

Exchange Traded Funds (ETFs)

A Comprehensive Investor's Guide



Blog by SubbuS | Retired Banker

Empowering Investors Through Knowledge & Clarity

Investing wisely begins with understanding the tools at your disposal. Exchange Traded Funds (ETFs) have revolutionised the way individuals invest — combining the diversification of mutual funds with the real-time flexibility of stock trading, all at remarkably low cost. This guide is crafted to give you a thorough, jargon-free understanding of ETFs — from the very basics to advanced portfolio construction.

Key Statistic	Data Point
Global ETF AUM (2024)	Approx. USD 12+ Trillion
Number of ETFs Worldwide	Over 10,000 products
India ETF AUM (FY 2024-25)	Approx. INR 7–8 Lakh Crore
Typical Index ETF Expense Ratio	0.04% – 0.30% per annum
World's First ETF	SPDR S&P; 500 ETF, USA (1993)
India's First ETF	Nifty BeES by Benchmark MF (2001)

1. What Are ETFs?

Definition and Core Concept

An **Exchange Traded Fund (ETF)** is an investment fund that pools money from multiple investors and invests in a basket of securities — stocks, bonds, gold, commodities, or a combination of asset classes. What makes an ETF unique is that it is listed and actively traded on a stock exchange, just like individual company shares, throughout the trading day.

Think of an ETF as a ready-made, diversified portfolio packed into a single, tradeable unit. When you purchase one unit of a Nifty 50 ETF, you automatically gain proportional ownership in all 50 companies that constitute the Nifty 50 Index — in one simple transaction.

Types of ETFs Available in India

ETF Type	Invests In	Examples
Equity / Index ETF	Stock market indices	Nifty 50 ETF, Sensex ETF, Nifty 500 ETF
Sectoral ETF	Specific industry stocks	Banking ETF, IT ETF, Pharma ETF
Midcap / Smallcap ETF	Mid or small-sized companies	Nifty Midcap 150 ETF
Debt / Bond ETF	Government or corporate bonds	Bharat Bond ETF, Gilt ETF
Gold ETF	Physical gold / gold derivatives	SBI Gold ETF, HDFC Gold ETF
International ETF	Global markets	Nasdaq 100 ETF, S&P; 500 ETF
Thematic ETF	Investment themes	ESG ETF, Technology ETF, Infrastructure ETF
Hybrid ETF	Mix of equity and debt	Multi-asset allocation ETFs

Key Characteristics at a Glance

- **Exchange-traded:** Bought and sold on NSE / BSE during live market hours (9:15 AM – 3:30 PM).
- **Real-time pricing:** NAV fluctuates second-by-second based on the underlying portfolio value.
- **Passive management:** Most ETFs simply track an index — no active stock picking, no fund manager bias.
- **Daily transparency:** Portfolio holdings are disclosed every trading day — you always know what you own.
- **Low cost:** Expense ratios are significantly lower than actively managed funds.
- **Demat account required:** Unlike regular mutual funds, ETFs require a Demat and trading account.

2. ETFs vs. Mutual Funds — Key Differences

Both ETFs and mutual funds pool money from investors into diversified portfolios. However, they differ significantly in structure, trading mechanism, pricing, and flexibility. Understanding these differences helps you choose the right investment vehicle.

Feature	ETF	Mutual Fund (Regular)
Trading Mechanism	Stock exchange — intraday	Fund house — end of day only
Pricing	Live market price (real-time)	End-of-day NAV
Demat Account	Mandatory	Not required
Expense Ratio	Typically 0.04% – 0.30%	Typically 0.50% – 2.25%
Liquidity	Exchange volume dependent	Redeemed with AMC at NAV
Intraday Trading	Yes — fully possible	Not possible
Limit / Stop-Loss Orders	Yes — available	Not available
SIP Facility	Limited (select brokers)	Widely and easily available
Minimum Investment	Price of 1 unit (e.g., ~Rs.200)	As low as Rs.500/month via SIP
Transparency	Daily portfolio disclosure	Monthly / quarterly disclosure
Management Style	Mostly passive (index tracking)	Both passive and active
Brokerage Cost	Applies on each transaction	No brokerage (direct plans)

Practical Illustration

Imagine the Nifty 50 surges 2% between 2:00 PM and 3:00 PM on a particular trading day:

- **ETF Investor:** Can immediately buy more units at the prevailing price — capturing the opportunity in real time, or exit with a limit order before the market closes.
- **Regular Mutual Fund Investor:** Any buy or sell order placed today will be executed only at today's closing NAV — no ability to act on intraday price movements.

