

Which is the best Nifty-based index fund to buy basis expense ratio and tracking error?

By Surbhi Khanna, Published on: July 3, 2026



With several Nifty-based index funds tracking the same benchmark, choosing the right one is no longer as simple as opting for the fund with the lowest expense ratio. Investors also need to consider tracking error, a metric that indicates how closely a fund replicates its benchmark. Together, these two factors can significantly influence long-term returns, especially for passive investors.

So, which Nifty-based index fund should investors choose? Should they prioritise a lower expense ratio or a lower tracking error?

Niranjan Avasthi, President, Edelweiss Mutual Fund shared with ETMutualFunds that both tracking error and expense ratio are important and the two metrics should be evaluated together rather than in isolation. He said the objective of an index fund is to closely replicate its benchmark, and while a low expense ratio is desirable, it is meaningful only if the fund consistently tracks the index efficiently.

For long-term investors, Avasthi recommended choosing funds that combine competitive expense ratios with consistently low tracking error.

Vishal Dhawan, Founder & CEO, Plan Ahead Wealth Advisors shared with ETMutualFunds that tracking error captures hidden costs such as cash drag and transaction inefficiencies. According to him, a higher tracking error indicates that a portfolio is deviating from its intended benchmark, potentially creating performance gaps over time.

Dhawan further said that investors should generally prioritise low tracking error over small differences in expense ratios and poor index replication can impact returns more than a slightly higher expense ratio, making replication accuracy a more reliable indicator of fund quality.

Anup Bhaiya, Founder Money Honey, Wealth Services Ltd told ETMutualFunds that both metrics are important but serve different purposes. According to him, if investors are choosing between two index funds tracking the same index, prioritise lower tracking error first, then the lower expense ratio.

He further said that if one is comparing different indices (e.g., Nifty 50 vs. Nifty Next 50), the expense ratio comparison is less meaningful because the index construction itself drives more of the return difference.

Low expense ratio and tracking error

An analysis of nearly 22 Nifty based index funds were analysed on the basis of their expense ratio and tracking error. This data included index funds benchmarked against Nifty50, Nifty Smallcap, Nifty Midcap and other benchmarks.

The data showed that Edelweiss Nifty 50 Index Fund (Direct Plan) stood out with one of the lowest expense ratios at 0.05% and lowest base expense ratio of 0.04%.

Several other funds, including Navi Nifty 50 Index Fund, Motilal Oswal Nifty 50 Index Fund and Axis Nifty 50 Index Fund featured among funds with relatively low tracking errors of 0.04% each and competitive costs ranging between 0.06% to 0.10%. (Three year tracking error).

Can a lower tracking error improve long-term returns?

While expense ratio is an upfront cost that investors can easily compare, tracking error has a more direct impact on how closely an index fund delivers the returns of its benchmark over time. Even small differences in tracking error can compound over several years, potentially creating a noticeable gap between the fund's performance and that of the index it seeks to replicate.

Avasthi said that over long investment horizons, even small differences in tracking performance can compound into meaningful differences in returns and since index investing is about capturing market returns as efficiently as possible, consistently lower tracking error helps investors stay closer to the benchmark.

He cautioned against reacting to short-term fluctuations in tracking error or minor differences in expense ratios. According to him, tracking error can temporarily rise due to cash holdings, corporate actions, market conditions or index rebalancing. Investors should consider switching only if there is persistent evidence of higher tracking error, a meaningful cost advantage or structural improvements in another fund.

Dhawan said lower tracking error ensures investors capture returns closer to the benchmark over the long term. He recommended reviewing a fund only if it consistently underperforms peers over multiple quarters, indicating possible operational inefficiencies or liquidity issues. However, investors should also evaluate tax implications and exit loads before making the switch.

When should one switch between an index fund?

Anup Bhaiya said one can switch between index funds when these five triggers are there. These triggers include tracking error consistently above 0.15-0.20% for 4+ quarters, expense ratio gap exceeds 15-20 bps with similar tracking error, fund size drops below viable threshold.

Performance of these Nifty based index funds

Edelweiss Nifty 50 Index Fund with the lowest expense ratio lost 5.42% in the last one year whereas Bajaj Finserv Nifty 50 Index Fund lost the most of around 6.07% in the same period.

In the current calendar year, where these index funds fell upto 8.14%, Edelweiss Nifty 50 Index Fund fell 7.79%. SBI Nifty Index Fund and Navi Nifty 50 Index Fund lost 5.40% and 5.26% respectively.

Are low-cost index funds always the best choice?

Expense ratio is one of the most visible metrics in passive investing, but experts say it should not be the sole deciding factor.

Anup Bhaiya said cost should be viewed as the first filter, not the only one. He warned that investors should avoid chasing the cheapest fund if it struggles with operational efficiency. According to him, a fund charging 0.15% with superior replication can deliver better investor outcomes than one charging 0.08% but suffering from significantly higher tracking error. He also noted that larger funds often execute index rebalancing and corporate actions more efficiently, which may justify a slight higher expense ratio.

Dhawan said low-cost funds are not automatically superior if they experience delayed rebalancing or poor trade execution. A slightly higher-cost fund with efficient portfolio management may actually provide better returns by minimising tracking divergence.

Avasthi agreed, adding that investors should consider the total cost of owning an index fund, which includes both the expense ratio and tracking difference. According to him, efficient cash management, liquidity and securities lending practices also influence how closely a fund replicates its benchmark.

Should investors worry about changes in tracking error?

Tracking error can vary across market cycles due to factors such as volatility, index rebalancing, corporate actions and changes in liquidity. While temporary spikes are common, should investors worry about these short-term fluctuations or focus on long-term performance?

Dhawan explained that tracking error often increases during volatile phases because liquidity constraints and sudden fund flows make index replication more challenging. He said temporary deviations usually normalise once market conditions stabilise and suggested monitoring tracking error over rolling one-to-three-year periods.

Avasthi also emphasised that investors should evaluate consistency over time rather than reacting to isolated monthly or quarterly numbers. According to him, temporary increases during exceptional market conditions are normal as long as the fund has a strong long-term record of closely tracking its benchmark.

Anup Bhaiya said tracking error tends to widen during sharp market corrections, index reconstitution, corporate actions and periods of heavy inflows or outflows. However, he advised investors not to worry about short-term spikes if they are event-driven and normalise within one or two quarters. Instead, investors should focus on the three-year rolling tracking error to identify structural deterioration rather than temporary noise.

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