



04:05 PM 26 SEP EOD MARKET STATS ▼	SENSEX 31,599 ▼ -26.87	NIFTY 50 9,871 ▼ -1.10	GOLD (MCX) (Rs/10g.) 29,869.00 ▼ -170.00	USD/INR 65.44 ▲ 0.32	CREATE PORTFOLIO	Download ET MARKETS APP	CHOOSE LANGUAGE ENG
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Prasanth Prabhakaran

Senior President & CEO, YES Securities (India)

He holds a PGDRM from the Institute of Rural Management, Anand (IRMA), and is a science graduate (B.Sc, Physics) from Fergusson College. He has over two decades of experience in the BFSI space. Prior to joining YES Securities (India), he was associated with India Infoline Ltd as Executive Director and President – Retail Broking for almost seven years. Previously, he was also associated with Kotak Securities, HDFC Bank, Kotak Mahindra and Venky's India Group.

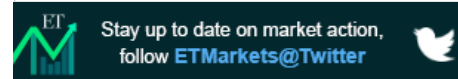
ETF way to wealth creation: Does index investing work?

ET CONTRIBUTORSUPDATED: AUG 06, 2017, 10.58 AM IST

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There is enough evidence and research to show that equities have been the best performing asset class over a long term horizon. However, directly participating in equities can be quite a task for novice investors as there are thousands of [stocks](#) to choose from. The choice is based on using and interpreting either roller coaster resembling charts or deciphering various financial ratios or using a combination of the two. As such, it can get quite intimidating. Not to mention that having burnt their hands in the past, many individuals have simply decided to stay away from equities altogether. However, for creating real [wealth](#), we believe equities is a must have in one's portfolio. And there are many ways for novice investors to participate in the India growth story.

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This is where [mutual funds](#) come in, with professionals - their wide experience, knowledge and wisdom - invest the pool of monies that come in from investors. Over time, there has been a host of products/schemes that have been launched by mutual funds, thereby giving more power to individuals to invest as per their respective risk taking capabilities and requirements. Some of these schemes include balanced funds, small cap funds, mid cap funds, [large cap funds](#), sector-specific funds, thematic funds, amongst others.

One such product that is quite popular is an index exchange traded fund or index ETF. Investors are able to diversify exposure across a number of companies through a single instrument. An index [ETF](#) aims to mimic the underlying index, thereby providing investors with the possibility to garner the same returns (in most cases marginally better) as the index over the long term. For example, an ETF based on the [Sensex](#) would invest in all of the 30 stocks that form the Index in the same weightage as that of the index. This makes it a passive approach to invest in stocks which are relatively simple as compared to active investing wherein regular buying and selling takes place.

Why ETFs?

ETFs offer an ease of transaction as they can be easily bought or sold like any other stock on the exchange. They also provide an ease of liquidity as they can be bought or sold anytime during market hours (subject to availability of buyer or seller) at prices prevailing in the market. Thus, investor transacts at real-time prices.

They provide a relatively low ticket size option for investing in a bucket of stocks. For instance, if an investor wishes to mirror the Nifty Index, then he would have to buy all the 50 stocks that are a part of the Index which would require the necessary funds. However, if he was to invest in an ETF where the underlying is the Nifty 50 Index, then the investment would be only towards the unit value of the ETF, thus allowing investors to invest in an index by investing smaller amounts.

In addition to this, ETFs are also relatively less expensive as compared to mutual funds due to lower expense ratios/ management fees.



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Other features include instant diversification through exposure to a large number of stocks/ sectors as well as the ability to put limit orders.

Why index ETFs?

In the world of investing, whether through a [mutual fund](#) or direct equities, the benchmarks are usually the respective indices. For large cap investing, the usual benchmarks are Nifty or Sensex. And rightly so, considering that Sensex companies form a considerable chunk of the entire market capitalisation. For instance, as of 27th July 2017, total market capitalisation of companies trading on the Bombay Stock Exchange stood at almost INR 132 trillion. The same statistic for the Sensex was INR 55.7 trillion or a little over 42% of the total. This figure for the Nifty would be higher as there are 50 companies as part of the index.

We believe investing in Index ETFs broadly has three key benefits. Firstly, it provides a hassle free opportunity to participate in the growth story of India Inc.'s bellwether companies. Secondly, it allows investors to diversify their risks across sectors. Finally, investing in such large companies takes out the risk of highly volatile financial performances; being industry leaders, companies forming part of the Nifty tend to have relatively strong and stable numbers given their large scale of operations and market leadership.

All of these factors put together, combined with the low expense ratios allow for a good way for retail investors to participate in the Indian growth story.

Notwithstanding, the sharp run up in financial [markets](#) over the past few quarters, we believe the best is yet to come as companies are likely to see a strong recovery in [earnings](#) over the next two to three years. This, coupled with aspects such as low utilisation ratios (which have led to low asset turnovers) and strong balance sheets (with lower debt on books of companies), should lead the way for a sharp improvement in return on capital going forward. For investors looking for debt instrument beating returns coupled with stability (in terms of lower risk of investment within the equities world), we believe index ETFs are a good investment option.

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