Key Insight: For long-term, buy-and-hold investors, this intraday flexibility may not matter much. However, for investors who want tactical flexibility — to invest during sharp dips or exit during sudden rallies — ETFs offer a clear and practical advantage over regular mutual funds.

3. Advantages and Disadvantages of ETFs

Advantages

A. Low Cost — The Power of Fee Compounding

The most compelling advantage of ETFs is their low expense ratio. While the difference between 0.10% and 1.50% looks trivial on paper, over decades of investing the impact is dramatic:

Investment Scenario	Initial Investment	Expense Ratio	Assumed Returns	Value After 20 Years
Nifty 50 ETF	Rs.10,00,000	0.10% p.a.	12% gross	Approx. Rs.96.5 Lakh
Active Equity Fund	Rs.10,00,000	1.50% p.a.	12% gross	Approx. Rs.80.6 Lakh
Difference (Benefit of ETF)	—	1.40% less	—	Approx. Rs.15.9 Lakh MORE

B. Instant Diversification With a Single Transaction

One unit of a Nifty 50 ETF gives you exposure to 50 of India's largest companies spanning IT, banking, energy, FMCG, healthcare, and more. This dramatically reduces single-stock risk without requiring you to research and buy individual stocks.

C. Transparency — You Always Know What You Own

ETFs disclose their complete portfolio holdings every single trading day. This is in sharp contrast to many actively managed funds that reveal their portfolio only monthly or quarterly — often after significant portfolio changes have already occurred.

D. Real-Time Trading and Tactical Flexibility

You can place buy, sell, limit, and stop-loss orders on ETFs during any market hour — exactly as you would for individual stocks. This makes ETFs useful not just for long-term wealth creation, but also for short-term tactical adjustments to your portfolio.

E. No Fund Manager Bias — Pure Index Returns

Research consistently shows that over 10–15 year periods, 80–90% of actively managed equity funds fail to beat their benchmark index after costs. Passive ETFs eliminate this risk entirely — your return is the index return, minus a tiny expense ratio.

F. Tax Efficiency

Because index ETFs rebalance only during index reconstitution (typically once or twice a year), they generate far fewer capital gains events within the fund. This reduces the tax drag compared to actively managed funds that frequently churn their portfolios.

Disadvantages — Important Considerations

Limitation	Why It Matters	How to Manage It
Demat Account Needed	Brokerage and account maintenance charges apply	Compare brokers; choose low-cost discount brokers
Tracking Error	ETF may underperform its index due to costs and cash drag	Choose ETFs with consistently low tracking error
Liquidity Risk	Low-volume ETFs have wide bid-ask spreads	Stick to ETFs with high Average Daily Trading Volume
No Outperformance	Index ETFs can only match (not beat) the benchmark	Accept market returns — most active funds underperform anyway
Market Risk	ETF falls when the market falls	Long investment horizon reduces this risk significantly
Behavioural Risk	Easy intraday trading tempts impulsive decisions	Set an investment policy; review quarterly, not daily
No Easy SIP	Systematic investing is less seamless than MF SIPs	Some brokers offer ETF SIP; or use index mutual fund as alternative

4. Who Should Invest in ETFs?

ETFs are among the most versatile investment products available. Here is a practical framework to determine the right ETF mix based on age and risk appetite:

Age-Based Allocation Framework

Age Group	Risk Capacity	Equity ETFs	Gold ETFs	Debt ETFs	Recommended ETF Categories
20–35 Years	High	70–90%	5–15%	5–15%	Nifty 50, Nifty Next 50, Midcap 150, Nasdaq 100
35–50 Years	Moderate–High	60–75%	10–20%	10–20%	Nifty 50, Banking, Gold, Flexi Index ETFs
50–60 Years	Moderate	40–55%	10–20%	25–35%	Broad Market, Bharat Bond, Gold ETFs
60+ Years	Conservative	20–35%	10–20%	45–60%	Bharat Bond, Gilt, Large-cap, Gold ETFs

