



EQUITY MARKET

Arbitrage

Buying and selling the same thing in two markets to capture a price gap,
and how arbitrage funds use it

AMFI data as on 31 August 2026; rules as on 12 October 2026

For training and education only. Not investment advice.

Arbitrage is buying in one market and selling the same thing in another at the same time, to capture a gap.

The trader takes no view on whether the price will rise or fall. The gaps are usually small and close quickly. The trade is not free of risk.

Where the price gaps come from



Two exchanges

The same share trades on two exchanges. If the two prices differ for a moment, a trader buys on the lower one and sells on the higher one.



Cash and futures

A share and its future are prices for the same thing on two dates. If the future is priced above the share by enough, buy the share and sell the future.



Why gaps close

Buying pushes the lower price up and selling pushes the higher price down. The trade itself narrows the gap, usually quickly.

A cash-and-futures arbitrage

THE TWO TRADES

An invented share is at ₹1,000. Its one-month future is at ₹1,006.

A trader buys 1,500 shares for ₹15,00,000 and sells futures on 1,500 shares at ₹1,006.

All figures are assumed.

- 1 The gap locked in: $(1,006 - 1,000) \times 1,500 = ₹9,000$. At expiry the future settles at the share's price.
- 2 Share at ₹1,100 on expiry: shares gain ₹1,50,000; futures lose $(1,100 - 1,006) \times 1,500 = ₹1,41,000$. Net: ₹9,000.
- 3 Share at ₹900 on expiry: shares lose ₹1,50,000; futures gain $(1,006 - 900) \times 1,500 = ₹1,59,000$. Net: ₹9,000.
- 4 ₹9,000 on ₹15,00,000 is 0.6% for the month, before brokerage, taxes and the cost of margin.

The gap was the same whichever way the price went. Costs and taxes come out of it.

Illustration with an invented share and assumed prices. Not an indication of the gap or return available.

Why a future usually prices above the share

1

Interest until expiry

A buyer of the future does not pay for the shares today. The futures price reflects the interest on that money until expiry.

2

The theoretical price

NSE's formula is $F = S \times e^{(rt)}$: the cash price S , grown at an interest rate r for the time t left to expiry.

3

Dividends pull it down

The holder of a future receives no dividend. A dividend expected before expiry lowers the futures price against the cash price.

4

The gap closes at expiry

A future is finally settled at the closing price of the underlying, so the two prices meet on the last trading day.

The gap between the two prices is called the basis. It is roughly an interest rate, not a windfall.

Source: NSE Clearing, equity derivatives settlement mechanism and settlement price pages, read 12 Oct 2026.

What can go wrong

Risk	What happens
Execution	The two trades are separate orders. If one is done and the other is late or only partly done, the position is exposed to the price.
Margin calls	The futures leg is settled in cash every day. If the price rises, cash must be paid on the futures while the gain on the shares is on paper.
Early exit	The two prices must meet only at expiry. Before that the gap can widen, so closing early can return less than the gap, or a loss.
Costs	Brokerage, taxes and charges come out of a thin gap. STT on a futures sale rose from 0.02% to 0.05% of the price on 1 April 2026.
Crowding	When more money chases the same gaps, the gaps shrink. The gap on offer changes from month to month.

Sources: NSE Clearing settlement pages (read 12 Oct 2026); NSE circular NSE/FATAX/73524, 31 Mar 2026 (Finance Act, 2026).

How an arbitrage fund is built

65%



Equity

At least 65% of total assets is in equity and equity-related instruments. Usually, shares bought are matched by futures sold.



The rest

Debt held for liquidity and margin, e.g. CDs, government securities up to 1 year, liquid or money-market scheme units.



The return

Mainly the gap between cash and futures prices, less costs. It moves with the gaps on offer and is not assured.

Trustner distributes mutual funds. It does not distribute or recommend derivative trading.

Source: SEBI Master Circular for Mutual Funds as on 20 March 2026: scheme category table (hybrid schemes) and paras 13.18.1 and 13.18.6.

