HSBC Mutual Fund

Here’s how you can make the most of arbitrage funds.

Arbitrage is simply a process of buying stocks or shares in one market and selling them in another market to exploit the price difference between them. Arbitrage Funds fall under the category of Hybrid Funds that seek profits on arbitrage opportunities between cash and derivative segments of equity markets. The fund managers look for opportunities that can generate profits between these differences to generate returns.

Here’s how Arbitrage Funds work

These Funds start the process by buying a stock in the cash segment and simultaneously selling equal quantity of the stock in the futures segment of the market. The positions initiated are thus to be reversed before or during the expiry of the futures series.

Stock A (different price quote in different markets)

Price in Cash market = ₹100 → **Buy** in Cash market

Price in Future market = ₹102 → Simultaneously **Sell** in Future market

Lock-in a **profit of ₹2 per share**

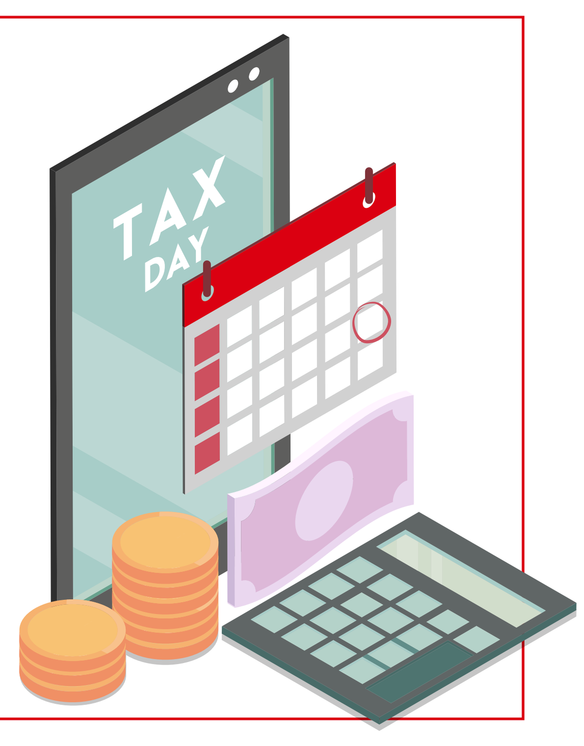
(The above example shows an illustration of the arbitrage opportunity. It is assumed that the cash and futures prices will converge on the day of the expiry. The above opportunity may or may not be always available in the market. This is for illustration purpose only. No assurance can be given that prices of stock and stock futures will correlate perfectly on expiry date of stock futures)

Features of Arbitrage Funds

- Endeavor to generate positive returns during market volatility
- TAX: Tax-efficient, as tax treatment is similar to equity funds
- Offer relatively risk-free returns among equity investments
- Aims to generate returns through fully hedged exposure to equities

Arbitrage Funds and Taxation

Since Arbitrage Funds hold a minimum 65% in equities where the same is hedged, they are thus taxed as equity-oriented funds. If an investor redeems their investment after one year, the gains from overall equities are tax-free up to Rs.1 lakh. Beyond this limit, the investor has to pay 10% Long-Term Capital Gains tax. Short Term Capital Gains tax is also lower than other debt funds at 15%.



Who are Arbitrage Funds suitable for?

1. Investors seeking low-risk but reasonable returns in a volatile market
2. Those in a higher income bracket can use them to park surplus money for a short period
3. Those with an investment horizon of 3 months or more can park a part of their portfolio in these funds

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