An investor education initiative by LIC MUTUAL FUND

An Introduction to Passive Funds

1. What are Passive funds?

Passive funds are the funds which invests in a particular Index in similar proportion to generate returns similar to the Index. It’s an investment style of mirroring the Index. In Passive fund, capital allocation is in the same proportion as the index weight to which it is created to mirror. The objective is to obtain the same return as the index instead of trying to beat the market.

2. How does it work?

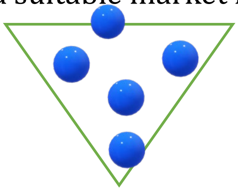
Passive investment involves selecting a market index. Then creating a replica of the index by investing in similar stock in same proportion as is Index.

Then religiously tracking it and adjusting the portfolio for any changes in the underlying index to keep it as identical to the index as possible.

Since the stocks are similar to that in index, there is no stock selection process involved in Passive funds, hence the role of fund manager is limited.

The entry and exit of a particular stock in the portfolio is determined by its weightage in the underlying index, thus the fund manager intervention is restricted and passive. That’s why these funds are called passive funds.

Select a suitable market index



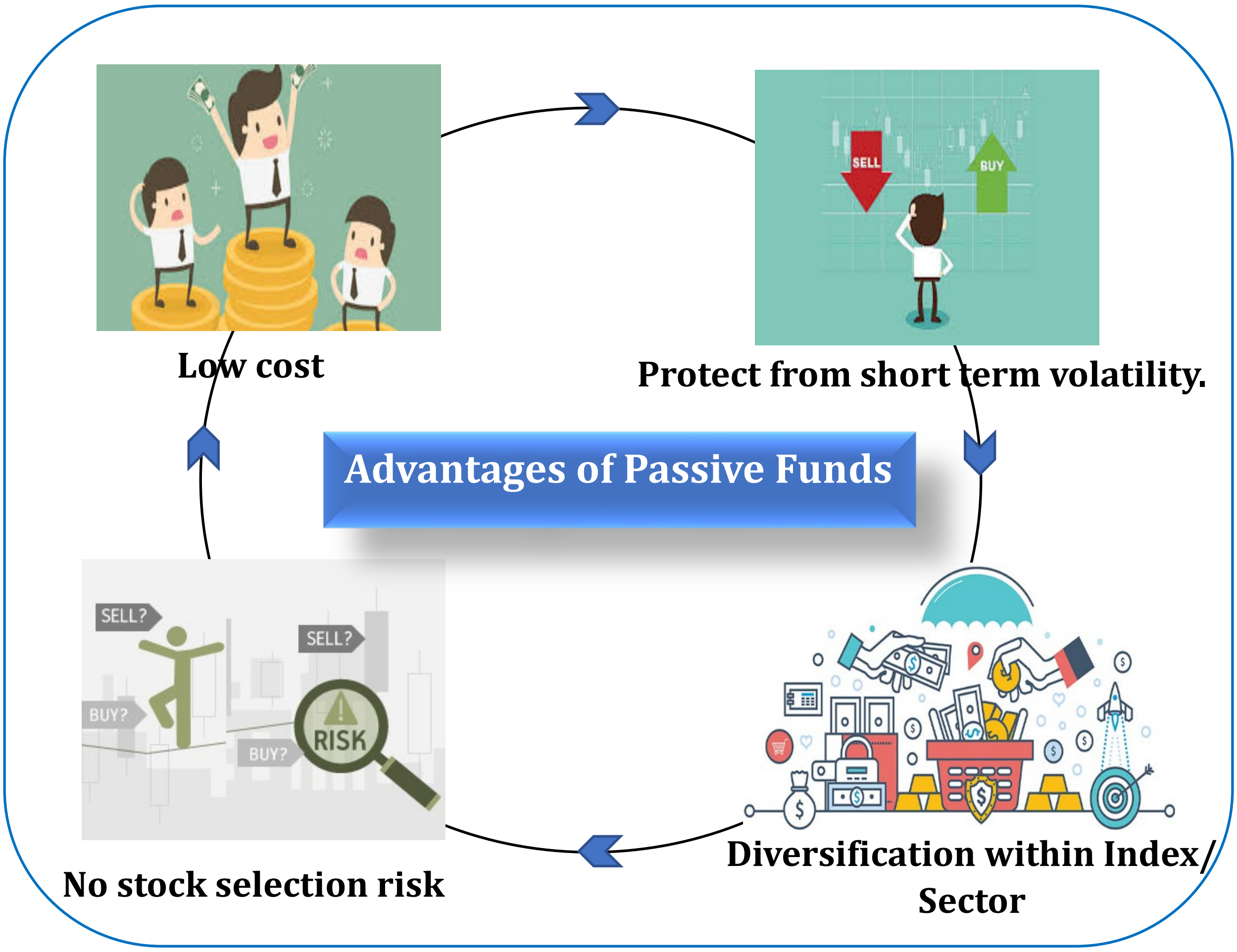
Replicate the portfolio in same proportion

Track index and keep making necessary changes

3. How are Passive funds different from Active funds?

Basis	Active Investment	Passive Investment
Objective	Outperforming the market/benchmark index	Obtain same return as the benchmark Index/asset class
Strategy	Selection of asset class, sectoral allocation, stock picking, timing and stop loss / profit booking	In proportion with the benchmark index/ asset class
Expense Ratio	Relatively higher	Relatively lower
Costs involved	Cost of research, higher management fees, hiring of professional fund managers, trading costs, etc	Cost of trading and management fees
Tax	Higher net taxes due to frequent profit booking	Low net taxes
Key risks	Timing of entry and exit, Inappropriate sector/ stock selection, change in fund manger and market volatility	Market Volatility only

4. What are the benefits of Passive funds?



5. Who should invest in Passive funds?

- Millennials who are inexperienced should start investing in equities through Passive funds.
- Any investor who is new to equity market, should invest in passive funds.
- New investors generally are unaware of the risks and dynamics of equity markets. Hence it is advised to start with passive investment before getting actively involved.
- Seasoned investors who is bullish on particular sector or Index.
- Seasoned Investor who wants no fund manager bias in stock selection of his portfolio.
- Investors who want to invest for a really long term (20-30 years) but does not want to actively manage his portfolio. That way investor remains unaffected from short term volatility.

6. What are the types of Passive funds?

There are two types of Passive funds in India. Index funds and Exchange Traded Funds (ETFs).

Index Funds: Index Funds are open-ended schemes which tracks the underlying benchmark where investors can buy and redeem units of Mutual Fund at the end of the day NAV.

ETF: ETFs are listed on the stock exchange and investors can buy and sell units (similar to stocks) at real-time prices through Demat account on the exchanges. As the Units of the Schemes are listed on NSE & BSE, an Investor can buy Units on a continuous basis on the capital market segment of NSE &BSE during trading hours like any other publicly traded stock at prices which may be close to the actual NAV of the Scheme

7. What is the difference between Index fund and ETFs?

Index Funds and ETFs both mimic underlying index. They are similar but different:

Particulars	ETFs	Index Fund
Minimum investment	High due to lot system	Low
Tracking error	Relatively Low	Relatively High
Expense ratio	Relatively Low	Relatively High
Entry or Exit Load	No Entry or Exit Load	Exit Load
NAV	Real-Time	Day end
Intra-Day Trading	Possible at low cost	Not possible
Mode of holding	Only Demat mode	Physical or Demat mode
SIP/SWP/STP Option	No	Yes
Best suited for (Investor)	HNI/Institutional/Trust	Retail/Millennials

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