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MUTUAL INDEX FUND AND EXCHANGE TRADED FUNDS: A COMPARATIVE STUDY

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ABSTRACT

This research paper compares the performance of two competitive financial instrument available to indian investors namely ETFs and Index fund, with the perspective different parameters like return, performance effectiveness, expense ratio, tracting ability etc and investment behaviour of investor. This analysis demonstrate better performance of ETFs in terms of their expense ratio and performance effectiveness over long term investment horizon. To the best of our knowledge, there has been no previous published research study which empirically compares the performance of ETFs and index funds in India, and this is the first attempt in this direction.

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INTRODUCTION

Exchange-traded funds (ETFs are increasingly finding favour in the global financial markets; foreign institutional investors (FIIs) in particular are using ETFs to gain exposure to emerging markets. In India ETFs are making their presence felt gradually. In fact' ETFs are one of the disinvestment modes proposed by Indian government for public sector undertakings (PSUs). After liberalization 1991, FIIs played a significant role in the Indian stock market. It has been estimated that a sizable chunk of FII flows comes through offshore –focused equity funds and ETFs. Notably, several India specific ETFs that exist in the U.S. such as wisdom tree India earning funds, is hares MSCI India ETF, and powers hares India portfolio concentrate exclusively on Indian stocks.
Exchange traded funds are one of the best innovations in the financial markets. ETFs holds assets such as stocks, commodities or bonds, an trade close to their Net asset value (NAV) throughout the day. ETFs can track a specific index, a particular sector of an industry, or even the stock market of a foreign country. ETFs that are passively managed and track their bench mark indices known as classical ETFs.

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ETFs combine the passive aspects of close ended and open ended mutual funds. Etfs have several advantage over traditional mutual funds, such as lover expense ratio, trading flexibility, tax efficiency transparency and exposure to diverse asset classes. Mutual funds have higher expense ratio than ETFs because of entry and exit loads. It is pertinent to note that in India, entry load for mutual funds have been banned but exit loads do exist. ETFs can be traded like stocks throughout the day while open ended mutual funds can be accessed only at the end of day. ETFs are more tax efficient because of their in-kind creation and redemption process, while allows for arbitrage and pricing efficiency. In the case of ETFs only transacting shareholder's are taxed, while gains are distributed to the other shareholders. On the other hand , the transactions of mutual fund generate tax consequences for all the unit holders. ETFs are more transparent than mutual funds as they declare their daily holdings, unlike mutual funds, which declare their holdings at the end of the quarter. In addition to numerous advantages of ETFs, investors can have exposure to various asset classes, from commodities to live stock. The phenomenol growth of ETFs globally has attracted the attention of researchers and investors, and extensive studies have been done on ETFs in the context of the developed markets of the U.S. and Europe. Globally, most of the ETFs were passive in nature, at least to begin with. Currently however; there are many ETFs that are actively managed. ETFs were introduced in U.S. in 1993 and the first ETF to be listed was standard and poor's Depository receipts (SPDRs). Although the growth of ETFs was sedate initially, the subsequent growth has been phenomenal. In Indian, the Nifty Benchmark Exchange traded scheme (Nifty BeES), wsa the first to be introduced in 2001.Nifty BeES was subsequently taken over by Goldman sachs asset Management Company. At present, there are over 0 ETFs listed in India and a majority of the ETFs are still passively managed, meaning that the ETFs track their underlying benchmark indices. Globally, the total assets under management (AUM) of mutual funds equaled USD 28.87 trillion at the end of the third quarter of 2013. The first mutual fund in India was set up by the government of India when the Unit trust of India (UTI) was created in 1963. UTI had a monopoly in mutual fund business and the next mutual fund-the SBI Mutual fund was established in 1987.

management. Index funds are considered appropriate for conservative long term investors looking at moderate risk, moderate return arising out of well diversified portfolio. Index funds today are a source of investment for investors. Indices and index linked investment products provide considerable benefits. But it is equally important to know the associated risk that comes as part of such exposure. Important concepts and terminologies are associated with the indices.

Tracking error

Tracking error is defined as the annualized standard deviation of the difference in returns between the index fund and its target index. In simple terms, it is the difference between returns from the index fund to that of the index. An index fund manager needs to calculate his tracking error on a daily basis especially when it is open ended fund. Lower the tracking error, closer are the returns of the fund to that of the target index.

Table 1.

s.no.	Index Fund	Fund rating	Underlying index	Launch date	Aum as on dec2017(rs.cr)	Expense ratio	Annualized 5year return(%)	Return since launch
1	Aditya birla SL index	**	-	09/02	181	0.75	12.3	16.5
2	Hdfc index nifty	**	nifty	07/02	298	0.30	13.1	15.6
3	Hdfc index sensex	**	sensex	07/02	102	0.30	13.0	15.4
4	Hdfc index sensex plus	**	sensex	07/02	120	1.00	13.	18.8
5	Idbi nifty index	*	nifty	06/10	212	2.00	11.8	9.2
6	Lic MF index nifty	*	nifty	11/02	23	1.20	12.1	13.1
7	Lic MF index sensex	*	sensex	11/02	15	1.70	11.6	13.7
8	Reliance index nifty	**	Nifty	09/10	126	0.85	12.4	8.0
9	Reliance index sensex	NR	Sense	09/10	2	0.85	11.9	7.3
10	Sbi nifty index	**	nifty	02/02	226	0.67	12.1	14.8

ETFs (about exchange traded fund): ETFs are just what threir name implies; basket of securities that are traded, like individual stocks, on an exchange. Unlike regular open-end mutual funds, ETFs can be bought and sold throughout the trading day like any stock. Most etfs charge lower annual expense than index mutual funds. however, as with stocks, one must pay a brokerage to buy and sell etf units, which can be significant drawback for those who trades frequently or invest regular sums of money. They first came into existence in USA in 1993,it took several years to attract public interest. But once they did, the volumes took off with vengeance.

