PGIM
India Mutual Fund

Impact of recent market volatility on Arbitrage Funds

Utkarsh Katkoria
Co-Fund Manager

The recent market movements have been unprecedented and this has led to several questions being raised in the minds of the investor as well as the distribution community. Please find below some key points on the impact of recent market volatility on Arbitrage Funds:

- In the recent past, equity markets globally have been volatile and seen sharp corrections owing to concerns relating to COVID-19 pandemic and the resultant fear of slowdown in economic activity. The movement in Indian equity markets has been similar to its global peers. Taking note of very high volatility in the markets, SEBI has introduced new measures which makes taking short directional positions in the market more difficult. These measures include revision in MWPL (market wide position limits) and increase in minimum margin requirements. These measures we believe would provide support to premiums / spreads in the F&O market.

- For Arbitrage funds, the existing book that is deployed in the market, only the Futures position needs to be rolled over to the next month. This is called as Short Roll. Short Roll premium levels have definitely decreased compared to historical averages but have not turned negative. Currently there are enough stocks in the market, where Short Roll premium levels are in the positive, allowing us to comfortably Short Roll our existing Fund / AUM to next month without incurring any capital loss

- In an Arbitrage fund if there are some stocks where the futures price is trading at a discount to cash price, the fund can unwind / exit the position. To do so fund will have to buy back existing short Futures position and sell existing Cash position. The fund gains as the spread captured is higher than original spread. For e.g. if the original trade was executed when the Cash price was Rs. 100 and Futures price was quoting at Rs.101. The original arbitrage was Rs.1. Now assuming that the Cash price is Rs.95 and Future is quoting at Rs. 94, the fund will gain Rs. 7 when it buys back the Future and lose Rs.5 on Cash position netting Rs 2, instead of Rs.1. The portfolio can be re-balanced at favourable levels thereby benefiting overall returns. -

- The challenge in current market conditions is to deploy large quantum of fresh funds, where Fresh Arbitrage premium levels (difference between Cash equity and corresponding Futures price) are much lower and closer to parity. Hence select schemes in the market, have stopped accepting fresh inflows till month end. Given our size and execution capabilities we are in a position to deploy fresh funds.

- We run a concentrated portfolio strategy (~40 stocks) in PGIM India Arbitrage Fund. Given our size we can be agile and selective in our approach and invest in companies wherein the premiums are higher compared to market average. We remain true to our mandate and manage a pure arbitrage portfolio that is fully hedged at all times

- Arbitrage Funds offer moderately low-risk fixed income type annualized returns, but with added benefits of lower equity taxation and limited impact from market volatility due to hedged positions.

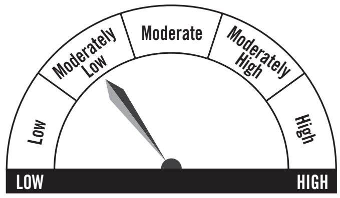
PGIM India Arbitrage Fund
(An open ended scheme investing in arbitrage opportunities)

This product is suitable for investors who are seeking*

- Income over short term
- Income through arbitrage opportunities between the equity spot and equity derivatives market and arbitrage opportunities within the equity derivatives segment
- Degree of risk – MODERATELY LOW

* Investors should consult their financial advisers if in doubt about whether the product is suitable for them.

Riskometer



Investors understand that their principal will be at moderately low risk