Risk Profile Based Suitability

Risk Profile	Suitable ETF Mix	Core Objective
Conservative	Debt ETFs (60%) + Gold ETFs (25%) + Large-cap (15%)	Capital preservation + inflation hedge
Moderate	Nifty 50 (50%) + Debt ETFs (30%) + Gold (20%)	Balanced growth with stability
Aggressive	Equity ETFs (75%) + Gold (15%) + International (10%)	Long-term wealth creation
Very Aggressive	Midcap/Thematic/International ETFs (85%) + Gold (15%)	Maximum growth, high volatility tolerance

Ideal Investor Profiles for ETFs

- **First-time investors** wanting diversified market exposure without stock-picking complexity.
- **Salaried professionals** seeking disciplined, low-maintenance long-term wealth creation.
- **Retirement planners** building a corpus over a 20–30 year horizon with minimal costs.
- **Cost-conscious investors** who understand that fees compound just as powerfully as returns.
- **Passive investors** satisfied with market returns and not trying to outperform the index.
- **NRIs and HNIs** seeking transparent, tax-efficient, and liquid market exposure.

5. Key Factors to Evaluate Before Investing

Not all ETFs are created equal. Two ETFs tracking the same index can deliver meaningfully different outcomes over time. Here are the critical evaluation parameters every investor must assess:

A. Liquidity — Can You Enter and Exit Efficiently?

Liquidity in ETFs has two dimensions: the liquidity of the ETF units on the exchange (measured by Average Daily Trading Volume) and the liquidity of the underlying securities it holds. Low liquidity leads to wide bid-ask spreads — meaning you overpay when buying and receive less when selling.

- Prefer ETFs with Average Daily Traded Value (ADTV) of Rs.5 crore or more.
- For large positions, look for ADTV of Rs.50 crore or higher.
- During volatile markets, illiquid ETFs can trade at significant premiums or discounts to their actual NAV.

B. Tracking Error — How Faithfully Does the ETF Follow Its Index?

Tracking error measures the deviation between the ETF's actual returns and the benchmark index returns over a period. A lower tracking error indicates better index replication.

Cause of Tracking Error	Explanation	Investor Impact
Expense Ratio	Annual fees reduce returns below the index	Direct and unavoidable cost
Cash Holdings	Cash earns less than invested securities	Drag on performance
Rebalancing Delay	ETF may lag when index constituents change	Slippage at reconstitution
Transaction Costs	Buying/selling underlying stocks has costs	Slight drag on returns
Securities Lending	ETFs may lend holdings to earn income	Can partially offset tracking error

Rule of Thumb: For large-cap index ETFs (Nifty 50, Sensex), seek tracking error below 0.20% annually. For sectoral or international ETFs, up to 0.50% is acceptable given the complexities involved.

C. Expense Ratio — The Silent Compounder Against You

The expense ratio is deducted daily from the ETF's NAV and is not visible as an explicit charge. Over decades, even a 0.20% difference can translate to lakhs of rupees in lost wealth. Always compare expense ratios when choosing between ETFs on the same index.

D. Assets Under Management (AUM)

AUM reflects investor trust and scale. Larger AUM generally means better operational efficiency, lower per-unit costs, and a reduced risk of the fund being wound up.

- Preferred: ETFs with AUM above Rs.500 crore (Rs.2,000+ crore for flagship index ETFs).

- **Caution:** ETFs with AUM below Rs.100 crore may face higher tracking errors, lower liquidity, and closure risk.

E. Bid-Ask Spread — The Hidden Transaction Cost

Term	Definition	Ideal Target
Bid Price	The price at which you can SELL ETF units on the exchange	—
Ask Price	The price at which you can BUY ETF units on the exchange	—
Spread	Ask Price minus Bid Price — your implicit cost per transaction	As narrow as possible
Ideal Level	For large liquid ETFs, spreads should be negligible	Below 0.05% of unit price

F. Underlying Index Quality

The quality of the benchmark index determines the quality of your investment. Strong indices have broad diversification, clear rebalancing rules, and high constituent liquidity.

