EDELWEISS MUTUAL FUND

What are Passive Index Funds? Know all the details

Introduction

If you are looking for a hands-off approach to investing, passive index funds may be exactly what you need. These mutual funds follow a 'sit back, relax, and let the market do the work for you' kind of philosophy to investing. They also offer benefits like diversification, inflation-beating growth in the long run, and all other conveniences of investing in mutual funds like Systematic Investment Plans (SIPs), Systematic Withdrawal Plans (SWPs), and the like. Let's find out more about these passive champions and whether or not they can take you to the finishing line.

What are passive index funds?

As the name suggests, passive index funds follow a passive investment strategy where they invest in an underlying index's securities. These funds track a benchmark index and replicate its portfolio. In simple words, they invest in the same stocks and bonds as the index they follow. According to the Securities and Exchange Board of India (SEBI), a passive index fund must invest at least 95% of its total assets in the securities of the underlying benchmark index.

These funds can offer multiple types based on your risk tolerance and financial goals, such as passive debt funds and passive equity funds.

Let's proceed to the pros and cons of passive index funds to get to know them better.

Advantages of passive index funds.

o Cost-effective: Passive index funds do not spend time and money on research, buying and selling stocks, etc. As a result, they have lower associated investing costs.

o Optimum diversification: Passive index funds track indices and invest in the same securities as the index. As a result, you get exposure to all the diversified investments within the index.

o Benchmark returns: Passive funds mirror the investment composition of an index and hence deliver the same

returns as the benchmark.

Disadvantages of passive index funds

o Lack of flexibility: A passive index fund mimics the investment portfolio of an index. The fund manager has no involvement in actively managing funds during certain market conditions.

o Lack of choice: Since the passive fund invests in an index, you cannot choose specific stocks or sectors for investments.

o Risks: Passive index funds carry market risks. If the benchmark does not perform, your investment returns can be affected. You may be exposed to sector-specific risks if the underlying index is heavily concentrated in certain sectors.

Things to keep in mind when investing in passively-managed index funds

Passive index investing is ideal if you wish to eliminate fund manager risk and earn returns in line with an index. However, it is important to note that they contain some risks and must be chosen after careful evaluation and research of the benchmark they follow. Each index has a different methodology for selecting its components, which can impact the performance of the fund. Make sure the index aligns with your investment objectives and strategy. It is also essential to compare expense ratios across different funds to find the most cost-effective option.

Conclusion

Passive index funds are a great way to gain exposure to a particular market or sector. You can use them as part of a diversified investment portfolio and consider investing in a mix of passive index funds and active mutual funds based on your goals and needs.

An investor education initiative by Edelweiss Mutual Fund
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For more info on KYC, RMF and procedure to lodge/redress any complaints, visit - https://www.edelweissmf.com/kyc-norms

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.