ET

IN THE CLASSROOM

Index Funds

Index funds are getting popular with investors as they offer a simple and low-cost way to gain exposure to a broad and diversified portfolio.

WHAT IS AN INDEX FUND?

An index fund is a type of mutual fund or exchange-traded fund (ETF) that tracks the performance of a market index by buying the same stocks or bonds as the index. These funds aim to replicate the investment returns of particular benchmark indices by holding a securities portfolio that closely mirrors the index's composition.

WHAT ARE THE EQUITY INDEX FUNDS IN INDIA?

The Indian market has several equity-oriented index funds. Some popular index funds are based on broad indices – Nifty 50, S&P BSE Sensex, Nifty 100, Nifty Midcap 150, Nifty Smallcap 250, Nifty 500 and the Nifty Total Market Index; and thematic indices based on IT, pharma, consumption, manufacturing, defence, among others. There are international index funds as well, which are based on the Nasdaq 100 and the S&P 500.

WHO SHOULD INVEST IN THESE SCHEMES?

Index funds work well for first-time investors in mutual funds who are keen to invest in equity, want to keep things simple and want a low-cost product but do not know which scheme to choose or how to go about the process, or do not have access to an advisor. It also works well for investors with a long-term horizon of over ten years who do not want the risks associated with active equity funds, such as changes in the fund manager or fund objective during a scheme's life cycle, which could affect its performance.

FOR WHOM ARE THESE FUNDS NOT SUITABLE?

Indices are rigid portfolios of securities. Even a fund manager has no control over the holdings and cannot exit or add a company if they believe the fundamentals are in favour or vice versa. Aggressive equity investors who want to generate alpha in their portfolios may not be satisfied with bare index returns. Such investors who are comfortable with higher risk and can actively manage their equity portfolio based on changes happening in the environment can stay away from index funds.

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