



# Ready for passive investing? Here is how to kick-start your portfolio

Experts say new passive investors should avoid sector or theme-based indices or factor-based strategies

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Passively managed funds offer investors a low-cost way to participate in markets, with expense ratios far lower than those of actively managed funds. By tracking the same indices that active funds use as benchmarks, they eliminate the risk of underperforming the benchmark—because investors are invested in the benchmark itself.

Today, passive funds track more than 100 indices, spanning market-cap-weighted, sectoral and thematic indices, as well as factor-based strategies. As of 30 September, there were 268 exchange-traded funds (ETFs) and index funds tracking these indices. ETFs accounted for ₹9.5 trillion in assets under management (AUM), while index funds managed ₹3.08 trillion in AUM as of the same date.

Since each index carries its own risk-return profile, here are some dos and don'ts for your passive investing journey.

## Keeping it simple

Advisors and experts recommend a simple approach for beginners. "For most investors who are starting out, a large-cap-oriented equity portfolio is the best starting point. If someone is comfortable skipping mid- and small-caps entirely, a Nifty 50 or a Nifty 100 index fund is more than sufficient," said M. Pattabiraman, founder of personal finance platform Freefincal.

A beginner can consider combining the Nifty 50 Index with the Nifty Next 50 Index. The latter can give a flavour of mid-caps, even though it is a large-cap fund, said Anil Ghelani, head of passive investments and products, DSP Mutual Fund.

"It is not a true mid-cap index, but the risk-reward is similar to that of mid-caps, as it represents stocks beyond the widely-tracked Nifty 50 stocks," Pattabiraman added.

Besides the Nifty 50 Index, beginners can consider broader indices, said Vishal Dhawan, founder of Plan Ahead Wealth Advisors. "The Nifty 100 or the Nifty 500 indices can be considered, as they give a much broader exposure to the market. However, it is advisable to build exposure through systematic investment plans (SIPs) as it helps to bring down the average buying costs during market volatility," he said.

Broader market indices tend to be more volatile due to exposure to mid- and small-caps, or to new entrants from the mid-cap space, as in the case of Nifty 100. The index is rebalanced

## Passive funds: Beginner's toolkit

Here is how investors starting their passive funds journey can navigate through a plethora of options

### Problem of plenty

ETFs split	Number of ETFs	AUM (₹ crore)
Equity	207	7,32,486
Debt	37	95,770
Gold	22	90,136
Silver	16	37,518

  

Index funds split	Number of index funds	AUM (₹ crore)
Equity	235	2,00,540
Debt	109	1,08,175

  

### ETF AUM growth

AUM (₹ crore)

### Index funds AUM growth

AUM (₹ crore)

ETF: Exchange-traded fund; AUM: Assets under management; CAGR: Compounded annual growth rate; SIP: Systematic investment plan

Source: niftyindices.com; data as of 30 September 2025

### How beginners can build passive portfolio

- ▶ Look for simple strategies
- ▶ Prefer large-cap oriented strategies
- ▶ Liquidity of large-caps keeps impact costs low
- ▶ Prefer index funds for SIPs; less complexity
- ▶ ETFs require grasp of bid-ask spreads, trading volumes
- ▶ Use for asset allocation; equity, gold, debt

Note: SIPs are systematic investment plans that allow investors to deploy their funds in staggered manner

### What are impact costs?

- ▶ Impact costs refer to price movement caused by executing a trade, where buying or selling large quantities pushes stock price away, increasing transaction costs for investors. It can be more pronounced in stocks lacking liquidity.

### What to avoid

- ▶ Smart-beta funds with complex strategies
- ▶ Indices with back-tested data, but less real market data
- ▶ Sector or theme-based strategies
- ▶ Indices where stocks lack liquidity
- ▶ Funds tracking such indices may see high impact costs

ETFs. "Investing in ETFs requires a bit more tracking of bid-ask spreads, impact costs, ETF's iNAV, etc.," he said. This is because ETFs trade on stock exchanges, where prices can deviate from fair value due to liquidity constraints and demand-supply dynamics, unlike index funds that are bought and sold at NAV.

iNAV, or an ETF's indicative net asset value, represents its fair value. However, ETFs can sometimes trade at significant premiums or discounts to their iNAV due to demand-supply dynamics on stock exchanges.

If trading volumes are thin, exit can be difficult, or you may not get an exit at fair values. Price distortions can happen in two scenarios. When demand is high and sellers few, ETF prices can top their fair value—and the reverse can happen when there is a lack of buyers.

For instance, several silver ETFs recently traded at steep premiums amid a shortage of physical silver. The supply constraint made it difficult for market makers to create new ETF units and meet the surge in demand, leading to sharp premiums.

While ETFs allow investors to take advantage of intraday dips, as they are traded on exchanges like any stock, index funds simply offer end-of-day NAVs like any regular mutual fund. As an index fund is a mutual fund, investors can also do a monthly SIP.

## Takeaways

New investors can use passive funds for asset allocation. Anubhav Srivastava, partner and fund manager at Infinity Alternatives, said investors can just combine the Nifty 50 Index with a US index or ETF for international exposure. "Along with this, they can take exposure to a gold ETF or index fund and a debt-based index," he said.

Passive funds can simplify investing by removing fund manager risk, as investors need not worry about identifying the right fund or manager to deliver outperformance. In market segments such as large caps, where active fund outperformance has historically been limited, low-cost passive funds may even be the better choice. So, start passive funds with simple investment strategies. Instead of going with new strategies with limited real market data, stick with strategies that have a credit market track record.

every six months, when new stocks are included—which transition from mid-cap to large-cap—and certain underperforming stocks are excluded.

## What to avoid

Experts say new passive investors should avoid sector or theme-based indices or factor-based strategies.

"Several smart-beta strategies or factor strategies are fairly new. While the base date of these indices is 2005 and there is back-tested data, there is no adequate real-market track record with actual trading volumes. These strategies often look very attractive in back-tested data, but real-world per-

formance can be quite different," said Pattabiraman.

"For instance, some mid- and small-cap quality indices have underperformed in recent years. Low volatility, in particular, is often misunderstood. Investors assume it means lower drawdowns, but that's not always true. A low-volatility index can still fall more than the Nifty 50 during certain market phases," he explained.

"Our research shows that these factor funds tend to underperform their parent indices if just bought and held for a long period. To make the most of them, investors need to correctly

time their entry and exit from each factor, with knowledge of which factor performs in which stage of the market," said Aarati Krishnan, head of advisory, PrimeInvestor Financial Research Pvt. Ltd.

"It is better to avoid narrow sectors or thematic ideas when you are starting out, unless the investor has a deep understanding of the sectoral dynamics," said Siddharth Srivastava, head-ETF products, and fund manager, Mirae Asset India Mutual Fund.

## Index vs ETFs

Ghelani added that new investors should opt for index funds instead of



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