

NOTICE

**DSP**  
MUTUAL FUND

NOTICE is hereby given to the investors/Unit Holders of DSP Dynamic Asset Allocation Fund ('Scheme') that the Board of Directors of DSP Trustee Private Limited, Trustee to DSP Mutual Fund ('Fund'), have approved change in fundamental attribute of the Scheme as summarized below which would be effective from **September 18, 2019**.

The following changes will be carried out in the Scheme:

Sr. No.	Particulars	Existing	Proposed																																																																																	
1.	Investment Objective	<p>The investment objective of the Scheme is to seek capital appreciation by managing the asset allocation between equity and fixed income securities. The Scheme will dynamically manage the asset allocation between equity and fixed income based on the relative valuation of equity and debt markets.</p> <p>The Scheme intends to generate long-term capital appreciation by investing in equity and equity related instruments and seeks to generate income through investments in fixed income securities and by using arbitrage and other derivative strategies.</p> <p>However, there can be no assurance that the investment objective of the scheme will be realized.</p>	<p>The investment objective of the Scheme is to seek capital appreciation by managing the asset allocation between equity and fixed income securities. The Scheme will dynamically manage the asset allocation between equity and fixed income. Equity allocation will be decided based on a combination of valuation and momentum while fixed income and arbitrage will be resultant allocation.</p> <p>The Scheme intends to generate long-term capital appreciation by investing in equity and equity related instruments and seeks to generate income through investments in fixed income securities and by using arbitrage and other derivative strategies.</p> <p>However, there can be no assurance that the investment objective of the scheme will be realized.</p>																																																																																	
2.	Investment Strategy	<p>The key value proposition of the Scheme is to provide an asset allocation overlay to investors. The Scheme will dynamically manage the asset allocation between equity and fixed income based on the relative valuation of equity and debt markets.</p> <p>The factor that would be used for determining the asset allocation is the yield gap ratio, which is the ratio of debt market yield to equity market yield.</p> <p>Yield gap = 10Y GSec yield / Earnings yield of Nifty</p> <p>10Y G-Sec is used as the proxy for debt market yield, while earnings yield of equity markets is simply the reciprocal of Price/Earnings ratio. So by looking at the ratio of these two yields, one can assess whether equity markets are overpriced or underpriced relative to debt markets.</p> <p>If the ratio is &lt;= 1, one can deduce that return expectations from equity markets are higher than from debt and hence one should be invested more in equity.</p> <p>Similarly, if the ratio is &gt;1, the return from equity is expected to be less than from debt and hence debt allocation should be gradually increased.</p> <p>The actual or current values of these parameters will be compared against the historical trend to determine the relative attractiveness of equity versus debt markets. The asset allocation table based on the yield gap bands would be as follows:</p> <table border="1"> <thead> <tr> <th>Yield Gap Ratio</th> <th>Equity Allocation</th> <th>Yield Gap Ratio</th> <th>Equity Allocation*</th> </tr> </thead> <tbody> <tr> <td>&lt;1.10</td> <td>90%</td> <td>1.50 – 1.60</td> <td>40%</td> </tr> <tr> <td>1.10 – 1.20</td> <td>80%</td> <td>1.60 – 1.70</td> <td>30%</td> </tr> <tr> <td>1.20 – 1.30</td> <td>70%</td> <td>1.70 – 1.80</td> <td>20%</td> </tr> <tr> <td>1.30 – 1.40</td> <td>60%</td> <td>&gt;1.80</td> <td>10%</td> </tr> <tr> <td>1.40 – 1.50</td> <td>50%</td> <td></td> <td></td> </tr> </tbody> </table> <p>*unhedged equity exposure (exposure to equity shares alone without a corresponding equity derivative exposure)</p> <p>The model also considers the modified yield gap, which uses 1Y G-Sec yield in the numerator.</p> <p>If the difference between the yield gap ratio and the modified yield gap ratio is less than 0.05, which is an indicator of a flat yield curve, the following asset allocation bands based on the modified yield gap ratio would be used:</p> <table border="1"> <thead> <tr> <th>Yield Gap Ratio</th> <th>Equity Allocation</th> <th>Yield Gap Ratio</th> <th>Equity Allocation*</th> </tr> </thead> <tbody> <tr> <td>&lt;0.7</td> <td>90%</td> <td>1.1 – 1.2</td> <td>40%</td> </tr> <tr> <td>0.7 – 0.8</td> <td>80%</td> <td>1.2 – 1.3</td> <td>30%</td> </tr> <tr> <td>0.8 – 0.9</td> <td>70%</td> <td>1.3 – 1.4</td> <td>20%</td> </tr> <tr> <td>0.9 – 1.0</td> <td>60%</td> <td>&gt;1.4</td> <td>10%</td> </tr> <tr> <td>1.0 – 1.1</td> <td>50%</td> <td></td> <td></td> </tr> </tbody> </table> <p>*unhedged equity exposure (exposure to equity shares alone without a corresponding equity derivative exposure)</p> <p>The primary objective of the scheme is to generate income through investments in fixed income securities and using arbitrage and other derivative Strategies. The Scheme also intends to generate long-term capital appreciation by investing a portion of the Scheme's assets in equity and equity related instruments</p> <p><b>Investment Strategy for Equity Investments</b></p> <p>The scheme aims to provide long term capital growth by investing in a well-diversified portfolio of equity and equity related securities. The fund manager proposes to concentrate on business and economic fundamentals driven by in-depth research techniques and employing the full potential of the research team at the AMC. The stock selection process proposed to be adopted is generally a bottom-up approach seeking to identify companies with long term sustainable competitive advantage (as this is one of the key factors responsible for withstanding competitive pressures and does not allow rivals to eat up any excess profits earned by a successful business). The fund would also use a top down discipline for risk control by ensuring representation of companies from select sectors.</p> <p>In a scenario where Equity markets are attractive, the Scheme would exploit such opportunities with increased equity participation.</p> <p>In a scenario where equity markets are expensive, the Scheme would reduce the equity participation and actively use arbitrage and cash to hedge the portfolio and generate low volatility returns.</p> <p><b>Investment Strategy for Debt Investments</b></p> <p>The Fund Manager will invest only in those debt securities that are rated investment grade by a domestic credit rating agency such as CRISIL, ICRA, CARE, FITCH etc. or in unrated debt securities which the Fund Manager believes to be of equivalent quality. In the case of unrated debt securities, the approval of the Board of Directors of the AMC and Trustee shall be obtained prior to investment.</p> <p>The securities mentioned above could be listed, unlisted, privately placed, secured, unsecured, rated or unrated (subject to the rating or equivalency requirements discussed above) and of any maturity. The securities may be acquired through Initial Public Offerings (IPOs), secondary market operations, private placements, rights offers or through negotiated deals.</p> <p>Subject to the limits indicated above, the Fund may invest a part of the portfolio in securities issued and guaranteed by State and Central Governments. The Fund may also invest in Securities of issuers supported by Government of India or State Governments subject to such securities satisfying the criteria relating to rating etc.</p> <p><b>Investment Strategy for Arbitrage Opportunities</b></p> <p>The market provides opportunities to the investor to derive returns from the implied cost of carry between the underlying cash market and the derivatives market. This provides for opportunities to generate returns that are possibly higher than short term interest rates with minimal active price risk on equities. Implied cost of carry and spreads across the spot, futures and options markets can potentially lead to profitable arbitrage opportunities. The Scheme would carry out arbitrage strategies, which would entail taking offsetting positions in the various markets simultaneously. The arbitrage strategy can also be on account of buy-back of shares announced by a company and/or differences in prices between two exchanges/markets. In this case the arbitrage strategy will not include an offsetting derivatives transaction.