

## 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.

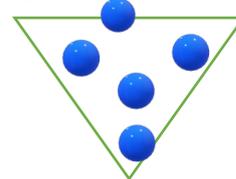
Then religiously tracking it and adjusting the portfolio for any changes in the underlying index to keep it as identical to the index as possible.

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

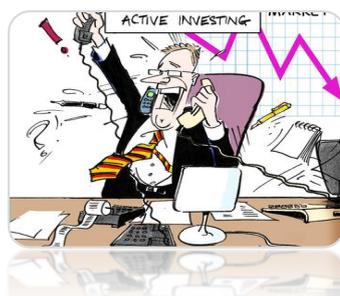


Replicate the portfolio in same proportion



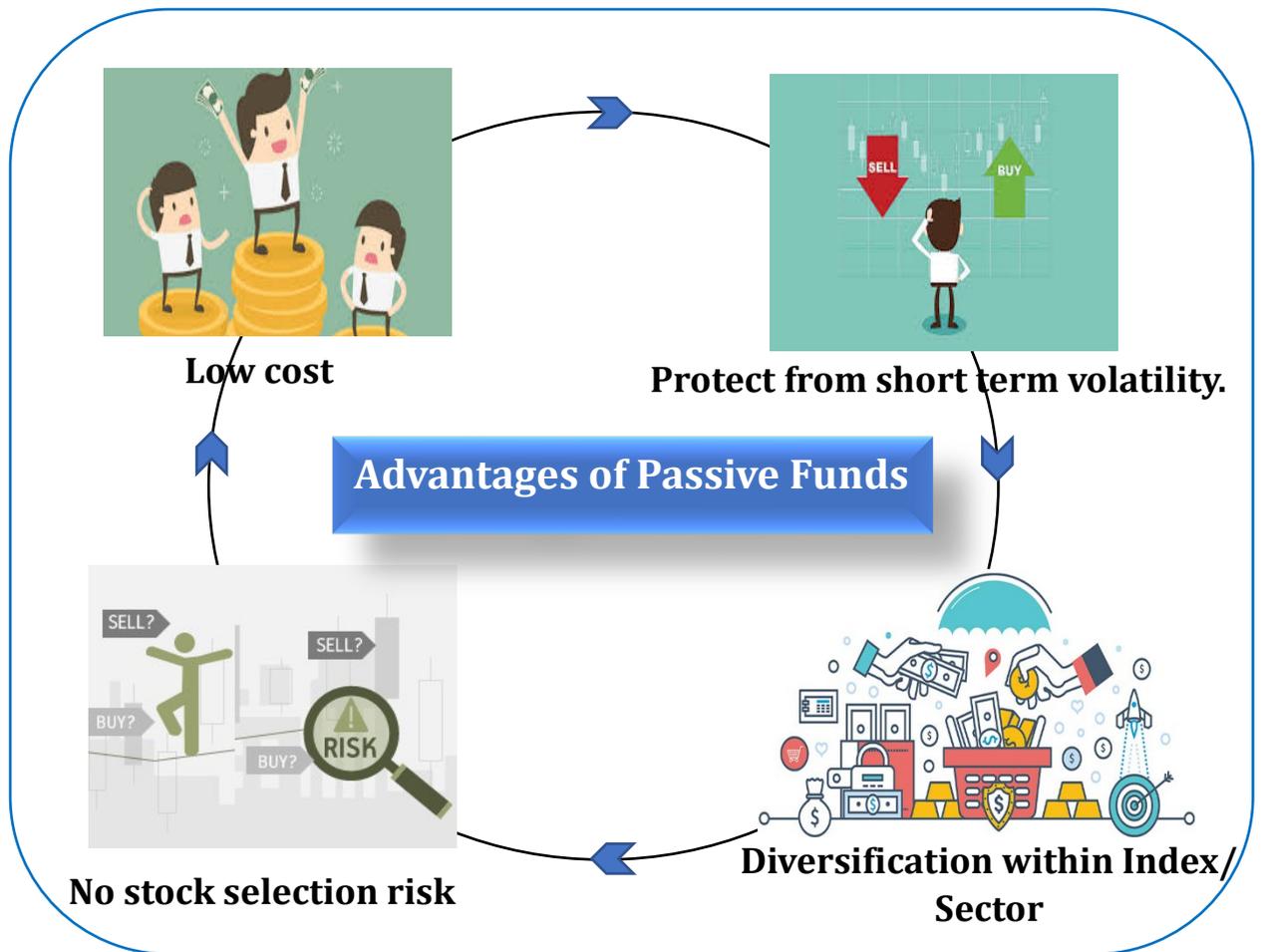
Track index and keep making necessary changes

### 3. How are Passive funds different from Active funds?



| Basis                 | Active Investment  | Passive Investment                                    |
|-----------------------|--|---|
| <b>Objective</b>      | Outperforming the market/benchmark index   | Obtain same return as the benchmark Index/asset class |
| <b>Strategy</b>       | Selection of asset class, sectoral allocation, stock picking, timing and stop loss / profit booking          | In proportion with the benchmark index/ asset class   |
| <b>Expense Ratio</b>  | Relatively higher  | Relatively lower                                      |
| <b>Costs involved</b> | Cost of research, higher management fees, hiring of professional fund managers, trading costs, etc           | Cost of trading and management fees                   |
| <b>Tax</b>            | Higher net taxes due to frequent profit booking  | Low net taxes   |
| <b>Key risks</b>      | 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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