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KUNAL VENKATRAMAN, 35, a working professional, has been investing in mutual funds (MFs) for 10 years. Venkatraman has shifted a part of his portfolio to a passive fund from an actively managed fund and is pleased with his move.

The shift has made his holdings "much more balanced," Venkatraman, who is based in Bengaluru, says. "I am now assured of at least benchmark returns from my

core holding, which is now invested in a Nifty 50 index fund. The low cost and transparency tilted my preference towards passive funds."

Lakhs of individual investors like Venkatraman are increasingly switching to passive MFs—pools of money that mimic the movement of market indices—as a more cost-effective and safer alternative to MFs that are actively traded by the fund managers. Rising investor awareness, proliferation of digital investment platforms, and a range of new products, have contributed to the growing popularity of these funds, say experts.

The debate over the merits and demerits of passive funds has gained extra currency due to extreme volatility in stock markets. Local and global factors, including tensions in the Middle East, and trade and tariff policies of US President Donald Trump have contributed to a 16.5% fall in the NSE Nifty index from its record high of 26,277.35 points in September 2024. The dip has forced investors to think about low-risk investing, which is one reason for their increased interest in passive funds.

The fact of passive investing's growing popularity is borne out by the numbers: In February, retail investors had 593 passive schemes to choose from, an almost four-fold increase from 149 in 2020. The number of retail folios in passive funds rose 50% from 27.3 million to 40.9 million in the same period. Investors are finding passive funds more accessible and convenient, says Radhika Gupta, Managing Director and Chief Executive Officer, Edelweiss Asset Management.

Sure, the share of passive funds in India is very low when compared with developed markets like the US, where passive funds' Assets Under Management (AUM) was about 51% as of December 2024, according to the Association of Mutual Funds in India (AMFI).

The pace of growth, however, has been rapid in recent years and months. The AUM of passive funds, which include index funds, exchange-traded funds (ETFs), gold ETFs and fund of funds investing over-

seas, reached ₹11.08 lakh crore as of February 2025 from ₹8.99 lakh crore in February 2024. Since 2021, passive AUM has grown over three times.

Out of the 243 new fund offerings last year, 140 were passive schemes. Net passive inflows in February 2025 reached ₹10,249 crore.

As of February, passive funds accounted for 16.40% of the mutual fund industry in India. This number was 7.42% in March 2020. Since March 2020, the passive AUM has grown at a compound annual growth rate of 48% while the rest of the MF industry has expanded by 23%, show AMFI data.

MFLITE

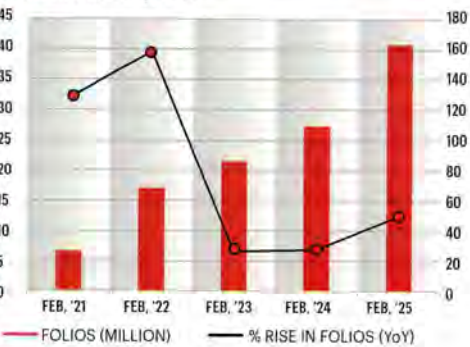
The trend has got a push from the regulator too. In November, the Securities and Exchange Board of India (Sebi) introduced MF Lite regulations, which specifies less stringent criteria for licenses for passively managed schemes.

MF Lite is a simplified alternative to traditional mutual funds, designed to streamline investments in passive schemes such as index funds and ETFs. The framework streamlines compliance, reducing the operational burden on fund houses launching passive funds.

This leads to cost savings and fewer regulatory hurdles. Sebi aims to provide a more cost-effective choice

STEADY MARCH

- The number of passive folios has risen more than six times since February 2021
- The sharpest increase came between February 2021 and February 2022



SOURCE AMFI

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MUTUAL FUNDS • PASSIVE INVESTING

for retail investors by offering passive investment strategies that track equity or debt markets. The relaxed compliance environment makes it easier for new entrants, particularly small MF houses, to introduce their products.

GLOBAL MARKETS

The growth of passives in India is following the trajectory of what transpired in developed markets where financial inclusion and expanding role of professional managers made markets more competitive and consequently efficient.

