# BEAR FUNDS ADVANCED STRATEGIES

## How ETFs can offer protection in down markets

The market turmoil seen in 2020 has seen massive increases in trading volumes in 'short' equity funds. Average daily trading volumes in the ASX-traded funds that provide short exposure to either the Australian or the U.S. sharemarket have been ten times or more higher than average daily trading volumes in 2019.

In the paper below we look at how these funds work, their risks and benefits, and how they differ from other products or strategies that offer short exposure.

## What is a short, or Bear, fund?

Short, or Bear, funds are designed to increase in value as the market falls ('Bear funds'). They can be used to seek to protect against, or profit from, declines in the equity market. Keep in mind they will typically go down in value if the market rises.

Some products offer unleveraged returns – for a 1% fall in the sharemarket on a given day, the value of the fund should increase by approximately 1% (and vice versa) on that day.

Other products are leveraged and seek to generate magnified returns that are negatively correlated to the sharemarket. For example, a fund might aim to produce a return of between 2 and 2.75% for a 1% fall in the sharemarket on a given day (and vice versa).

## How do Bear funds achieve their short exposure?

Bear funds typically achieve their short exposure by selling share index futures contracts – not by short selling the shares in the index. This means that they would still be able to operate if the government brings in a ban against short-selling shares, which has been raised as a possibility in the past.

Australian sharemarket Bear funds sell futures over Australia's benchmark S&P/ASX 200 Index (SPI 200 futures), while funds offering short exposure to the U.S. sharemarket sell S&P 500 Index futures.

As a result, the prices of the Funds reflect futures prices – which are not always precisely the price level of the sharemarket index. This is a very important point to understand when looking at price movements in Bear funds, and one we'll cover in more detail shortly.

## Benefits of Bear funds

Share investors are mainly used to rising markets, investing in shares they hope will go up in price. In falling markets, investors typically either sell their shares or sit on the sidelines and wait the downturn out. Neither of these strategies produces a meaningful positive return while the market is falling (excluding any dividends received). Bear funds are one of the few ways you can seek to position yourself to earn a positive return from a declining market.

They offer benefits over alternative methods of going short, such as selling futures or trading CFDs:

- You can lose no more than you invest – selling futures, for example, involves the risk of open-ended losses
- No margin calls for investors
- Administratively simple – traded on the ASX just like shares
- Transparent – you can see live pricing throughout the trading day on the ASX. The net asset value (NAV) and current gearing level of your investment are readily available on the fund issuer's website.

## Risks of Bear funds

- The main risk of a Bear fund is that the market rises, in which case your investment will fall in value.
- In the case of funds such as BBOZ and BBUS, there are the risks associated with gearing, which magnifies both gains and losses. Geared investments involve significantly higher risk than non-geared investments and may not be suitable for all investors.

### What funds are available on the ASX?

BetaShares is the only issuer currently offering ASX-traded Bear funds, with three funds available:

- Australian Equities Bear Hedge Fund (ASX: BEAR)
- Australian Equities Strong Bear Hedge Fund (ASX: BBOZ)
- U.S. Equities Strong Bear Hedge Fund – Currency Hedged (ASX: BBUS)

Each fund targets a return that is negatively correlated to the return of either the Australian or the U.S. sharemarket:

- BEAR targets an unleveraged return that is negatively correlated to the Australian sharemarket - specifically a correlation of between -90% and -110% on a given day.
- BBOZ and BBUS seek to generate magnified returns that are negatively correlated to the Australian and U.S. sharemarket respectively – specifically a correlation of between -200% and -275% on a given day.

(Please note, ETF Securities has recently launched funds that offer leveraged short exposure to international tech stocks and it is likely that further products will be issued).

### How are prices of the Bear funds determined?

As stated above, Bear funds achieve their short exposure by selling share index futures contracts. The prices of the Funds therefore reflect futures prices – not the price level of the sharemarket index.

Typically, equity index futures prices and the relevant sharemarket index move in parallel, and so in the hours when the relevant sharemarket is open, price movements in the Bear funds should closely reflect movements in the physical sharemarket.

However, trading hours for the sharemarket and the futures market are different. Futures markets operate almost around the clock, even when sharemarkets are closed. When the sharemarket is closed, futures prices continue to move – and at volatile times these moves can be significant. Futures price movements translate into movements in the prices of the Bear funds.

This is particularly important with a fund such as BBUS, as the U.S. sharemarket operates in a different timezone to ASX trading hours.

There have been examples where the U.S. sharemarket (as measured by the S&P 500 index) fell significantly overnight, but at the open of ASX trading, the price of BBUS was only slightly higher than at the close of ASX trading the previous day.

### Key takeout

Understand the connection between Bear funds and index futures prices.

Over the long term, futures markets will be highly correlated with the underlying equities market. In the short term they will typically be highly correlated – but in very volatile times, there can be unpredictable moves.

### What returns can I expect?

It's important to note that Bear funds target the stated negative correlation on a given day. It should not be expected that the return over a longer period will necessarily fall within the target range. One of the reasons for this is the rebalancing that occurs from time to time to maintain the fund's short exposure within the target range.

Portfolio exposure changes on a daily basis as the market moves. If the portfolio exposure moves outside the target range, the Fund will be rebalanced to bring it back within the target range. BetaShares publishes each fund's approximate portfolio exposure daily on their website.

The 'rebalancing' effect is particularly marked during periods of high volatility.

The Bear Funds target a return over a one-day period and should not be relied upon to generate exactly that return over a period of longer than one day. Investors should not expect a Bear fund to hit a certain price at a specific Index level.

Bear funds are designed to provide returns that are negatively correlated with the Australian or U.S. sharemarket, and so may be used to help protect against, or profit from, sharemarket declines.

It is important for investors in a Bear fund to understand its features, including how it is priced, and that it targets a return over a one-day period only. If you are considering investing in a Bear fund, be sure to review the fund's PDS and TMD, and consider the risks associated with the fund.

The Bear funds' strategy of seeking returns that are negatively correlated to market returns are the opposite of most managed funds. Also, gearing magnifies gains and losses and may not be a suitable strategy for all investors. Investors in geared strategies should be willing to accept higher levels of investment volatility and potentially large moves (both up and down) in the value of their investment. Investors should seek professional financial advice before investing and monitor their investment actively. An investment in any of the Bear funds should only be considered as a component of an investor's overall portfolio.