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INVESTOR EDUCATION
AN INVESTOR EDUCATION AND AWARENESS INITIATIVE FROM HDFC MUTUAL FUND

Keep Your Investments SAFE With Capital Protection Oriented Funds

Capital Protection Oriented Schemes (CPOS) are oriented towards capital protection and do not offer guaranteed returns. The orientation towards protection of the capital originates from the portfolio structure of CPOS and not from any bank guarantee, insurance cover etc.

What are Capital Protection Oriented Schemes?

Capital Protection Oriented Schemes (CPOS) are close ended schemes. Typically, CPOS are hybrid schemes with majority of the portfolio invested in debt/ money market instruments and balance in equity and equity related instruments. CPOS generally has tenure of 3 to 5 years.

As per the SEBI Guidelines, CPOS have to be rated by a registered credit rating agency such as CRISIL, ICRA or others from the viewpoint of the ability of their portfolio structure to attain protection of the capital invested therein. Such rating is reviewed on a quarterly basis by the concerned rating agency. CPOS are required to invest in debt/ money market instruments in accordance with the rating assigned. For e.g. if rating assigned to CPOS is "AAA", then CPOS can invest only in debt/ money market instruments with "AAA" rating or its equivalent. Investors can assess the safety of their capital from the rating assigned to these funds.

What is the level of risk in CPOS?

Low Risk -

Note: Risk is represented as:

(BLUE) Investors understand that their principal will be at low risk

(YELLOW) Investors understand that their principal will be at medium risk

(BROWN) investors understand that their principal will be at high risk

Due to the typical structuring of CPOS which are oriented to protect the capital, CPOS are categorized as low risk product indicating that the principal will be at low risk.

How does Capital Protection work?

In a Hybrid CPOS, the allocation to debt instruments is done in such a way that at the end of the term of CPOS, the value of debt investment grows to the original investment in the fund. The equity portion aims to add to the returns of CPOS at maturity.

The equity component is generally invested in diversified equity and equity related securities with potential for long term appreciation. The debt portion is invested in commercial papers, certificate of deposits, bonds and non-convertible debentures that will mature along with the maturity of the fund.

Let's assume that the Scheme invests ~83% in highest rated Debt and Money market instruments. The 83% of the debt portfolio will grow over the tenure of the Scheme to 100% (net of annual recurring expenses) thereby protecting your capital.

Rest ~17% will be invested in equities and equity related instruments. As explained in the scenarios given below, over three years the initial Scheme investment has remained intact and the value of portfolio appreciated, despite positive or negative equity returns. Thus, as illustrated below, the fixed income allocation allows capital protection and equity provides the upside to the portfolio.

Scenario analysis over 3 years (Direct equity strategy)

The below illustration shows how CPOS function in different market scenarios:

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Scheme Corpus (Rs.)	100	100	100	100	100
Debt Allocation (Rs.)	~83	~83	~83	~83	~83
Debt Value on maturity (Rs.) (A)	100.00	100.00	100.00	100.00	100.00
Direct Equity allocation (Rs.)	~17	~17	~17	~17	~17
CAGR (%) on equity allocation	(20)	(10)	0	10	20
Equity Value at the time of Scheme maturity (Rs.) (B)	8.70	12.39	17.00	22.63	29.38
Scheme Value at maturity (Rs.) (A+B)	108.70	112.39	117.00	122.63	129.38

In the above example, in scenario 4, if the Compounded Annual Growth Rate (CAGR) is 10%, the debt portion grows from Rs 83 to Rs 100 over three years and Rs 17 invested in equity grows to Rs 22.63 over three years. Thus, Rs 100 invested over three years grows to Rs 122.63.

As an alternative, the fund manager may also invest in equity options instead of direct equity so that there can be greater participation in equity in case the equity markets give above average returns over the tenure of the scheme. However, if the options contract does not make money on maturity then there is a possibility of nil returns from the equity portion of the portfolio thereby returning the amount originally invested as explained below:

Scenario analysis over 3 years (Equity option strategy)

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Scheme Corpus (Rs.)	100	100	100	100	100
Debt Allocation (Rs.)	~83	~83	~83	~83	~83
Debt Value on maturity (Rs.) (A)	100.00	100.00	100.00	100.00	100.00
Option Premium Paid (to obtain 70% notional exposure)	17	17	17	17	17
Annualised Nifty Returns (%)	(20)	(10)	-	10	20
Equity Value at the time of Scheme maturity (Rs.) (B) (70% of Rs 100 with CAGR of 10% i.e. 70% of Rs 33.10)	-	-	-	23.17	50.96
Scheme Value at maturity (Rs.) (A+B)	100.00	100.00	100.00	123.17	150.96

In the above example the returns in the equity portion are calculated assuming only 70% participation based on the premium paid on the options contract. When the overall Nifty returns are negative, the index options contract does not generate money. Hence, the value of the equity allocation in the above table is zero. When the overall Nifty returns are positive the index options contract generates money, 70% of the returns generated are gained through the options contract (70% of Rs 100 with CAGR of 10% i.e. 70% of Rs 33.10).

The illustrations above are purely to explain the concept of orientation towards protection of original investment at Scheme's maturity. The portion of debt/equity portfolio does not offer any assured returns and is subject to market risks including risk of issuer default. The equity returns generated by CPOS would depend on the portion of assets allocated to equity.

Who should consider investment in CPOS?

- Risk averse investors who have safety first in mind as key consideration while investing
- Investors who do not want to take interest rate risk and want to earn prevailing yields over the tenure of the scheme
- Investors who desire to participate in equities with the stability in the portfolio being provided by the debt portion of the portfolio
- Investors seeking tax efficient returns when compared to fixed income deposits as investors of CPOS can take benefit of indexation (refer table below)
- Investors who do not have an appetite for volatility and do not have the expertise to time their exit from a similar portfolio which is open ended
- Investors whose investment horizon matches with tenure of CPOS

How are earnings from CPOS taxed? ^^

	Resident Investors	Mutual Fund
Dividend Income	Nil	Dividend Distribution Tax (DDT) Individual / HUF 28.325% * Others 33.99% * (Refer Note below)
Capital Gains		
Long Term	10%* / 20%*	Nil
Short Term	Income tax rate applicable to the Unit holders as per their income slabs.	Nil

* including applicable surcharge, education cess and secondary and higher education cess.

Note:
On income distribution, if any, made by a Mutual Fund, additional income tax is payable under section 115R of the Act, in the case of "other than equity oriented funds". An equity oriented fund is a fund where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund).

^^ The information given herein is as per the prevailing tax laws. Investors should be aware that the fiscal rules/ tax laws may change and there can be no guarantee that the current tax position may continue indefinitely.

Can an investor redeem units of CPOS before its maturity?

As CPOS are close-ended schemes which mature at a pre determined date, the Units of CPOS cannot be redeemed by the investors directly with the Fund until the Maturity / Final Redemption date. However, the Units of the Scheme are listed on the Stock Exchange(s) such as National Stock Exchange of India Ltd. (NSE) or BSE Ltd. (BSE). The Units can be purchased / sold during the trading hours like any other publicly traded stock on the exchange where they are listed.

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