</p> <p>The Investment Manager will use a disciplined quantitative analysis while accessing arbitrage opportunities. The Investment Manager will have an effective risk monitoring and control process to ensure adherence to regulatory guidelines and limits.</p> <p>As arbitrage opportunities are dependent on ensuing market conditions, there will be a part of the portfolio, which will be invested in debt securities and money market securities. This component of the portfolio will provide the necessary liquidity to meet redemption needs and other liquidity requirements of the Scheme.</p> <p>The arbitrage strategies the Fund may adopt could be as under. The list is not exhaustive and the Fund could use similar strategies and any other strategies as available in the markets.</p> <p><b>a) Index/ Stock spot – Index/ Stock Futures:</b></p> <p>This strategy is employed when the price of the future is trading at a premium to the price of its underlying in spot market. The Scheme shall buy the stock in spot market and endeavor to simultaneously sell the future at a premium on a quantity neutral basis.</p> <p>Buying the stock in spot market and selling the futures results into a hedge where the Scheme has locked in a spread and is not affected by the price movement of cash market and futures market. The arbitrage position can be continued till expiry of the future contracts. The future contracts are settled based on the last half an hour's weighted average trade of the spot market. Thus there is a convergence between the spot price and the futures market on expiry. This convergence helps the Scheme to generate the arbitrage return locked in earlier.</p> <p>On or before the date of expiry, if the price differential between the spot and futures position of the subsequent month maturity still remains attractive, the scheme may rollover the futures position and hold onto the position in the spot market. In case such an opportunity is not available, the scheme would liquidate the spot position and settle the futures position simultaneously.</p> <p>Rolling over of the futures transaction means unwinding the short position in the futures of the current month and simultaneously shorting futures of the subsequent month maturity, and holding onto the spot position.</p> <p><b>b) Index Arbitrage:</b></p> <p>The S&amp;P CNX Nifty derives its value from fifty constituent stocks; the constituent stocks (in their respective weights) can be used to create a synthetic index matching the Nifty Index. Also, theoretically, the fair value of a future is equal to the spot price plus the cost of carry.</p> <p>Theoretically, therefore, the pricing of Nifty Index futures should be equal to the pricing of the synthetic index created by futures on the underlying stocks.</p> <p>Due to market imperfections, the index futures may not exactly correspond to the synthetic index futures. The Nifty Index futures normally trades at a discount to the synthetic Index due to large volumes of stock hedging being done using the Nifty Index futures giving rise to arbitrage opportunities.</p> <p>One instance in which an index arbitrage opportunity exists is when Index future is trading at a discount to the index (spot) and the futures of the constituent stocks are trading at a cumulative premium.</p>	Yield Gap Ratio	Equity Allocation	Yield Gap Ratio	Equity Allocation*	<1.10	90%	1.50 – 1.60	40%	1.10 – 1.20	80%	1.60 – 1.70	30%	1.20 – 1.30	70%	1.70 – 1.80	20%	1.30 – 1.40	60%	>1.80	10%	1.40 – 1.50	50%			Yield Gap Ratio	Equity Allocation	Yield Gap Ratio	Equity Allocation*	<0.7	90%	1.1 – 1.2	40%	0.7 – 0.8	80%	1.2 – 1.3	30%	0.8 – 0.9	70%	1.3 – 1.4	20%	0.9 – 1.0	60%	>1.4	10%	1.0 – 1.1	50%			<p>The key value proposition of the Scheme is to provide an asset allocation overlay to investors. The Scheme will dynamically manage the asset allocation between equity and fixed income. Equity allocation will be decided based on a combination of valuation and momentum while fixed income and arbitrage will be resultant allocation.</p> <p>The valuation factor that would be used for determining the equity allocation is the average of P/E and P/B allocation.</p> <p>Average percentile score of the two will be considered for deciding the final equity allocation.</p> <p>Post that the model will also have an overlay of momentum (determined by 50DMA and 200 DMA) which will add an additional 10% to the equity allocation if the markets are in momentum.</p> <p>For the momentum filter, Nifty 50 values will be compared with 50 DMA and 200 DMA values:</p> <ul style="list-style-type: none"> <li>• If the Nifty 50 is greater than both 50 DMA and 200 DMA, then it is regarded as an entry signal for momentum</li> <li>• If the Nifty 50 is greater than any of the two, then it is a signal for Continuation.</li> <li>• If Nifty is less than both 50DMA and 200 DMA, then it is an exit signal</li> <li>• If signal is Entry or Continuation, then 10% is added to equity allocation with a capping to 90% and if signal is exit, then keep the equity allocation as it is.</li> </ul> <p>Based on the bands mentioned in the below table equity allocation will be calculated:</p> <table border="1"> <thead> <tr> <th>Lower Range</th> <th>Higher Range</th> <th>Equity allocation*</th> </tr> </thead> <tbody> <tr> <td>0%</td> <td>10%</td> <td>90%</td> </tr> <tr> <td>10%</td> <td>20%</td> <td>90%</td> </tr> <tr> <td>20%</td> <td>30%</td> <td>80%</td> </tr> <tr> <td>30%</td> <td>40%</td> <td>70%</td> </tr> <tr> <td>40%</td> <td>50%</td> <td>60%</td> </tr> <tr> <td>50%</td> <td>60%</td> <td>50%</td> </tr> <tr> <td>60%</td> <td>70%</td> <td>40%</td> </tr> <tr> <td>70%</td> <td>80%</td> <td>30%</td> </tr> <tr> <td>80%</td> <td>90%</td> <td>20%</td> </tr> <tr> <td>90%</td> <td>100%</td> <td>20%</td> </tr> </tbody> </table> <p>*unhedged equity exposure (exposure to equity shares alone without a corresponding equity derivative exposure)</p> <p>The model takes the average of last 30 days of equity allocation and rounds it to the nearest tenths.</p> <p>Since both the parameters will be ranked on a percentile basis everyday as compared to its history, the model places equal emphasis on new data.</p> <p>The primary objective of the scheme is to generate income through investments in fixed income securities and using arbitrage and other derivative Strategies. The Scheme also intends to generate long-term capital appreciation by investing a portion of the Scheme's assets in equity and equity related instruments.</p> <p><b>Investment Strategy for Equity Investments</b></p> <p>The scheme aims to provide long term capital growth by investing in a well-diversified portfolio of equity and equity related securities. The fund manager proposes to concentrate on business and economic fundamentals driven by in-depth research techniques and employing the full potential of the research team at the AMC. The stock selection process proposed to be adopted is generally a bottom-up approach seeking to identify companies with long term sustainable competitive advantage (as this is one of the key factors responsible for withstanding competitive pressures and does not allow rivals to eat up any excess profits earned by a successful business). 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Also, theoretically, the fair value of a future is equal to the spot price plus the cost of carry.</p> <p>Theoretically, therefore, the pricing of Nifty Index futures should be equal to the pricing of the synthetic index created by futures on the underlying stocks.</p> <p>Due to market imperfections, the index futures may not exactly correspond to the synthetic index futures. The Nifty Index futures normally trades at a discount to the synthetic Index due to large volumes of stock hedging being done using the Nifty Index futures giving rise to arbitrage opportunities.</p> <p>One instance in which an index arbitrage opportunity exists is when Index future is trading at a discount to the index (spot) and the futures of the constituent stocks are trading at a cumulative premium.</p>	Lower Range	Higher Range	Equity allocation*	0%	10%	90%	10%	20%	90%	20%	30%	80%	30%	40%	70%	40%	50%	60%	50%	60%	50%	60%	70%	40%	70%	80%	30%	80%	90%	20%	90%	100%	20%
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The investment manager shall endeavour to capture such arbitrage opportunities by taking long positions in the Nifty Index futures and short positions in the synthetic index (constituent stock futures). Based on the opportunity, the reverse position can also be initiated.

