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**Topic:** Tracking Error of Exchange Traded Funds & Factors Affecting Tracking Error: Evidence from Indian Stock Market

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### **ABSTRACT**

Exchange Traded Funds (ETFs) are recently popularised financial instruments. Thus, lack extensive research .Through this study an attempt has been made to; analyse the performance of Indian ETFs in relation to their underlying indices, examine the size of tracking error and thereby identifying factors affecting tracking error. Along with these objectives pricing efficiency aspect of ETFs is also addressed. For the purpose of study 29 Indian ETFs have been selected. Upon analysis, it has been brought out that there is a negligible difference in performance of almost all the ETFs and their underlying benchmark indices. Concerning magnitude of tracking error it has been brought out that average tracking error increase as we move from daily returns to yearly returns. Among factors affecting tracking error, age of fund, volume traded, risk, expense ratio, and volatility can be regarded as significant drivers of tracking error. Also majority of the ETFs were found to be trading at discount which gives rise to considerable arbitrage opportunity. It is believed that this study will be valuable to investors and other market participants specifically arbitrageurs and hedgers. Additionally, it will also pave a way for potential researchers to add to the existing pool of knowledge.