Individual alphas are turning inconsistent and, hence, investors are increasingly focusing on a market rate of return that can be easily captured via passive products, says Hemen Bhatia, Executive Director and CEO of Asset Management at fintech company Angel One. Passive-only fund houses like Angel One Asset Management Company believe that passive investing is “investment without guesswork.” The strategy removes stock and manager selection risks and ensures

46-48
PER CENT
GEN Z AND MILLENNIALS
PREFER INDEX FUNDS



capturing of market returns in a simple, cost-effective and transparent manner, says Bhatia.

When we compare the performance of active and passive funds to see whose returns are the closest to the rise in their benchmarks, we see that in the long term, a large number of active funds fail to beat the benchmark returns given by the passive funds. In a five-year period, only 50% active funds have beaten their benchmarks; in mid-cap funds, the number is 30%, making passives a better choice for the long term.

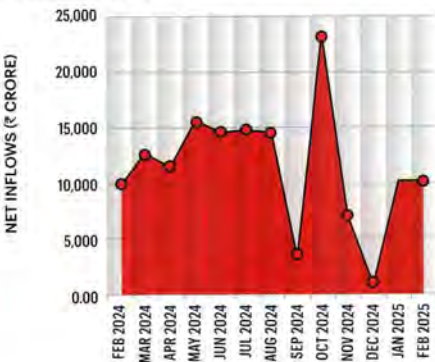
PASSIVE POPULARITY

According to an investor survey on passive funds conducted by Motilal Oswal Mutual Fund in November 2024, index funds lead in popularity, with 74% of investors choosing them (43% exclusively index funds, 31% both ETFs and index funds). As per AMFI data of February, index funds have an AUM of ₹2.74 lakh crore; it was just ₹7,878 in March 2020. Also, index funds are more pop-

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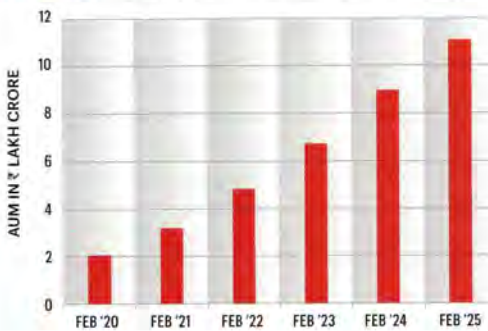
PEAKS AND TROUGHS

- Net passive fund inflows in February 2025 reached ₹10,249 crore
- They rebounded from just ₹784 crore in December 2024



SETTING RECORDS

- The average AUM of passive funds reached ₹11.08 lakh crore as of February 2025
- Passive AUM has grown more than 3X times since 2021



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ular among Gen Z and millennials, with 46-48% investors aged under 43 favouring them, compared to 35% among Gen X and boomers.

Pratik Oswal, Chief of Business (Passive Funds) at Motilal Oswal Asset Management, says some of the popular strategies in passive funds include picking sectoral funds and factor-based funds.

Sectoral funds allow investors to capitalise on growth opportunities in these areas. Factor-based funds, on the other hand, focus on specific market attributes such as value, momentum, quality and volatility. These funds use predefined rules to select stocks based on these characteristics, aiming to enhance portfolio performance by aligning with investor preferences and risk tolerance. The survey showed

that 67% respondents invested in sector funds while millennials and Gen X showed a stronger preference for factor funds.

SMART BETA STRATEGIES

Chintan Haria, Principal Investment Strategist at ICI- CI Prudential Asset Management, says while most investor interest is directed towards benchmark-based offerings, there is increased traction in several smart beta strategies such as low volatility, alpha low volatility and momentum. This has been largely due to improving investor awareness and increasing comfort around passive strategies. Smart beta strategies combine elements of passive and active investing to outperform traditional market-cap weighted indices by focusing on specific factors or characteristics of companies.

