National Post

Looking for shelter in a bear market

Monday, July 16, 2007
Page: FP4
Section: Advisor Post
Byline: Jonathan Chevreau
Column: Well Advised
Source: Financial Post
Illustrations: Color Photo: Glenn Baglo, CanWest News Service / Howard Atkinson, president of Horizons BetaPro ETFs, is familiar to advisors from Barclays, a dominant Canadian player in ETFs.

Exchange-traded funds, like mutual funds, have been perceived largely as "long-only" investment vehicles. The mushrooming ETF industry has certainly profited from the global stock market boom that has raged since 2003. However, with markets near all-time highs and storm clouds on the horizon, advisors are looking to protect clients' portfolios from any sharp reversals.

A new family of ETFs available in Canada can protect portfolios from the ravages of a bear market. They're called the Horizons BetaPro ETFs. Advisor who sells ETF will know Howard Atkinson, who became president of Horizons BetaPro ETFs late in 2006. Atkinson was head of marketing for Barclays Global Investors Canada Ltd., the dominant ETF player in Canada. He is also lead author of The New Investment Frontier (Insomniac Press, Toronto.)

BetaPro ETFs come in two distinct flavours: bull and bear. The bull versions make leveraged two-for-one bets on further upside in the markets or sectors of the market. The bears do the same but on the downside -- they work like the Rydex funds in the United States, popularly known as "reverse index funds."

Thus, if you buy a Bull ETF and the market rises, the investor gets twice the daily gain that would arise with a normal ETF. Conversely, if you buy a Bear ETF and the corresponding market obliges by falling, the daily profit will be twice as much as it would be from simply shorting a normal ETF tracking that index. Of course if the market keeps rising, those in the bear ETF will lose money, as will bull ETF investors in a down market.

In a recent client report, Fred Kirby, a certified financial planner based in British Columbia, says buying the bear ETFs or selling short the bull versions can help investors hedge portfolios if they believe the market is poised for a serious decline.

The first BetaPro series was launched this past January to allow Canadian investors to play the S&P/TSX composite index. They include the Horizons BetaPro S&P/TSX 60 Bull Plus ETF (HXU/TSX) and the Bear version (HXD/TSX). As a memory aid, think "U for up" and "D for down."

In June, BetaPro added six more ETFs that work the same way in specific sectors of the Canadian market: Bull and bear ETFs for the financial sector (HFU/TSX) and (HFD/TSX); a pair for the energy sector (HEU/TSX) and (HED/TSX); and a pair for gold (HGU/TSX) and (HGD/TSX).

Canadians can also access U.S. ETFs trading on the Amex, offered by ProShares, BetaPro's portfolio manager. ProShare's parent company, ProFunds Group, was formed by two former executives of Rockville, Md.-based Rydex Investments. Like Rydex, ProFunds offer both mutual fund and ETF versions of its products. Canadians can't buy ProFunds or Rydex mutual funds but can buy their ETFs, as they can any other ETF trading on foreign exchanges. Canadian advisors offering either Horizon BetaPro ETFs or mutual funds must be IDA-licensed.

As Kirby notes, the Proshares UltraS&P500 and UltraShort S&P500 make the same "double" bet on the S&P500. They are denominated in U.S. dollars, which may be a plus for those who wish to diversify their currency exposure.

Further to the column on "insurifying," Kirby believes in hedging only half the long equity part of portfolios.

Since BetaPro bear funds are themselves leveraged 2:1, that means you only have to invest $1 in hedging for every $4 of long equities in a client portfolio. As Kirby puts it, "sometimes, the timing of the hedge will be right and will be profitable, other times it will be wrong and there will be an opportunity cost. But in the long run, it should break even. Its purpose is to decrease portfolio volatility and help keep its value."

One portfolio manager who welcomes the bear funds is Barrie, Ont.-based Danielle Park. Park is a partner in Venable Park Investment Counsel Inc. and author of Juggling Dynamite (Insomniac Press, Toronto, 2007).

The book is somewhat cautious about current valuations. Park says most ETFs long the market minimize company-specific risk but do little to avoid market risk. While, unlike mutual funds, ETFs can be shorted, that exposes clients to excessive risk.

BetaPro funds put at risk only the amount of capital committed to the funds -- similarly to how put options work. Traditional derivatives may be more cost-effective for institutional trades, Park says, but if you are using segregated accounts where people have money in multiple RRSPs and accounts, it may be cheaper to use Betapro ETFs.

"As a hedging tool they are going to be quite a useful product and as a speculative tool they may be more defined and user-friendly than options."

Also, put options require specific options accounts, while Betapro funds can be held in RRSPs and regular investment accounts. Buying Betapro funds requires putting up money for the purchase, which is fine for outright positions and if you have the cash. But when hedging, Kirby says there is no need to put up additional funds in taxable accounts when you can sell short the HXU. That's the equivalent of buying HXD less any distributions.

NATIONALPOST.COM

www.wealthyboomer.ca

Jonathan Chevreau

jchevreau@nationalpost.com------ ---

ETFs Help Protect Clients' Portfolios In Sharp Reversal