Where arbitrage funds stand

Industry figures for the arbitrage fund category, August 2026.

SCHEMES

40

Arbitrage fund schemes as on 31 August 2026.

AUM, ₹ LAKH CRORE

3.02

Net assets of ₹3,02,175 crore on 31 August 2026 (month-end, not average).

FOLIOS, LAKH

9.37

9,36,561 investor accounts in the category on 31 August 2026.

NET INFLOW, ₹ CRORE

3,789

Sales less redemptions in the month of August 2026.

Source: AMFI, Monthly Report for August 2026 (hybrid schemes, arbitrage fund row). Industry net assets on the same date: ₹87.08 lakh crore.

How an arbitrage fund is taxed

20%



Held 12 months or less

The gain is short-term and is taxed at 20%.

12.5%



Held over 12 months

The gain is long-term. Tax is 12.5% on such gains above ₹1.25 lakh a year, counted across all equity holdings.

65%



The test behind it

These rates apply to a fund with at least 65% in listed domestic equity shares. The shares an arbitrage fund buys count.

Tax rules change and depend on the investor. This is general information, not tax advice.

Source: Income-tax Act, 2025, sections 196 and 198; rates in force since 23 July 2024, as set out in a fund-house tax reckoner for FY 2026-27 (secondary).

If you learnt this from older material

What older decks say

- Arbitrage is a profit without risk.
- Long-term gains on equity funds are taxed at 10%.
- STT on a futures sale is 0.02%.
- NSE futures expire on the last Thursday.

What holds now

- The gap is fixed at the start; costs, timing and margin calls are not.
- 12.5% on gains above ₹1.25 lakh a year, from 23 July 2024.
- 0.05% from 1 April 2026, a higher cost on each futures sale.
- The last Tuesday, for expiries from 1 September 2025.

Sources: NSE circular NSE/FATA/73524 (Finance Act, 2026); NSE circular NSE/FAOP/68747, 25 Jun 2025; tax rates as on the previous slide.

Four things people get wrong



'Arbitrage is risk-free.'

Price risk is largely offset. Execution, margin calls, early exit and costs remain, and any of them can remove the gap.



'An arbitrage fund cannot fall.'

Its NAV is market-linked and can fall over short periods, for example when the gap widens. Returns are not assured.



'It is a debt fund.'

SEBI classes it as a hybrid scheme with at least 65% in equity and equity-related instruments, and it is taxed as equity-oriented.



'The fund bets on futures.'

The futures are sold against shares the fund holds, so the two largely offset each other. The aim is no view on direction.

An arbitrage fund is a market-linked product. Read the scheme documents before investing.

Check yourself

Q1

An invented share is at ₹800 and its future at ₹804. A trader buys 2,000 shares and sells futures on 2,000. What gap is locked in, in rupees and as a % of the share cost?

Q2

Brokerage, taxes and other charges on those trades come to an assumed ₹3,200. What is left, in rupees and as a percentage?

Q3

A client says: 'An arbitrage fund is risk-free and its returns are fixed.' Name two things you would correct.

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Futures pricing and settlement: NSE Clearing, equity derivatives settlement mechanism and settlement price pages, read 12 Oct 2026.
- Arbitrage fund category and exposure limits: SEBI Master Circular for Mutual Funds as on 20 March 2026 (scheme category table; paras 13.18.1, 13.18.6 and 14.2.4).
- Category size: AMFI, Monthly Report for August 2026 (schemes, folios, net inflow and net assets under management as on 31 August 2026).
- Securities transaction tax: Finance Act, 2026, per NSE circular NSE/FATAX/73524. Expiry day: NSE circular NSE/FAOP/68747 (25 Jun 2025).
- Capital gains tax on equity-oriented funds: Income-tax Act, 2025, sections 196 and 198; rates as set out in a fund-house tax reckoner for FY 2026-27 (secondary).
- The shares, traders, prices, quantities and costs in the examples and quiz are invented for the arithmetic only.

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