**c) Corporate Action / Event Driven Strategies:**

**I. Dividend Arbitrage**

At the time of declaration of dividend, the stock futures / options market can provide a profitable opportunity. Generally, the stock prices decline by the dividend amount when the stock becomes ex-dividend.

**II. Buy-Back/ Open Offer Arbitrage**

When the Company announces the buy-back or open offer of its own shares, there could be opportunities due to price differential in buyback price and traded price.

**III. Merger**

When the Company announces any merger, amalgamation, hive off, de-merger, etc, there could be opportunities due to price differential in the cash and the derivative market.

**d) Portfolio Hedging:**

This strategy will be adopted:

- (i) If in an already invested portfolio of a Scheme, the Investment manager is expecting a market correction, the Investment manager may sell Index Futures to insulate the portfolio from the market related risks.
- (ii) If there are significant inflows to the Scheme and the market expectations are bullish, the Investment manager may buy Index Futures to continue participation in the equity markets. This strategy is used to reduce the time to achieve the desired invested levels.

**Portfolio Turnover**

Portfolio turnover is defined as the lower of the aggregate value of purchases or sales as a percentage of the corpus of a scheme during a specified period of time. This will exclude purchases and sales of money market securities. The Scheme is open ended, with subscriptions and redemptions expected on a daily basis, resulting in net inflow/outflow of funds, and on account of the various factors that affect portfolio turnover; it is difficult to give an estimate, with any reasonable amount of accuracy.

Therefore, the Scheme has no specific target relating to portfolio turnover.

**Trading in Derivatives**

The Mutual Fund may use various derivatives and hedging products/ techniques, in order to seek to generate better returns for the Scheme. Derivatives are financial contracts of pre-determined fixed duration, whose values are derived from the value of an underlying primary financial instrument, commodity or index.

**Advantages of Trading in Derivatives**

Advantages of derivatives are many. The use of derivatives provides flexibility to the Schemes to hedge whole or part of the portfolio. The following section describes some of the more common derivatives transactions along with their benefits:

Derivatives are financial contracts of pre-determined fixed duration, whose values are derived from the value of an underlying primary financial instrument, commodity or index, such as interest rates, exchange rates, commodities and equities.

**1. Futures**

A futures contract is a standardized contract between two parties where one of the parties commits to sell, and the other to buy, a stipulated quantity of a security at an agreed price on or before a given date in future.

Currently, futures contracts have a maximum expiration cycle of 3 months. Three contracts are available for trading, with 1 month, 2 months and 3 months expiry respectively. A new contract is introduced on the next trading day following the expiry of the relevant monthly contract. Futures contracts typically expire on the last Thursday of the month. For example a contract with the April 2018 expiration expires on the last Thursday of April 2018 (April 26, 2018).

**Basic Structure of an Index Future**

The Stock Index futures are instruments designed to give exposure to the equity markets indices. The Stock Exchange, Mumbai (BSE) and The National Stock Exchange (NSE) have trading in index futures of 1, 2 and 3 month maturities. The pricing of an index future is the function of the underlying index and short-term interest rates. Index futures are cash settled, there is no delivery of the underlying stocks.

Example using hypothetical figures:

1 month ABC Index Future	
If the Scheme buys 2,000 futures contracts, each contract value is 50 times the futures index price.	
Purchase Date	: April 01, 2018
Spot Index	: 10,200.00
Future Price	: 10,300.00
Date of Expiry	: April 26, 2018
Margin	: 10%

Assuming the exchange imposes a total margin of 10%, the Investment Manager will be required to provide a total margin of approx. Rs. 103,000,000 (i.e. 10%\*10300\*2000\*50) through eligible securities and cash.

Assuming on the date of expiry, i.e. April 26, 2018, ABC Index closes at 10,350, the net impact will be a profit of Rs. 5,000,000 for the Scheme, i.e. (10,350-10,300) \* 2000 \* 50 (Futures price = Closing spot price = Rs. 10,350.00)  
Profits for the Scheme = (10,350-10,300) \* 2000\*50 = Rs. 5,000,000.

Please note that the above example is given for illustration purposes only. Some assumptions have been made for the sake of simplicity.

The net impact for the Scheme will be in terms of the difference of the closing price of the index and cost price. Thus, it is clear from the above example that the profit or loss for the Scheme will be the difference between the closing price (which can be higher or lower than the purchase price) and the purchase price. The risks associated with index futures are similar to those associated with equity investments. Additional risks could be on account of illiquidity and potential mis-pricing of the futures.

**Basic Structure of a Stock Future**

A futures contract on a stock gives its owner the right and obligation to buy or sell stocks. Single Stock Futures traded on NSE (National Stock Exchange) are cash settled; there is no delivery of the underlying stocks on the expiration date. A purchase or sale of futures on a security gives the trader essentially the same price exposure as a purchase or sale of the security itself. In this regard, trading stock futures is no different from trading the security itself.

Example using hypothetical figures:

The Scheme holds shares of XYZ Ltd., the current price of which is Rs. 500 per share. The Scheme sells one month futures on the shares of XYZ Ltd. at the rate of Rs. 540.  
If the price of the stock falls, the Mutual Fund will suffer losses on the stock position held. However, in such a scenario, there will be a profit on the short futures position.

At the end of the period, the price of the stock falls to Rs. 450 and this fall in the price of the stock results in a fall in the price of futures to Rs. 470. There will be a loss of Rs. 50 per share (Rs. 500 - Rs. 450) on the holding of the stock, which will be offset by the profits of Rs. 70 (Rs. 540 - Rs. 470) made on the short futures position.

Please note that the above example is given for illustration purposes only. Some assumptions have been made for the sake of simplicity. Certain factors like margins and other related costs have been ignored. The risks associated with stock futures are similar to those associated with equity investments. Additional risks could be on account of illiquidity and potential mis-pricing of the futures.

**2.Options**

An option gives a person the right but not an obligation to buy or sell something. An option is a contract between two parties wherein the buyer receives a privilege for which he pays a fee (premium) and the seller accepts an obligation for which he receives a fee. The premium is the price negotiated and set when the option is bought or sold. A person who buys an option is said to be long in the option. A person who sells (or writes) an option is said to be short in the option.

**An option contract may be of two kinds:**

**1) Call option**

An option that provides the buyer the right to buy is a call option. The buyer of the call option can call upon the seller of the option and buy from him the underlying asset at the agreed price. The seller of the option has to fulfill the obligation upon exercise of the option.

**2) Put option**

The right to sell is called a put option. Here, the buyer of the option can exercise his right to sell the underlying asset to the seller of the option at the agreed price.  
Option contracts are classified into two styles:

**(a) European Style**

In a European option, the holder of the option can only exercise his right on the date of expiration only.

**(b) American Style**

In an American option, the holder can exercise his right anytime between the purchase date and the expiration date.

