs.

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INVEST WITH CONFIDENCE®

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

Additional Disclosure

Important Information

Consider the investment objectives, risks, and charges and expenses carefully before investing. For a prospectus or, if available, a summary prospectus containing this and other information, visit troweprice.com. Read it carefully.

T. Rowe Price Active Equity ETFs are different from traditional ETFs. Traditional ETFs tell the public what assets they hold each day. T. Rowe Price Active Equity ETFs will not. **This may create additional risks for your investment.** T. Rowe Price active equity ETFs publish a daily Proxy Portfolio, a basket of securities designed to closely track the daily performance of the actual portfolio holdings. While the Proxy Portfolio includes some of the ETF's holdings, it is not the actual portfolio. Daily portfolio statistics will be provided as an indication of the similarities and differences between the Proxy Portfolio and the actual holdings. The Proxy Portfolio and other metrics, including Portfolio Overlap, are intended to provide investors and traders with enough information to encourage transactions that help keep the ETF's market price close to its net asset value (NAV). There is a risk that market prices will differ from the NAV. ETFs trading on the basis of a Proxy Portfolio may trade at a wider bid/ask spread than shares of ETFs that publish their portfolios on a daily basis, especially during periods of market disruption or volatility, and, therefore, may cost investors more to trade. The ETF's daily Proxy Portfolio, Portfolio Overlap, and other tracking data are available at troweprice.com.

Although the ETF seeks to benefit from keeping its portfolio information confidential, others may attempt to use publicly available information to identify the ETF's investment and trading strategy. If successful, these trading practices may have the potential to reduce the efficiency and performance of the ETF.

ETFs are bought and sold at market prices, not NAV. Investors generally incur the cost of the spread between the prices at which shares are bought and sold. Buying and selling shares may result in brokerage commissions, which will reduce returns.

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Portfolio construction services discussed are available only to financial professionals and not to the retail public.

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