Arbitrage Fund

Definition: Arbitrage funds are mutual fund schemes that provide returns by using the opportunity of price differences in an asset between two or more markets. The returns depend on the volatility of the asset.

Example: For example, the stock price of ABC Ltd. is quoting at Rs. 1,000. Let's say the stock is also traded in derivatives segment, where its future price is Rs. 1,050. In such a case, quick profit can be made by selling futures contract of ABC Ltd. at Rs. 1,050 and buying an equivalent number of shares in the equity market at Rs. 1,000. Accordingly, fund earns the spread between the purchase price of the equity shares and the sale price of futures contract.

Explanation: Arbitrage funds take the advantage of an arbitrage opportunity to make profit by using price differential opportunities in the stock market. For example, difference between a stock's price on BSE & NSE, or a difference in prices of an asset in the spot market and the futures market, or difference between this month's future contract and the next month's future contract help earn better returns. Their basic principle is to sell in overpriced market and buy in underpriced market. Arbitrage funds can generate large returns on rising volatility.

DID YOU KNOW?

5 WRONG REASONS TO BUY LIFE INSURANCE!!

You want to oblige the seller: The first thing a life insurance agent is taught is to go out and sell policies to his friends, relatives and associates. Unless it's a very close relative who needs help, don't feel obliged to buy if you don't need it. Even then, it might be a better idea to help the person with cash instead of throwing money for 15-20 years in the policy.

You want to save tax: This has been emphasised endlessly, but needs to be reiterated: don't buy life insurance to save tax. There are better, more lucrative investment avenues that can get you tax deduction under Section 80C. The PPF gives assured returns and tax-free corpus. Fixed deposits give higher returns even though the income is taxable. ELSS gives tax-free income and potentially higher returns.

It combines insurance with investment: Agents like to say that endowment or money-back insurance policies offer the twin benefits of insurance and investment. In reality, they fall between the two stools. As an investment, an endowment policy gives very low returns, yielding barely 5-6 per cent returns.

You are looking for guaranteed returns: Many buyers are looking for the guaranteed returns promised by life insurance companies. However, this guarantee comes at a high price, forcing the company to invest in safe, debt-based options. There are other instruments that give guaranteed returns and offer better yields than a traditional insurance policy. The PPF, for instance, offers assured 8.7 per cent returns with tax-free corpus.

No medical check-up is required: If the cover is below Rs 5 lakh, the buyer is not put through a medical test but is asked to submit a declaration about his health condition. Don't buy a policy just because the insurer is being lenient. A stringent medical test puts the onus on the company to assess the buyer's health condition. If he dies of a health condition, the company cannot claim that he had hidden facts.

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