- **Core holdings (60–80% of equity allocation):** Nifty 50, Sensex, Nifty 500 — broad, liquid, time-tested.
- **Satellite positions (10–20%):** Nifty Next 50, Nifty Midcap 150, Nifty Bank — tactical sector bets.
- **Global diversification (5–15%):** Nasdaq 100, S&P; 500 — exposure to global technology leaders.
- **Avoid:** Obscure, low-liquidity, or untested thematic indices with short track records.

6. Taxation of ETFs in India (Updated 2024–25)

The Union Budget 2024 introduced significant changes to ETF taxation. Understanding the current tax structure is critical for calculating net returns and planning redemptions.

ETF Category	Holding Period	Tax Treatment	Key Note (Budget 2024)
Equity ETFs (65%+ in Indian equities)	Less than 12 months	STCG @ 20%	Rate increased from 15% to 20% in Budget 2024
Equity ETFs	12 months or more	LTCG @ 12.5% above Rs.1.25 lakh exemption	Exemption limit raised; rate raised from 10% to 12.5%
Gold ETFs	Less than 24 months	Added to income — taxed at slab rate	Short-term gains taxed as ordinary income
Gold ETFs	24 months or more	LTCG @ 12.5% without indexation	Budget 2024 removed indexation benefit
Debt / Bond ETFs	Any holding period	Added to income — taxed at slab rate	Post April 2023 amendment: no LTCG benefit
International ETFs (less than 65% in Indian equity)	Any period	Taxed at slab rate	Treated as non-equity — slab rates apply

Important Disclaimer: Tax laws are subject to change. The above is indicative based on available information as of mid-2025. Always verify the current provisions with a qualified Chartered Accountant or SEBI-registered investment advisor before making investment or redemption decisions based on tax considerations.

Practical Tax Planning Tips

- **LTCG Exemption:** Plan equity ETF redemptions across financial years to utilise the Rs.1.25 lakh annual LTCG exemption limit efficiently.
- **Tax-Loss Harvesting:** Book losses on underperforming ETFs to offset capital gains elsewhere, reducing your net tax liability.
- **Hold for the Long Term:** For equity ETFs, simply holding beyond 12 months reduces your effective tax rate from 20% to 12.5%.
- **Gold ETF vs SGB:** Sovereign Gold Bonds offer 2.5% annual interest PLUS tax-free maturity proceeds (if held 8 years). Compare before choosing Gold ETF.

7. How to Start Investing in ETFs — Step by Step

Step	Action Required	Practical Guidance
1	Open Demat & Trading Account	Choose SEBI-registered broker: Zerodha, Groww, Upstox, ICICI Direct, HDFC Securities, Kotak Securities etc.
2	Complete KYC Process	Submit PAN, Aadhaar, bank details online. Process takes 1–3 business days at most brokers.
3	Fund Your Account	Transfer money from your bank account to the trading account via NEFT/IMPS/UPI.
4	Research Your ETF	Check: expense ratio, tracking error, AUM, daily volume on NSE/BSE website, Value Research, or Morningstar India.
5	Place Your Buy Order	Search the ETF by name or NSE ticker (e.g., NIFTYBEES, GOLDIETF, JUNIORBEES) on your broker platform.
6	Monitor Periodically	Review performance every quarter. Rebalance annually to stay on track with target allocation.
7	Redeem When Needed	Place a sell order during market hours. Proceeds credited to your account within T+1 or T+2 days.

Popular ETFs in India — Quick Reference (Indicative)

Category	ETF Name	Benchmark	Indicative TER
Large-cap Equity	Nippon India Nifty 50 BeES	Nifty 50	~0.04%
Large-cap Equity	SBI Nifty 50 ETF	Nifty 50	~0.07%
Large-cap Equity	HDFC Nifty 50 ETF	Nifty 50	~0.05%
Nifty Next 50	Nippon India Junior BeES	Nifty Next 50	~0.19%
Midcap	Motilal Oswal Midcap 150 ETF	Nifty Midcap 150	~0.25%
Banking	Nippon India Bank BeES	Nifty Bank	~0.22%
Gold	SBI Gold ETF	Domestic Gold Price	~0.65%
International	Motilal Oswal Nasdaq 100 ETF	Nasdaq 100	~0.50%
Debt	Bharat Bond ETF Apr 2030	Nifty Bharat Bond Apr 2030	~0.0005%

Note: TER (Total Expense Ratio) figures are indicative and subject to change. Verify current data from respective AMC websites and AMFI before investing.

