ET IN THE CLASSROOM

Active Vs Passive Funds

Indian investors have a wide variety of schemes to choose from -- both in the actively and passively managed mutual fund space. Over the last few years, fund houses have gone for new launches, increasing the number of offerings available to investors. Wealth managers believe investors could buy into a mix of active and passive funds in their portfolio.

WHAT ARE ACTIVELY MANAGED MUTUAL FUND SCHEMES?

An actively managed fund is a scheme where the fund manager is in charge. The fund manager monitors stocks, makes buy or sell decisions on each stock, decides weightage in the portfolio based on the objectives of the scheme.

WHAT ARE PASSIVE FUNDS?

Passive funds are schemes that track a benchmark index and try to mimic its performance. They include passive index funds, exchange-traded funds (ETFs), and fund of funds (FoF) that could invest in ETFs. These funds follow a benchmark and aim to deliver returns in tandem with the benchmark, subject to expense ratio and tracking errors.

WHAT IS THE DIFFERENCE BETWEEN AN ACTIVE AND A PASSIVE FUND?

Passive schemes come with a lower cost option, do not have any fund manager bias and do not require active buying and selling. Some passive funds like ETFs can be bought in market hours, while units of active open-end funds will be allotted at the end-of-day NAV only. Active fund managers have the liberty to buy or sell a stock, or change allocation, while passive managers merely mimic the index.

HOW SHOULD INVESTORS CHOOSE BETWEEN ACTIVE AND PASSIVE FUNDS?

The decision between active and passive funds depends on every investor's investment goals, risk tolerance, and preference for management style. For investors who just want a low-cost option, do not want changes in their portfolio and are happy with returns that mirror the market, passive funds are a good fit.

In categories like large-cap, where the scheme has to compulsorily invest at least 80% corpus in the top 100 stocks by market cap, many funds could have a large overlap with the benchmark, due to which investors opt for a index fund based on the Nifty 50, Sensex or Nifty 100. In categories like small cap, where fund manager conviction and research in taking concentrated bets is important, investors could opt for an active fund. There are a lot of sectoral funds that are offered through index funds and are not offered through actively managed funds, leading to investors wanting to bet on that space buying these passive funds.

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