What is an Index? And how to do index investing

The Indian stock market has been on a roller coaster ride over the last year and a half, moving from euphoria to distemper in a matter of months. Luckily for you, the market has now begun its upward climb, reclaiming lost ground seamlessly. In this scenario, you may be looking forward to re-entering the market with a bang, but that is not all. You may also be one of the many newcomers who are also considering this an opportunity to gain equity exposure. If you are new to the investing world and are keen on being a part of the rapidly booming equity market, the index may be a good place to start. Here, we will answer a variety of questions from what is an index to how to undertake index investing efficiently.

What is an Index?

If you are a first-time investor then passive equity funds or index investing is a wonderful starting point towards wealth generation and accumulation. Answering the question of what is an index, the term refers to a benchmark which comes in handy when measuring or tracking the performance of stocks or other asset classes like commodity and debt. An index is made up of a basket of similar securities, and the performance of these securities can be tracked seamlessly by way of the index. For instance, the Nifty Bank index is composed of select bank stocks in India, and when you track this index, you get a good idea of where the sector is heading. Indexes in India are both broad-based and sector-specific, ensuring you have an index suited for every need.

Major features of index to consider

The biggest feature of an index revolves around its purpose of measuring the price performance of the underlying basket of stocks or securities. Around the globe, indexes are leveraged as a benchmark to monitor and track the performance of a pre-decided group of securities and this performance is then compared with the returns being generated by mutual fund investing in the same sub-set. This helps both you and the fund houses ascertain the quality of the mutual fund. Another feature of indexes is that it fosters index exchange-traded funds or schemes which invest in the pre-decided list of securities that the underlying index tracks. For example, the HDFC Nifty 50 fund will track the performance of the underlying Nifty 50 index and work towards unlocking returns in line with the index. This is known as investing in index.

Need of indexes

Indexes are usually utilised for the following purposes –

- Tracking the impact of economic and financial data such as growth figures, inflation, interest rates, etc., on a specific asset

class
- Passive equity investing in index funds
- Tracking mutual fund portfolio returns, in comparison to the underlying index

What is index investing?

The term index investing refers to the practice of parking your funds in the underlying index, without actively picking the securities. When you undertake index investing, your returns will be in line with the broader market, as against active investment. Investors can use their preferred benchmark and find index funds to invest in, based on their profile which includes aspects such as their risk appetite, return requirements, time horizon and financial goals. Index investing is a great option for passive investors who do not have adequate knowledge or time to track the market and take informed decisions. Over the longer term, index investing also allows you to make significant gains thanks to the low expense ratio involved in index funds.

Basics of index investing

As you have seen, index investing, also known as passive investing, is a popular investment strategy that seeks to match the performance of a particular market index, such as the Nifty or the BSE Sensex. The index ETF accomplishes this ask by investing in a portfolio of securities that mirrors the index's composition and weighting. The idea is that by investing in a diverse range of companies in the index, the overall returns should track the performance of the market. Index investing is popular due to its simplicity, low fees, and low risk compared to active investing, which seeks to outperform the market by choosing individual stocks or timing the market. Index investing is often achieved through exchange-traded funds (ETFs) or mutual funds.

Examples of indexes in India

There are many indexes in India, and these include the Nifty 50 index, the Nifty next 50 index, Nifty mid cap 100, Nifty small cap 250, Nifty Bank, Nifty IT, BSE Sensex index, Nifty FMCG, Nifty Auto, Nifty Pharma, Nifty Metal, etc.

While these are a few of the popular names in equity index investing, you can also invest in other securities like gold and debt, through index investing, and participate in the broad-based growth of the market. You can even use index investing to park your funds in global indexes, thus ensuring optimal diversification. Now that you know all about index investing, start your investment journey by choosing the right index for your requirements.