8. Building a Well-Diversified ETF Portfolio

A disciplined ETF portfolio built around core principles — broad diversification, low cost, and regular rebalancing — can serve as the foundation of long-term wealth. Below are three illustrative model portfolios for different investor profiles:

Model Portfolio 1: Young Professional (Age 25–32 | Aggressive Growth)

ETF Category	Allocation %	Rationale
Nifty 50 ETF	40%	Stable large-cap core — highest liquidity
Nifty Next 50 ETF	20%	Future large-caps — higher growth potential
Nifty Midcap 150 ETF	20%	Long-term outperformance vs large-caps
Nasdaq 100 / S&P; 500 ETF	15%	Global tech diversification — USD hedge
Gold ETF	5%	Safe haven and inflation hedge

Model Portfolio 2: Mid-Career Investor (Age 40–48 | Balanced Growth)

ETF Category	Allocation %	Rationale
Nifty 50 ETF	40%	Stable large-cap anchor
Banking / Sectoral ETF	15%	Tactical sector opportunity
Gold ETF	15%	Diversification and wealth protection
Bharat Bond ETF	20%	Stable, tax-efficient debt exposure
Nasdaq 100 / International	10%	Geographic diversification

Model Portfolio 3: Pre-Retiree (Age 55–62 | Capital Preservation)

ETF Category	Allocation %	Rationale
Nifty 50 ETF	25%	Inflation-beating growth component
Gold ETF	15%	Wealth preservation in uncertainty
Bharat Bond ETF (2030/2033)	35%	High credit quality, predictable returns
Gilt / Government Bond ETF	25%	Capital safety, sovereign guarantee

These model portfolios are purely illustrative and educational. They do not constitute personalised investment advice. Individual circumstances — income, goals, tax situation, liabilities, and risk tolerance — vary significantly. Please consult a SEBI-registered investment advisor for a personalised financial plan.

9. Common Mistakes to Avoid

Common Mistake	Why It Damages Returns	The Right Approach
Chasing recent performance	Last year's top ETF often underperforms the next year	Focus on index quality, costs, and your goals — not past returns
Ignoring liquidity	Wide bid-ask spreads silently increase transaction costs	Check ADTV before investing; prefer Rs.5 crore+ daily volume
Over-diversifying	10+ ETFs with overlapping indices add no real diversification	5–7 ETFs across distinct asset classes is usually optimal
Frequent trading	Brokerage, STT, exit loads, and taxes accumulate rapidly	Buy, hold, review quarterly, rebalance once a year
Ignoring tracking error	A 0.5% annual tracking error compounds to significant underperformance	Compare tracking errors when choosing between similar ETFs
Skipping rebalancing	Portfolio drifts from target — risk profile changes unintentionally	Annual rebalancing to target allocation is essential discipline
Confusing price and NAV	ETF price can trade at premium or discount to actual NAV	Check iNAV on NSE website before placing large orders
Panic selling in downturns	Markets recover; selling in panic locks in losses permanently	Stay invested through downturns — time in market beats timing the market

10. ETF Investor's Complete Evaluation Checklist

Run through this checklist before committing to any ETF investment:

#	Evaluation Criterion	What to Look For
1	Expense Ratio	Below 0.30% for equity ETFs; below 0.10% for large-cap index ETFs
2	Tracking Error	Below 0.20% for large-cap; below 0.50% for thematic / international
3	Average Daily Volume	Minimum Rs.5 crore daily ADTV; Rs.50+ crore preferred for large positions
4	Assets Under Management	Minimum Rs.500 crore; Rs.2,000+ crore for institutional-grade confidence
5	Bid-Ask Spread	Below 0.05% of unit price during normal market hours
6	Benchmark Index Quality	Well-established, rule-based, diversified, widely recognised index
7	Fund House Reputation	Top-tier AMC with strong operational and compliance track record
8	Replication Method	Physical replication preferred; understand synthetic ETF risks

