

# Entrepreneur

## On The Upside

The economy may be heading downhill, but for short funds, things are looking up.

By Farnoosh Torabi | Entrepreneur Magazine - August 2008

When life hands you lemons, make lemonade, right? The same goes for the gloomy stock market. One strategy of late for pessimistic investors has been betting on downward movements and buying so-called short, or bear, funds, which are designed to go in the opposite direction of a particular index or an actively managed fund. In practice, when the market slips, bear funds should make money. "It's great for investors who think the market is overvalued or is going down to actually profit from that," says Ryan Harder, a senior portfolio manager at investment management firm Rydex Investments.

Investment dollars have been pouring into this asset class over the past few years. Since 2005, holdings in bear funds have jumped from \$6 billion to \$16 billion, according to fund data provider Lipper. "Because of the negative fundamental data of oil, employment, slow growth and increased inflation, there are many more [investors] trying to benefit from the volatility," says Kevin Meehan, president of Summit Wealth Advisors.

Investing in short funds isn't as complex as playing in the manic derivative market, either. Those who bet against the market in the first three months of 2008 earned about 7.5 percent, while market followers lost nearly 10 percent, according to industry data firm Hedge Fund Research. But bears, beware: The market for short funds is no amateur act. It still demands an appetite for risk.

### Bear Necessities

Investors can bet against either a market index like the S&P 500 or a managed fund of shorted stocks. It depends on where their pessimism lies. ProFunds, the biggest provider of bear funds, has \$17 billion under management and specializes in short exchange-traded funds. For the more aggressive folks who are especially convinced the market will tank, "ultra" short funds offer double the inverse, such as the Rydex Inverse 2X S&P 500 ETF. So if, say, the S&P 500 falls by 2 percent, the short fund should rise by 4 percent. Rydex Investments also offers a large family of various short funds based on the Dow Jones Industrial Average and the Russell 2000 Index, among other market measures. Some, like ProFunds' offerings, are also designed to do 200 percent of the inverse of the index.

Of the short funds that actively hedge individual stocks, the Leuthold Grizzly Short Fund (GRZZX) is one of the category leaders. It's up, approaching 20 percent returns in the first three months of 2008. The fund bets against financials, housing and tech names. The Prudent Bear Fund (BEARX), which was up more than 5 percent in the first quarter of the year, also shorts individual stocks, in addition to possibly implementing options and futures contracts.

### Cutoff Shorts

While they offer a hedge against the market, critics say bear funds can be considerably dicey because investors need to be aggressive and time the market to make money. "You really have to make two decisions: When do I go short in the market, and when do I take my short positions off?" says Adam Bold, founder and CIO of the Mutual Fund Store. "The reality is that most people don't realize that by the time the market's going down, it is likely closer to a bottom." Bold believes the stock market has already reached a bottom and that investors should start recouping significant losses by year's end. "There will be a number of times where we'll have 10 percent to 20 percent corrections," he explains, "but during those times you have to be patient and realize things are eventually going to turn around."

Meehan also has reservations and suggests investors limit exposure to short funds to 10 percent of their retirement portfolio. Says Meehan, "[Investors] may not have the fortitude to stay in the strategy long enough to benefit from them."

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