**Basic Structure of an Equity Option**

In India, options contracts on indices are European style and cash settled whereas, option contracts on individual securities are American style and cash settled.

**Example using hypothetical figures:**

Market type	: N
Instrument Type	: OPTSTK
Underlying	: XYZ Ltd. (XYZ)
Purchase date	: April 1, 2018
Expiry date	: April 26, 2018
Option Type	: Put Option (Purchased)
Strike Price	: Rs. 8,750.00
Spot Price	: Rs. 8,800.00
Premium	: Rs. 200.00
Lot Size	: 100
No. of Contracts	: 50

**c) Corporate Action / Event Driven Strategies:**

**I. Dividend Arbitrage**

At the time of declaration of dividend, the stock futures / options market can provide a profitable opportunity. Generally, the stock prices decline by the dividend amount when the stock becomes ex-dividend.

**II. Buy-Back/ Open Offer Arbitrage**

When the Company announces the buy-back or open offer of its own shares, there could be opportunities due to price differential in buyback price and traded price.

**III. Merger**

When the Company announces any merger, amalgamation, hive off, de-merger, etc, there could be opportunities due to price differential in the cash and the derivative market.

**d) Portfolio Hedging:**

This strategy will be adopted:

- (i) If in an already invested portfolio of a Scheme, the Investment manager is expecting a market correction, the Investment manager may sell Index Futures to insulate the portfolio from the market related risks.
- (ii) If there are significant inflows to the Scheme and the market expectations are bullish, the Investment manager may buy Index Futures to continue participation in the equity markets. This strategy is used to reduce the time to achieve the desired invested levels.

**Portfolio Turnover**

Portfolio turnover is defined as the lower of the aggregate value of purchases or sales as a percentage of the corpus of a scheme during a specified period of time. This will exclude purchases and sales of money market securities. The Scheme is open ended, with subscriptions and redemptions expected on a daily basis, resulting in net inflow/outflow of funds, and on account of the various factors that affect portfolio turnover; it is difficult to give an estimate, with any reasonable amount of accuracy.

Therefore, the Scheme has no specific target relating to portfolio turnover.

**Trading in Derivatives**

The Mutual Fund may use various derivatives and hedging products/ techniques, in order to seek to generate better returns for the Scheme. Derivatives are financial contracts of pre-determined fixed duration, whose values are derived from the value of an underlying primary financial instrument, commodity or index.

**Advantages of Trading in Derivatives**

Advantages of derivatives are many. The use of derivatives provides flexibility to the Schemes to hedge whole or part of the portfolio. The following section describes some of the more common derivatives transactions along with their benefits:

Derivatives are financial contracts of pre-determined fixed duration, whose values are derived from the value of an underlying primary financial instrument, commodity or index, such as interest rates, exchange rates, commodities and equities.

**1. Futures**

A futures contract is a standardized contract between two parties where one of the parties commits to sell, and the other to buy, a stipulated quantity of a security at an agreed price on or before a given date in future.

Currently, futures contracts have a maximum expiration cycle of 3 months. Three contracts are available for trading, with 1 month, 2 months and 3 months expiry respectively. A new contract is introduced on the next trading day following the expiry of the relevant monthly contract. Futures contracts typically expire on the last Thursday of the month. For example a contract with the April 2018 expiration expires on the last Thursday of April 2018 (April 26, 2018).

**Basic Structure of an Index Future**

The Stock Index futures are instruments designed to give exposure to the equity markets indices. The Stock Exchange, Mumbai (BSE) and The National Stock Exchange (NSE) have trading in index futures of 1, 2 and 3 month maturities. The pricing of an index future is the function of the underlying index and short-term interest rates. Index futures are cash settled, there is no delivery of the underlying stocks.

Example using hypothetical figures:

1 month ABC Index Future	
If the Scheme buys 2,000 futures contracts, each contract value is 50 times the futures index price.	
Purchase Date	: April 01, 2018
Spot Index	: 10,200.00
Future Price	: 10,300.00
Date of Expiry	: April 26, 2018
Margin	: 10%

Assuming the exchange imposes a total margin of 10%, the Investment Manager will be required to provide a total margin of approx. Rs. 103,000,000 (i.e. 10%\*10300\*2000\*50) through eligible securities and cash.

Assuming on the date of expiry, i.e. April 26, 2018, ABC Index closes at 10,350, the net impact will be a profit of Rs. 5,000,000 for the Scheme, i.e. (10,350-10,300) \* 2000 \* 50 (Futures price = Closing spot price = Rs. 10,350.00)  
Profits for the Scheme = (10,350-10,300) \* 2000\*50 = Rs. 5,000,000.

Please note that the above example is given for illustration purposes only. Some assumptions have been made for the sake of simplicity.

The net impact for the Scheme will be in terms of the difference of the closing price of the index and cost price. Thus, it is clear from the above example that the profit or loss for the Scheme will be the difference between the closing price (which can be higher or lower than the purchase price) and the purchase price. The risks associated with index futures are similar to those associated with equity investments. Additional risks could be on account of illiquidity and potential mis-pricing of the futures.

**Basic Structure of a Stock Future**

A futures contract on a stock gives its owner the right and obligation to buy or sell stocks. Single Stock Futures traded on NSE (National Stock Exchange) are cash settled; there is no delivery of the underlying stocks on the expiration date. A purchase or sale of futures on a security gives the trader essentially the same price exposure as a purchase or sale of the security itself. In this regard, trading stock futures is no different from trading the security itself.

Example using hypothetical figures:

The Scheme holds shares of XYZ Ltd., the current price of which is Rs. 500 per share. The Scheme sells one month futures on the shares of XYZ Ltd. at the rate of Rs. 540.  
If the price of the stock falls, the Mutual Fund will suffer losses on the stock position held. However, in such a scenario, there will be a profit on the short futures position.

At the end of the period, the price of the stock falls to Rs. 450 and this fall in the price of the stock results in a fall in the price of futures to Rs. 470. There will be a loss of Rs. 50 per share (Rs. 500 - Rs. 450) on the holding of the stock, which will be offset by the profits of Rs. 70 (Rs. 540 - Rs. 470) made on the short futures position.

Please note that the above example is given for illustration purposes only. Some assumptions have been made for the sake of simplicity. Certain factors like margins and other related costs have been ignored. The risks associated with stock futures are similar to those associated with equity investments. Additional risks could be on account of illiquidity and potential mis-pricing of the futures.

**2. Options**

An option gives a person the right but not an obligation to buy or sell something. An option is a contract between two parties wherein the buyer receives a privilege for which he pays a fee (premium) and the seller accepts an obligation for which he receives a fee. The premium is the price negotiated and set when the option is bought or sold. A person who buys an option is said to be long in the option. A person who sells (or writes) an option is said to be short in the option.

**An option contract may be of two kinds:**

**1) Call option**

An option that provides the buyer the right to buy is a call option. The buyer of the call option can call upon the seller of the option and buy from him the underlying asset at the agreed price. The seller of the option has to fulfill the obligation upon exercise of the option.

**2) Put option**

The right to sell is called a put option. Here, the buyer of the option can exercise his right to sell the underlying asset to the seller of the option at the agreed price.  
Option contracts are classified into two styles:

**(a) European Style**

In a European option, the holder of the option can only exercise his right on the date of expiration only.

**(b) American Style**

In an American option, the holder can exercise his right anytime between the purchase date and the expiration date.

**Basic Structure of an Equity Option**

In India, options contracts on indices are European style and cash settled whereas, option contracts on individual securities are American style and cash settled.