#	Evaluation Criterion	What to Look For
9	Taxation	Know holding period rules for your specific ETF asset class
10	Portfolio Fit	Does this ETF add genuine diversification to your existing holdings?
11	Investment Horizon	Confirm your holding period matches the ETF's risk profile
12	Exit Mechanism	Verify you can exit easily — check volume and spread during volatile markets

Conclusion — Invest Smart. Stay the Course.

Exchange Traded Funds represent one of the most elegant financial innovations of the past three decades. They have democratised access to institutional-quality, diversified portfolios for every retail investor — at a fraction of the cost of actively managed funds, with complete transparency and the flexibility of stock-like trading.

The most powerful principle for ETF investors is elegantly simple: **Get your asset allocation right first. Then choose low-cost, high-liquidity ETFs. Stay invested through market cycles.** This disciplined approach, practised consistently over 15–30 years, outperforms the vast majority of complex investment strategies.

Whether you are a 25-year-old just beginning your wealth creation journey, or a 55-year-old recalibrating your retirement corpus — ETFs offer a powerful, proven, and affordable path to achieving your financial goals.

"The stock market is a device to transfer money from the impatient to the patient." — Warren Buffett "In investing, what is comfortable is rarely profitable. ETFs make long-term discomfort easier to manage by keeping costs low and strategy simple."

Key Takeaways for Every ETF Investor

- ✓ Start early — time in the market is the single greatest driver of long-term wealth.
- ✓ Keep costs relentlessly low — every rupee saved in fees compounds in your favour.
- ✓ Diversify across asset classes: equity, gold, and debt ETFs each serve a distinct role.
- ✓ Match your allocation to your age, income stability, and genuine risk tolerance.
- ✓ Ignore short-term noise — markets fluctuate; your long-term plan should not.
- ✓ Understand taxation before investing — net returns matter more than gross returns.
- ✓ Review quarterly, rebalance annually — discipline trumps market timing every time.

Disclaimer

Purpose of This Blog

This blog has been prepared by SubbuS, a Retired Banker, purely for educational and informational purposes. It is intended to help investors — beginners and experienced alike — understand the concept, structure, evaluation criteria, and practical application of Exchange Traded Funds (ETFs) in the Indian investment context.

Not Investment Advice

The content of this blog does not constitute investment advice, financial planning advice, trading advice, or any form of professional financial service. Nothing in this document should be construed as a solicitation, recommendation, or endorsement to buy, sell, or hold any specific ETF, fund, security, or financial instrument. All investment decisions are the sole responsibility of the investor.

No Guarantee of Accuracy or Completeness

While every effort has been made to ensure accuracy at the time of writing (June 2025), financial markets, tax laws, regulatory frameworks, fund details, and economic conditions change continuously. Readers must verify all data — including expense ratios, AUM figures, tax rates, regulatory requirements, and fund availability — from authoritative current sources such as SEBI, NSE, BSE, AMFI, RBI, and respective Asset Management Companies.

Consult a Qualified Professional

Every investor's financial situation, goals, risk tolerance, tax profile, investment horizon, and personal circumstances are unique. Before making any investment decision, readers are strongly encouraged to consult a SEBI-registered Investment Advisor (RIA), a SEBI-registered Research Analyst, or a qualified Chartered Accountant for personalised advice tailored to their individual needs and circumstances.

Market Risk Warning

All investments in ETFs, mutual funds, and securities are subject to market risks. The value of investments may increase or decrease based on market conditions, interest rate movements, economic factors, and other variables beyond investors' control. There is no assurance or guarantee of returns. Past performance is not indicative of future results. Investors should read all scheme-related documents carefully before investing.

Author's Background and Independence

SubbuS is a retired banker with extensive experience in financial services and banking operations. This blog represents personal views formed from professional experience and publicly available information. It is not associated with, endorsed by, or prepared on behalf of any financial institution, asset management company, brokerage firm, regulatory body, or any other organisation.

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