Application of ETFS

- Efficient trading
- Equitising cash
- Managing cash flow
- Diversifying exposure
- Filling gaps
- Shorting or hedging

Index Funds: An index fund is a mutual fund that tries to mirror a market index, like nifty or Jr. nifty, as closely as possible by investing in all stocks that comprise that index in proportions equal to the weight age of those stocks in the index. These are passively managed funds, wherein the fund's manager invests the fund in the stocks comprising the index in similar weight. Index fund while reducing the market offer many benefit to the markets. Firstly the investor is indirectly able to invest in a portfolio of blue chip stocks that constitute the index .next , they offer diversification across a multiplicity of sectors since index stocks are generally a basket of 20-25sectors.added to these is the relatively low cost of

Data and Analysis

Here we have analysed equity large cap ETF and index fund in terms of their expense ratio (as on November 30, 2017), returns/performance (as on december 31, 2017) and also assets under management (AUM as November 30, 2017). We have taken the mutual funds in different categories from CNX nifty ans sensex indices. Funds from ADITYA BIRALA, HDFC, RELAIANCE, SBI, LIC, IDFC HAS BEEN ANALYSED. Table 1 represesnt the characteristics of different categories of index fund while Table 2 represent the characteristics of different categories of ETFs.

DISCUSSION AND INTERPETATAION

Analysis of index fund

Here we have analysed 10 large cap equity index funds(nifty as well as sensex).

Analysis of Exchange Traded Funds (ETFs)

Here we have analyzed 10 large cap equity ETF.

Analysis and Observation: here we have analysed equity large cap ETF and index fund in terms of their expense ratio(as on November 30, 2017), returns/performance (as on december 31, 2017) and also assets under management(AUM as november30, 2017).we have taken the mutual funds in different categories from CNX nifty ans sensex indices. Funds from ADITYA BIRALA, HDFC, RELAIANCE, SBI, LIC, IDFC HAS BEEN ANALYSED. Table 1 represesnt the characteristics of different categories of index fund while table 2 represent the characteristics of different categories of ETFs

s.no.	Exchange traded fund	Fund rating	Underlying index	Launch date	Aum as on dec2017(Rs.cr)	Expense ratio	Annualized 5year return(%)	Return since launch
1	Aditya birla SL nifty ETF	***	Nifty	07/11	215	-	13.5	11.3
2	Hdfc nifty ETF	NR	Nifty	12/15	183	0.05	-	18.4
3	Hdfc sensex Etf	NR	Sensex	12/15	19	0.05	-	17.4
4	Idfc sensex ETF	NR	sensex	09/16	1	0.13	-	20.6
5	LIC MF ETF Nifty 50	NR	Nifty	11/15	443	0.10	-	16.2
6	LIC MF ETF sensex	NR	sensex	11/15	328	0.10	-	14.9
7	Relaince ETF Nifty 100	****	Nifty	03/13	9	0.89	-	16.0
8	Reliance ETF sensex	**	sensex	09/14	35	0.06	-	9.4
9	Sbi Etf nifty 50	NR	Nifty	07/15	26964	-	-	10.0
10	Sbi Etf sensex	**	sensex	03/13	8361	-	-	15.0

Hence in this analysis we have observed that most of the index fund has less long term five year return in comparisison with ETFs. and if we analysed the return since launch date of the fund then index fund i.e. HDFC INDEX SENSEX PLUS has given the maimum return of 18.8% while in case of IDFC SENSEX ETFS has given the maximum return since inception date of the fund which is 20.6%. hence we can analysed that ETFs are performing better in context of long term return and return since launce of the product. If we are comparing the expense ratio of index fund and ETFs. we see that in case of exchange traded fund most of the fund have expence ratio less than 1 that also indicate the better effectiveness of the fund while in case of the index fund, some fund have the expense ratio of 2. Expense ratio: the expense ratio is ameasure of what it cost an investment company to operate a mutual fund. An expense ratio is determine through an annual calculation where a fund's operating expenses are divided by the average dollar value of its asset under management(AUM).operatiing expenses are taken out of a fund's asset and lower the return to a fund's investor. it is also known as management expense ratio. In context of AUM the most of the ETFS have maximum AUM. as Asset under management measures the total market value of the financial assets which a financial institution such as mutual fund, venture capital firm or brokerage manage on behalf of its client and themselves. Hence as per analysis point of view we observed that most of ETFs have better performance in comparision of conventional index fund.

Conclusion

Hence by the above analysis we can conclude ETFs are better performing in contex of long term return, and also in context of expense ratio.

Limitataions

The result of this study could have been different if more number of mutual fund scheme were included for the analusis. The other limitations of this study is that there may be structural breaks in the time period and this has not been considered in the study.

This study also not taken into consideration macroeconomic factors like exchange rate, inflation and political risk which could have impacted the performance of the fund.

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