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Say, the Mutual Fund purchases on April 1, 2018, 1 month Put Options on XYZ Ltd. (XYZ) on the NSE i.e. put options on 5000 shares (50 contracts of 100 shares each) of XYZ.

As these are American style options, they can be exercised on or before the exercise date i.e. April 26, 2018. If the share price of XYZ Ltd. falls to Rs. 8,500/- on April 26, 2018, and the Investment Manager decides to exercise the option, the net impact will be as follows:

Premium Expense = Rs. 200 \* 50 \* 100 = Rs. 10,00,000/-  
Option Exercised at = Rs. 8,500/-  
Profits for the Mutual Fund = (8,750.00 - 8,500.00) \* 50 \* 100 = Rs. 12,50,000/-  
Net Profit = Rs. 12,50,000 - Rs. 10,00,000 = Rs. 2,50,000/-

In the above example, the Investment Manager hedged the market risk on 5000 shares of XYZ Ltd. by purchasing put options.

Please note that the above example is given for illustration purposes only. Some assumptions have been made for the sake of simplicity. Certain factors like margins have been ignored. The purchase of Put Options does not increase the market risk in the Mutual Fund as the risk is already in the Mutual Fund's portfolio on account of the underlying asset position (in his example shares of XYZ Ltd.). The Premium paid for the option is treated as an expense and added to the holding cost of the relevant security. Additional risks could be on account of illiquidity and potential mis-pricing of the options.

**Exposure to Equity Derivatives**

**i. Position limit for the Mutual Fund in index options contracts:**

- a. The Mutual Fund position limit in all index options contracts on a particular underlying index shall be Rs. 500 crore or 15% of the total open interest in the market in index options, whichever is higher, per Stock Exchange.
- b. This limit would be applicable on open positions in all options contracts on a particular underlying index.

**ii. Position limit for the Mutual Fund in index futures contracts:**

- a. The Mutual Fund position limit in all index futures contracts on a particular underlying index shall be Rs. 500 crore or 15% of the total open interest in the market in index futures, whichever is higher, per Stock Exchange.
- b. This limit would be applicable on open positions in all futures contracts on a particular underlying index.

**iii. Additional position limit for hedging:**

- In addition to the position limits at point (i) and (ii) above, Fund may take exposure in equity index derivatives subject to the following limits:
  - a. Short positions in index derivatives (short futures, short calls and long puts) shall not exceed (in notional value) the Mutual Fund's holding of stocks.
  - b. Long positions in index derivatives (long futures, long calls and short puts) shall not exceed (in notional value) the Mutual Fund's holding of cash, government securities, T-Bills and similar instruments.

**iv. Position limit for the Mutual Fund for stock based derivative contracts:**

The combined futures and options position limit shall be 20% of the applicable Market Wide Position Limit (MWPL).

**v. Position limit for the Scheme:**

The position limits for the Scheme and disclosure requirements are as follows:

- a. For stock option and stock futures contracts, the gross open position across all derivative contracts on a particular underlying stock of a Fund shall not exceed the higher of 1% of free float market capitalization (in terms of number of shares).
- Or
- 5% of the open interest in the derivative contracts on a particular underlying stock (in terms of number of contracts).
- b. This position limit shall be applicable on the combined position in all derivative contracts on a underlying stock at a Stock Exchange.
- c. For index based contracts, the Mutual Fund shall disclose the total open interest held by its scheme or all schemes put together in a particular underlying index, if such open interest equals to or exceeds 15% of the open interest of all derivative contracts on that underlying index.

**As and when SEBI notifies amended limits in position limits for exchange traded derivative contracts in future, the aforesaid position limits, to the extent relevant, shall be read as if they were substituted with the SEBI amended limits.**

**Exposure Limits:**

With respect to investments made in derivative instruments, the Schemes shall comply with the following exposure limits in line with SEBI Circular CIR/IMD/DF/11/2010 dated August 18, 2010 and SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2017/109 dated September 27, 2017:

1. The cumulative gross exposure through equity, debt and derivative positions will not exceed 100% of the net assets of the respective Scheme. However, the following shall not be considered while calculating the gross exposure:
  - a. Security-wise hedged position and
  - b. Exposure in cash or cash equivalents with residual maturity of less than 91 days
2. The total exposure related to option premium must not exceed 20% of the net assets of the Scheme.
3. The Mutual Fund shall not write options or purchase instruments with embedded written options.
4. Exposure due to hedging positions may not be included in the above mentioned limits subject to the following:
  - a. Hedging positions are the derivative positions that reduce possible losses on an existing position in securities and till the existing position remains.
  - b. Hedging positions cannot be taken for existing derivative positions. Exposure due to such positions shall have to be added and treated under limits mentioned in Point 1.
  - c. Any derivative instrument used to hedge has the same underlying security as the existing position being hedged.
  - d. The quantity of underlying associated with the derivative position taken for hedging purposes does not exceed the quantity of the existing position against which hedge has been taken.
5. The Mutual Fund may enter into plain vanilla interest rate swaps for hedging purposes. The counter party in such transactions has to be an entity recognized as a market maker by RBI. Further, the value of the notional principal in such cases must not exceed the value of respective existing assets being hedged by the scheme. Exposure to a single counterparty in such transactions should not exceed 10% of the net assets of the scheme.
6. Exposure due to derivative positions taken for hedging purposes in excess of the underlying position against which the hedging position has been taken, shall be treated under the limits mentioned in point 1.
7. Definition of Exposure in case of Derivative Positions:
  - Each position taken in derivatives shall have an associated exposure as defined under. Exposure is the maximum possible loss that may occur on a position. However, certain derivative positions may theoretically have unlimited possible loss. Exposure in derivative positions shall be computed as follows:

Position	Exposure
Long Future	Futures Price * Lot Size * Number of Contracts
Short Future	Futures Price * Lot Size * Number of Contracts
Option Bought	Option Premium Paid * Lot Size * Number of Contracts

8. Mutual funds may hedge the portfolio or part of the portfolio (including one or more securities) on weighted average modified duration basis by using Interest Rate Futures (IRFs). The maximum extent of short position that may be taken in IRFs to hedge interest rate risk of the portfolio or part of the portfolio, is as per the formula given below:

$$\frac{\text{(Portfolio Modified Duration * Market Value of the Portfolio)}}{\text{(Futures Modified Duration * Futures Price/ PAR)}}$$

9. The Scheme shall not carry out imperfect hedging using IRFs.

**Interest Rate Swap (IRS)**

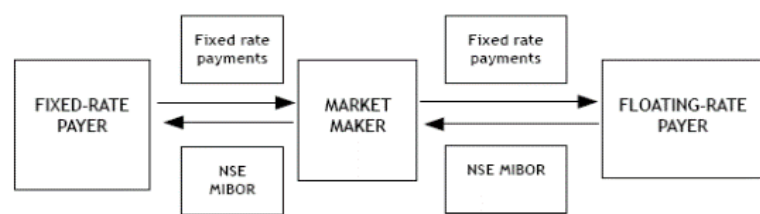
Any swap is effectively an exchange of one set of cash-flows for another considered to be of equal value. If the exchange of cash flows is linked to interest rates, it becomes an interest rate swap.

An interest rate swap is an agreement between two parties to exchange future payment streams based on a notional amount. Only the interest on the notional amount is swapped, and the principal amount is never exchanged.

