EXPENSE RATIOS PLAY AN IMPORTANT ROLE: DIFFERENCE BETWEEN ACTIVELY MANAGED AND PASSIVELY MANAGED FUNDS

Abby recently completed his Masters of Business Administration from Kurukshetra University. During the campus placements session, he got a job in Tata Autocomp Systems Ltd. After receiving his first paycheque, Abby's father called him to discuss the most important part in a salaried person's life- Wealth management. Since Abby was a marketing graduate, he had roped in a financial advisor who advised on buying a few stocks and starting a SIP in TDX large cap fund- Regular growth. Abby's father himself being a mediocre in finances supported his decision of doing so. An year later, Abby's mother had a major surgery for which the former had to withdraw all his deposits. Abby's principal investment had become Rs. 2,60,000 as being reflected in his De-mat account. When he withdrew, he only received 2,50,000 rupees. No more to his surprise, his financial advisor had already taken his fees and was not answering his calls now. This is when he called his friend Tia, who had done her MBA in Finance. Over a cup of coffee Tia explained the concepts of Expense ratio to Abby. She highlighted the fact that along with other expenses that the Asset Management Company (the company which ran and managed the fund), Abby had paid 2.5% of expense ratio on a simple large cap fund. Also, in order to earn commission, his advisor had made him buy a regular fund instead of a direct growth fund which did not involve any intermediaries.

Another trap for Abby being a novice was investment in a large cap mutual fund which could have easily been substituted by an Index fund which has minimal expense ratios.

It was after this incident that Abby got to learn about the role of expense ratios in a person's return. Expense ratios minimise the returns of an investor and serve as a fee for the AMC. So, if a mutual fund is charging 1% interest from the investors and promising an annual return of 10%, the investor's actual return would be 9% only. Further expenses would be deducted afterwards.

From the above scenario, following are the points of deliberation-

1. What is the difference between a Mutual fund/ Index fund and Exchange Traded fund.

2. What do we understand by STT, Exit load and Indexation.

3. What are the key pointers to short list a mutual fund for investment purposes?

4. SEBI’s regulation on expense ratios as announced in April 2022.

5. Can expense ratios alone impact decision making regarding choice of mutual funds?