Satish Dondapati, Fund Manager at Kotak Mahindra Asset Management, says single or multi-factor based passive funds are also attracting investors. Factor-based funds offer several benefits, including risk management: factors like low volatility, quality and value can reduce the overall risk in the portfolio. While these funds provide diversification and customisation by targeting specific factors, investors are able to choose the funds depending on their risk appetite and time horizon.

PASSIVE OR ACTIVE?

Passive investing can be considered any time, but investors must remember that market risk does not diminish simply because they have invested in a passive fund. For example, a small-cap index fund still has the inherent volatility of small-cap stocks, says Gupta. "There is no one-size-fits-all approach. Investors should assess their needs before choosing between active and passive funds. Passive funds offer simplicity, cost efficiency, and convenience, while active funds provide the opportunity for outperformance. A well-balanced portfolio can include both, depending on investment goals," she says.

Oswal believes investing is a habit that should be consistent. When considering passives in volatile markets, it's essential to have a long-term horizon. Passive strategies offer a range of diversified products that cater to different market cycles, providing stability and resilience. This helps investors navigate volatility effectively by spreading risk across asset classes. Whether markets are volatile or stable, passive investments can be reliable for those committed to long-term growth and stability.

Additionally, incorporating a systematic investment plan (SIP) in passive investing helps navigate volatility by averaging cost through regular investments, regard-

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HEMEN BHATIA
EXECUTIVE
DIRECTOR & CEO,
ANGEL ONE ASSET
MANAGEMENT

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BEHIND THE BENCHMARK

- Over a five-year period, only 50% active large-cap funds beat benchmarks
- The number is 30% in case of mid-cap funds

Fund category	Benchmark	1-year return (%)	3-year CAGR (%)	% active scheme outperforming	5-year CAGR (%)	% active scheme outperforming
Large-cap	BSE 100 TRI	1.5	12	62	16.8	50
Flexi-cap*	BSE 500 TRI	-0.4	12.6	57	17.9	31
Small-cap	BSE 250 SmallCap TRI	-6.9	16.6	48	24	67
Mid-cap	BSE 150 MidCap TRI	0.6	19	40	24.3	30

NOTE *INCLUDES FOCUSED AND SOLUTION ORIENTED FUNDS WITH A FLEXICAP STRATEGY; DATA AS OF FEB 2025; RETURNS IN CAGR
SOURCE VALUE RESEARCH

less of market conditions. This reduces timing risks and leverages compounding benefits, making it a reliable strategy for long-term growth, says Oswal.

Vardarajan, Chief Business Officer of Tata Asset Management says it is not about passive vs active, but passive plus active, as both have their merits. There are times when active funds will do well and times when passives will do well. If you know which one to buy and are a seasoned investor, you should opt for active funds.

"If you don't have too much idea about stock-picking, and want to benefit from equities at large, passive funds are good enough. Even for seasoned investors, passives can be useful if stock picking in an index is difficult," says Vardarajan.

Bhatia says anytime can be the right time to invest in passives, but investors should take advantage of the current market fall and put their money in broad market index products, i.e., ETFs or index funds, via the SIP route.

THINGS TO KNOW

An investor may consider a passive offering if he aims to participate in the growth of a sector or the broader market without taking a call on the fund manager. But what investors must be mindful of is that there is no scope for alpha generation here, unlike actively managed strategies; it's important to manage your return expectations,

as passive funds aim to replicate an index's performance rather than outperform it, says Haria.

Gupta says investors should understand the index and the asset class they are betting on as well as the market conditions that favour performance. Key factors to consider include how diversified or concentrated the portfolio is, the cyclical nature of the sector, and risks like tracking difference, or the difference between returns on an investment and its benchmark index over a period.

Dondapati says passive funds generally have lower expense ratios, meaning you keep more of your returns because the fund manager's role is limited, and the investment strategy is relatively pre-defined, whereas in active funds the expense ratio is much higher due to the extensive research, analysis, and management activities performed by the fund manager.

It's important to compare expense ratios within similar funds to minimise costs.

Finally, passive investing is best suited for long-term investors, as these strategies typically deliver consistent returns over extended periods, rather than quick gains, says Oswal. For investors with a long-term view, passives could be the way to go. **BT**

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