In a typical interest rate swap, one party agrees to pay a fixed rate over the term of the agreement and to receive a variable or floating rate of interest. The counterparty receives a stream of fixed rate payments at regular intervals as described in the agreement and pays the floating rate of interest. A fixed/ floating interest rate swap is characterized by:

1. Fixed interest rate;
2. Variable or floating interest rate, which is periodically reset;
3. Notional principal amount upon which total interest payments are based; and
4. The terms of the agreement, including a schedule of interest rate reset dates, payment dates and termination date.

The primary reason for engaging in an interest rate swap is to hedge the interest rate exposure. An illustration could be an institution having long-term fixed rate assets (longer tenor securities receiving fixed rate) in a rising interest rate environment; it can hedge the interest rate exposure by purchasing an interest rate swap where the institution receives floating interest rate and pays fixed rate. In this case, an interest rate swap is likely to reduce the duration and interest rate volatility of the fund.



**Example using hypothetical figures:**

Market type : N  
Instrument Type : OPTSTK  
Underlying : XYZ Ltd. (XYZ)  
Purchase date : April 1, 2018  
Expiry date : April 26, 2018  
Option Type : Put Option (Purchased)  
Strike Price : Rs. 8,750.00  
Spot Price : Rs. 8,800.00  
Premium : Rs. 200.00  
Lot Size : 100  
No. of Contracts : 50

Say, the Mutual Fund purchases on April 1, 2018, 1 month Put Options on XYZ Ltd. (XYZ) on the NSE i.e. put options on 5000 shares (50 contracts of 100 shares each) of XYZ.

As these are American style options, they can be exercised on or before the exercise date i.e. April 26, 2018. If the share price of XYZ Ltd. falls to Rs. 8,500/- on April 26, 2018, and the Investment Manager decides to exercise the option, the net impact will be as follows:

Premium Expense = Rs. 200 \* 50 \* 100 = Rs. 10,00,000/-  
Option Exercised at = Rs. 8,500/-  
Profits for the Mutual Fund = (8,750.00 - 8,500.00) \* 50 \* 100 = Rs. 12,50,000/-  
Net Profit = Rs. 12,50,000 - Rs. 10,00,000 = Rs. 2,50,000/-

In the above example, the Investment Manager hedged the market risk on 5000 shares of XYZ Ltd. by purchasing put options.

Please note that the above example is given for illustration purposes only. Some assumptions have been made for the sake of simplicity. Certain factors like margins have been ignored. The purchase of Put Options does not increase the market risk in the Mutual Fund as the risk is already in the Mutual Fund's portfolio on account of the underlying asset position (in his example shares of XYZ Ltd.). The Premium paid for the option is treated as an expense and added to the holding cost of the relevant security. Additional risks could be on account of illiquidity and potential mis-pricing of the options.

**Exposure to Equity Derivatives**

**i. Position limit for the Mutual Fund in index options contracts:**

- a. The Mutual Fund position limit in all index options contracts on a particular underlying index shall be Rs. 500 crore or 15% of the total open interest in the market in index options, whichever is higher, per Stock Exchange.
- b. This limit would be applicable on open positions in all options contracts on a particular underlying index.

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- a. The Mutual Fund position limit in all index futures contracts on a particular underlying index shall be Rs. 500 crore or 15% of the total open interest in the market in index futures, whichever is higher, per Stock Exchange.
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- In addition to the position limits at point (i) and (ii) above, Fund may take exposure in equity index derivatives subject to the following limits:
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The combined futures and options position limit shall be 20% of the applicable Market Wide Position Limit (MWPL).

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The position limits for the Scheme and disclosure requirements are as follows:

- a. For stock option and stock futures contracts, the gross open position across all derivative contracts on a particular underlying stock of a Fund shall not exceed the higher of 1% of free float market capitalization (in terms of number of shares).
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- 5% of the open interest in the derivative contracts on a particular underlying stock (in terms of number of contracts).
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1. The cumulative gross exposure through equity, debt and derivative positions will not exceed 100% of the net assets of the respective Scheme. However, the following shall not be considered while calculating the gross exposure:
  - a. Security-wise hedged position and
  - b. Exposure in cash or cash equivalents with residual maturity of less than 91 days
2. The total exposure related to option premium must not exceed 20% of the net assets of the Scheme.
3. The Mutual Fund shall not write options or purchase instruments with embedded written options.
4. Exposure due to hedging positions may not be included in the above mentioned limits subject to the following:
  - a. Hedging positions are the derivative positions that reduce possible losses on an existing position in securities and till the existing position remains.
  - b. Hedging positions cannot be taken for existing derivative positions. Exposure due to such positions shall have to be added and treated under limits mentioned in Point 1.
  - c. Any derivative instrument used to hedge has the same underlying security as the existing position being hedged.
  - d. The quantity of underlying associated with the derivative position taken for hedging purposes does not exceed the quantity of the existing position against which hedge has been taken.
5. The Mutual Fund may enter into plain vanilla interest rate swaps for hedging purposes. The counter party in such transactions has to be an entity recognized as a market maker by RBI. Further, the value of the notional principal in such cases must not exceed the value of respective existing assets being hedged by the scheme. Exposure to a single counterparty in such transactions should not exceed 10% of the net assets of the scheme.
6. Exposure due to derivative positions taken for hedging purposes in excess of the underlying position against which the hedging position has been taken, shall be treated under the limits mentioned in point 1.
7. Definition of Exposure in case of Derivative Positions:
  - Each position taken in derivatives shall have an associated exposure as defined under. Exposure is the maximum possible loss that may occur on a position. However, certain derivative positions may theoretically have unlimited possible loss.

**Exposure in derivative positions shall be computed as follows:**

Position	Exposure
Long Future	Futures Price * Lot Size * Number of Contracts
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Option Bought	Option Premium Paid * Lot Size * Number of Contracts

8. Mutual funds may hedge the portfolio or part of the portfolio (including one or more securities) on weighted average modified duration basis by using Interest Rate Futures (IRFs). The maximum extent of short position that may be taken in IRFs to hedge interest rate risk of the portfolio or part of the portfolio, is as per the formula given below:

$$\frac{\text{(Portfolio Modified Duration * Market Value of the Portfolio)}}{\text{(Futures Modified Duration * Futures Price/ PAR)}}$$

9. The Scheme shall not carry out imperfect hedging using IRFs.

**Interest Rate Swap (IRS)**

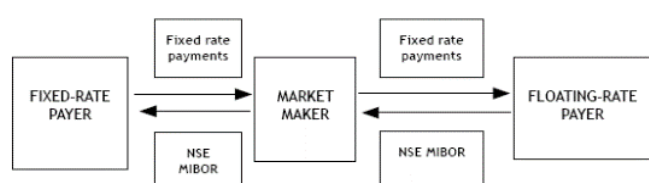
Any swap is effectively an exchange of one set of cash-flows for another considered to be of equal value. If the exchange of cash flows is linked to interest rates, it becomes an interest rate swap.

An interest rate swap is an agreement between two parties to exchange future payment streams based on a notional amount. Only the interest on the notional amount is swapped, and the principal amount is never exchanged.

In a typical interest rate swap, one party agrees to pay a fixed rate over the term of the agreement and to receive a variable or floating rate of interest. The counterparty receives a stream of fixed rate payments at regular intervals as described in the agreement and pays the floating rate of interest. A fixed/ floating interest rate swap is characterized by:

1. Fixed interest rate;
2. Variable or floating interest rate, which is periodically reset;
3. Notional principal amount upon which total interest payments are based; and
4. The terms of the agreement, including a schedule of interest rate reset dates, payment dates and termination date.

