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EXCHANGE TRADED FUNDS

Why ETFs are a good investment bet

For retail investors, ETFs are a low-cost investment option as they have lower operating cost, including the management fees

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EXCHANGE TRADED FUNDS (ETFs) from asset management companies (AMCs) have become popular following below average returns from most categories of equity-mutual funds in the past one year. All ETFs mirror the benchmark they represent and the returns are more-or-less in line with the benchmark they represent. It is transparent too, as the investing framework and stock composition is known to an investor at the beginning.

For retail investors, ETFs are a low-cost investment option as these have lower operating cost, including the management fees. In ETFs, the fund manager does not select stocks but mirrors a readymade index. The fund manager tracks the index stock and invests according to the composition of the index. However, investors will have to look at the tracking error which is the difference in the ETF return compared to the return of the underlying index. Fund houses have been steadily building their ETF products bouquet over the last couple of years.

Trading of ETFs

One of the major benefits of ETFs is that they are traded on the stock market. An investor can trade in these units actively. One can buy and sell ETFs through the demat account. Before deciding on a particular ETF, one must look at the trading volume as higher trading volume will make the particular ETF more liquid. Also, one must analyse the historical returns and the tracking error. If one invests in an index ETF for the long term, then the markets volatility will not have much impact on the returns.

Investors must note that in case of ETFs, the returns will not be more than the benchmark index. Moreover, if a portfolio manager has a view of a stock, he will not be able to take any decision as the mandate for the fund manager in case of an ETF is to mirror the holdings of the underlying benchmark.

Government's ETFs

The government had launched an ETF where stocks of state-run public sector companies were bundled and offered to investors for subscription. Moreover, the government is planning to come out with a follow-on offer of Bharat 22 ETF next month. The third tranche of Bharat 22 ETF would raise about ₹10,000 crore. The follow on offer is likely to have a base issue size of ₹5,000 crore, with a green-shoe option to retain an over-subscription of equal amount. Till now, the government has raised around ₹23,000 crore through the Bharat 22 ETF.

The Central Public Sector Enterprises (CPSE) that are part of the Bharat 22 ETF include Coal India, Bharat Petroleum Corp, Oil and Natural Gas Corp. Ltd , Indian Oil Corp. Ltd, State Bank of India, etc. Also, the government's strategic holding in Axis Bank, ITC and L&T held through SUUTI (Specified Undertaking of Unit Trust of India) has been put in the ETF basket.

At present, there are two government ETFs. One, the CPSE ETF managed by Reliance Nippon Mutual Fund, which tracks the Nifty CPSE Index of 11 CPSE stocks. The second Bharat 22 ETF is managed by ICICI Prudential Mutual Fund. The government may also launch a debt ETF soon, which will have a portfolio of debt papers of the central public sector entities. Unlike CPSE ETF or Bharat 22-ETF, proceeds from the debt ETF would not directly flow into the government's kitty.

Analysts say buying a government ETF is less risky than investing directly in the PSU stocks as the risk is diversified across companies and sectors. In fact, after Securities and Exchange Board of India's norm on categorisation and rationalisation of mutual fund schemes came into place, investors have been investing in ETS as they no longer have to bother about fund style.