The primary reason for engaging in an interest rate swap is to hedge the interest rate exposure. An illustration could be an institution having long-term fixed rate assets (longer tenor securities receiving fixed rate) in a rising interest rate environment; it can hedge the interest rate exposure by purchasing an interest rate swap where the institution receives floating interest rate and pays fixed rate. In this case, an interest rate swap is likely to reduce the duration and interest rate volatility of the fund.



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	<p><b>Example:</b> <b>Terms:</b> Fixed Interest Rate : 8.50% p.a. Variable Interest Rate : NSE Over-Night MIBOR reset daily and compounded daily Notional Principal Amount : Rs.100 Crore Period of Agreement : 1 year Payment Frequency : Semi-annual</p> <p>Now, suppose the six-month period from the effective date of the swap to the first payment date comprises 182 days and the daily compounded NSE Over-Night MIBOR is 8.15% p.a. on the first payment date, then the fixed and variable rate payment on the first payment date would be as follows:</p> <p><b>Fixed rate payment:</b> Rs. 4,23,83,562 = (Rs.100,00,00,000) x (8.50%) x (182 Days / 365 Days)</p> <p><b>Variable rate payment:</b> Rs. 4,06,38,356 = (Rs.100,00,00,000) x (8.15%) x (182 Days / 365 Days) Often, a swap agreement will call for only the exchange of net amount between the counterparties. In the above example, the fixed-rate payer will pay the variable-rate payer a net amount of Rs. 17,45,205 = Rs. 4,23,83,562 - Rs. 4,06,38,356. The second and final payment will depend on the daily NSE MIBOR compounded daily for the remaining 183 days. The fixed rate payment will also change to reflect the change in holding period from 182 days to 183 days.</p> <p><b>4. Forward Rate Agreement (FRA)</b> An FRA is an off balance sheet agreement to pay or receive on an agreed future date, the difference between an agreed interest rate and the interest rate actually prevailing on that future date, calculated on an agreed notional principal amount. It is settled against the actual interest rate prevailing at the beginning of the period to which it relates rather than paid as a gross amount. An FRA is referred to by the beginning and end dates of the period covered. Thus a 5x8 FRA is one that covers a 3-month period beginning in 5-months and ending in 8-months. FRAs are purchased to hedge the interest rate risk; an investor facing uncertainty of the interest rate movements can fix the interest costs by purchasing an FRA. An illustration could be a corporation having floating rate debt linked to an index such as say, 3-Month MIBOR. If the existing interest cost is at 8% on Rs.100 Crore for the next three months, the corporation can purchase a 3x6 FRA @ 8.1% on Rs.100 Crore and fix the interest cost for the 3-6 months period. If the actual 3-Month MIBOR after 3-months is at 8.25%, the corporation has saved 15 bps in interest cost. As the settlement is done at the beginning of the period, the savings in interest expense are discounted to a present value using a 3-month rate to calculate the actual settlement amount. The flows for the institution will be, as follows: Interest Savings = Rs. 100 Crore * 15 bps * 92/365 (assuming 92 days in the 3 month FRA period and 365 days in the conventional year) = Rs.3,78,082.19 Settlement Amount = Rs.3,78,082.19 / (1+8.25%*92/365) Please note that the above examples are hypothetical in nature and the figures are assumed.</p> <p><b>5. Interest Rate Futures</b> An Interest Rate Futures (IRF) contract is "an agreement to buy or sell a debt instrument at a specified future date at a price that is fixed today." The underlying security for Interest Rate Futures is either Government Bond or T-Bill. Interest Rate Futures are Exchange traded and standardized contracts based on 6 year, 10 year and 13 year Government of India Security and 91-day Government of India Treasury Bill (91DTB). These future contracts are cash settled. These instruments can be used for hedging the underlying cash positions. For example, assume a portfolio has Rs. 100 crores of Government security 7.59% GOI 2026 with face value Rs. 100/- . The bond is currently trading in market at 105.00. The futures on 7.59% GOI 2026, expiring on 26th October 2018 is trading on exchange at 105.10. Instead of exiting the cash position, the fund manager can decide to hedge the position by selling the same quantity in futures. Since one contract of IRF has a notional of Rs. 2 lakhs, in this example the fund manager sells Rs. 100 crores/2 lakhs = 5000 contracts, to hedge his position. At maturity, the settlement price of the futures will be almost same as closing price of the underlying security. <b>At maturity of the Interest Rate Futures</b> <u>Case 1: At maturity Bonds close higher than the price at which fund manager hedged the position, but below the futures price at which he hedged</u> Closing price of Bonds on day of maturity of futures = 105.05 Settlement price of futures = 105.05 MTM gain on the underlying bond = (105.05-105.00) * 100 crores / 100 (i.e. face value of bond) = Rs. 5,00,000 The profit on the futures leg is = 5000*2lakhs *(105.10-105.05)/ 100 (i.e. face value of bond) = Rs 5,00,000 Overall profit to the fund = Rs 10,00,000 <u>Case 2: At maturity bonds close higher than the level at which futures were sold</u> In case, the closing price of bonds on the day of maturity of futures = 105.20, Settlement price of futures = 105.20 The MTM gain on bonds = (105.20-105.00) * 100 crores /100 (i.e. face value of bond) = Rs. 20,00,000 Loss on futures leg = 5000*2 lakhs * (105.10-105.20)/100 (i.e. face value of bond) = (Rs 10,00,000) Total Profit to the fund = Rs 10,00,000 <u>Case 3: At maturity bonds sells off from levels were hedges were initiated</u> In case, the closing price of bonds on the day of maturity of futures = 104.80, Settlement price of futures = 104.80 The MTM loss on bonds = (104.80-105.00) * 100 crores = (Rs. 20,00,000) Profit on futures leg = 5000*2 lacs * (105.10-104.80) = Rs 30,00,000 Total Profit to the fund = Rs 10,00,000</p>	<p><b>Example:</b> <b>Terms:</b> Fixed Interest Rate : 8.50% p.a. Variable Interest Rate : NSE Over-Night MIBOR reset daily and compounded daily Notional Principal Amount : Rs.100 Crore Period of Agreement : 1 year Payment Frequency : Semi-annual</p> <p>Now, suppose the six-month period from the effective date of the swap to the first payment date comprises 182 days and the daily compounded NSE Over-Night MIBOR is 8.15% p.a. on the first payment date, then the fixed and variable rate payment on the first payment date would be as follows:</p> <p><b>Fixed rate payment:</b> Rs. 4,23,83,562 = (Rs.100,00,00,000) x (8.50%) x (182 Days / 365 Days)</p> <p><b>Variable rate payment:</b> Rs. 4,06,38,356 = (Rs.100,00,00,000) x (8.15%) x (182 Days / 365 Days) Often, a swap agreement will call for only the exchange of net amount between the counterparties. In the above example, the fixed-rate payer will pay the variable-rate payer a net amount of Rs. 17,45,205 = Rs. 4,23,83,562 - Rs. 4,06,38,356. The second and final payment will depend on the daily NSE MIBOR compounded daily for the remaining 183 days. The fixed rate payment will also change to reflect the change in holding period from 182 days to 183 days.</p> <p><b>4. Forward Rate Agreement (FRA)</b> An FRA is an off balance sheet agreement to pay or receive on an agreed future date, the difference between an agreed interest rate and the interest rate actually prevailing on that future date, calculated on an agreed notional principal amount. It is settled against the actual interest rate prevailing at the beginning of the period to which it relates rather than paid as a gross amount. An FRA is referred to by the beginning and end dates of the period covered. Thus a 5x8 FRA is one that covers a 3-month period beginning in 5-months and ending in 8-months. FRAs are purchased to hedge the interest rate risk; an investor facing uncertainty of the interest rate movements can fix the interest costs by purchasing an FRA. An illustration could be a corporation having floating rate debt linked to an index such as say, 3-Month MIBOR. If the existing interest cost is at 8% on Rs.100 Crore for the next three months, the corporation can purchase a 3x6 FRA @ 8.1% on Rs.100 Crore and fix the interest cost for the 3-6 months period. If the actual 3-Month MIBOR after 3-months is at 8.25%, the corporation has saved 15 bps in interest cost. As the settlement is done at the beginning of the period, the savings in interest expense are discounted to a present value using a 3-month rate to calculate the actual settlement amount. The flows for the institution will be, as follows: Interest Savings = Rs. 100 Crore * 15 bps * 92/365 (assuming 92 days in the 3 month FRA period and 365 days in the conventional year) = Rs.3,78,082.19 Settlement Amount = Rs.3,78,082.19 / (1+8.25%*92/365) Please note that the above examples are hypothetical in nature and the figures are assumed.</p> <p><b>5. Interest Rate Futures</b> An Interest Rate Futures (IRF) contract is "an agreement to buy or sell a debt instrument at a specified future date at a price that is fixed today." The underlying security for Interest Rate Futures is either Government Bond or T-Bill. Interest Rate Futures are Exchange traded and standardized contracts based on 6 year, 10 year and 13 year Government of India Security and 91-day Government of India Treasury Bill (91DTB). These future contracts are cash settled. These instruments can be used for hedging the underlying cash positions. For example, assume a portfolio has Rs. 100 crores of Government security 7.59% GOI 2026 with face value Rs. 100/- . The bond is currently trading in market at 105.00. The futures on 7.59% GOI 2026, expiring on 26th October 2018 is trading on exchange at 105.10. Instead of exiting the cash position, the fund manager can decide to hedge the position by selling the same quantity in futures. Since one contract of IRF has a notional of Rs. 2 lakhs, in this example the fund manager sells Rs. 100 crores/2 lakhs = 5000 contracts, to hedge his position. At maturity, the settlement price of the futures will be almost same as closing price of the underlying security. <b>At maturity of the Interest Rate Futures</b> <u>Case 1: At maturity Bonds close higher than the price at which fund manager hedged the position, but below the futures price at which he hedged</u> Closing price of Bonds on day of maturity of futures = 105.05 Settlement price of futures = 105.05 MTM gain on the underlying bond = (105.05-105.00) * 100 crores / 100 (i.e. face value of bond) = Rs. 5,00,000 The profit on the futures leg is = 5000*2lakhs *(105.10-105.05)/ 100 (i.e. face value of bond) = Rs 5,00,000 Overall profit to the fund = Rs 10,00,000 <u>Case 2: At maturity bonds close higher than the level at which futures were sold</u> In case, the closing price of bonds on the day of maturity of futures = 105.20, Settlement price of futures = 105.20 The MTM gain on bonds = (105.20-105.00) * 100 crores /100 (i.e. face value of bond) = Rs. 20,00,000 Loss on futures leg = 5000*2 lakhs * (105.10-105.20)/100 (i.e. face value of bond) = (Rs 10,00,000) Total Profit to the fund = Rs 10,00,000 <u>Case 3: At maturity bonds sells off from levels were hedges were initiated</u> In case, the closing price of bonds on the day of maturity of futures = 104.80, Settlement price of futures = 104.80 The MTM loss on bonds = (104.80-105.00) * 100 crores = (Rs. 20,00,000) Profit on futures leg = 5000*2 lacs * (105.10-104.80) = Rs 30,00,000 Total Profit to the fund = Rs 10,00,000</p>
3.	NAV as on August 7, 2019 (in Rs.)	DSP Dynamic Asset Allocation Fund - Direct Plan - Growth: 16.065 DSP Dynamic Asset Allocation Fund - Direct Plan - Monthly Dividend Payout - 10.830 DSP Dynamic Asset Allocation Fund - Regular - Growth - 15.181 DSP Dynamic Asset Allocation Fund - Regular Plan - Monthly Dividend Payout - 10.245
4.	No. of folios as on July 31, 2019	Direct Plan: 1992 Regular Plan: 15429
5.	AUM as on July 31, 2019 (in crores)	Direct Plan: 47.06 Regular Plan: 808.78

As the above proposal would constitute a change in Fundamental Attributes of the Scheme, in accordance with Regulation 18(15A) of the SEBI (Mutual Funds) Regulations, 1996, the existing unitholders under the Scheme are hereby given an option to exit, i.e. either redeem their investments or switch their investments to any other scheme of the Fund, within the 30 days exit period starting from **August 19, 2019 till September 17, 2019** (both days inclusive and upto 3.00 pm on September 17, 2019) at applicable NAV, without payment of any exit load, by filing up the requisite transaction slip and submitting the same at any of our designated Official Points of Acceptance (list available on [www.dspim.com](http://www.dspim.com)). If you have no objection to the proposed change, no action needs to be taken and it would be deemed that you have consented to the above change. The offer to exit from the Scheme is optional, at the discretion of the Unit Holder, and not compulsory. The Scheme will adopt the proposed change with effect from **September 18, 2019**.

Thus, all the applications for redemptions/switch-outs received under the Scheme shall be processed at applicable NAV of the day of receipt of such redemption / switch request, without payment of any exit load, provided the same is received during the exit period of 30 days mentioned above.

Unitholders who have pledged their units will need to procure a release of pledge prior to submitting their redemption request. In case a lien is marked on units held by a unit holder or units have been frozen/locked pursuant to an order of a governmental authority or a court, redemption/switch-out can be executed only after the lien/order is vacated/revoked within the period specified above.

Unitholders should ensure that their change in address or pay-out bank details are updated in records of DSP Mutual Fund as required by them, prior to exercising the exit option for redemption of units.

The redemption proceeds shall be dispatched within 10 business days of receipt of valid redemption request to those unitholders who choose to exercise the exit option.

**TAX IMPLICATIONS**

Redemption / switch-out of units from the Scheme, during the exit period, may entail capital gain/loss in the hands of the unitholder. Similarly, in case of NRI investors, TDS shall be deducted in accordance with the applicable Tax laws, upon exercise of exit option and the same would be required to be borne by such investor only. **In view of individual nature of tax implications, unitholders are advised to consult their tax advisors. For details on Tax implications, please refer to SID of the Scheme and Statement of Additional Information available on our website [www.dspim.com](http://www.dspim.com).**

We look forward to your continued support.

Any queries/clarifications in this regard may be addressed to:  
**DSP Investment Managers Pvt. Ltd.** (Formerly known as DSP BlackRock Investment Managers Pvt. Ltd.)  
CIN: U74140MH1996PTC099483, Investment Manager for DSP Mutual Fund,  
Mafatall Centre, 10th Floor, Nariman Point, Mumbai 400 021, Tel. No.: 91-22 66578000,  
Fax No.: 91-22 66578181, Toll Free No: 1800 200 4499, [www.dspim.com](http://www.dspim.com)

Place: Mumbai  
Date: August 16, 2019

**Mutual Fund investments are subject to market risks, read all scheme related documents carefully.**