ETF Self Defense!

ETF TRADING RESEARCH

Using ETFs To Short The Market

Investors often think of ETFs as ways to buy into certain markets or assets. After all, ETFs are used to invest in everything from the Russell 2000 to Central African stocks to sugar futures.

However, one extremely important feature of ETFs is that they can be used to take bearish positions. In other words, investors can use ETFs to take short positions on the market, specific sectors, certain asset classes, and more.

Why is this important?

There are several reasons. Let's take a closer look at them now.

The Benefits Of A Bearish Position

Taking a short position on the market can be lucrative for investors. It’s also an easy method to reduce portfolio risk.

First off, investors are all too aware of the dangers a major stock market selloff presents. For instance, the vast majority of retirement funds are invested in equities. And when a significant downturn occurs, it can seriously cut into a retirement portfolio's value.

However, if it's easy to take a short position in the market, investors have the ability to make money when market conditions deteriorate. Or, for peace of mind, holding an overall short market position can be a simple way to hedge your long portfolio.

Here's the thing...

There's plenty of money to be made during a down market.

Downturns can be substantial, like what we saw during the Financial Crisis of 2008 and its aftermath. Or, they can just be temporary week-long dips.

Either way, being able to quickly and easily take a short market position can be extremely profitable. Why should the average investor miss out on the opportunity?

What's more, hedging or protecting investments should also be easy and straightforward. An investor shouldn't need a math degree to figure out how to protect a long portfolio from a market selloff.

Yes, there are multiple ways to short the market - but many of these simply aren't options for non-professionals. You can short sell stocks, but it requires a ton of margin and can be dangerous. There are futures and options that can be used, but derivatives products aren't for everyone.

Fortunately, taking a bearish position on the market is now easier than ever. As you may have guessed, there are several bearish ETFs available that are quick and easy (and cheap) to trade.

The World of Bearish ETFs

With the popularity of ETFs skyrocketing in recent years, it's now as easy as it's ever been to go short using ETF products.

With bearish ETFs, you can take short positions in, well, almost anything.

Certainly, short market ETFs are commonly traded, such as a bearish S&P 500 ETF. But, there are even popular bearish ETFs on oil and gold.

In fact, buying a bearish (or inverse as they're commonly called) ETF is just like buying a stock. *The only difference is that the ETF's price goes up as the asset it's tracking goes down.*

As I mentioned, investors have a huge cross section of inverse ETFs to choose from.

There are inverse ETFs for all the major indices, from the S&P 500 to the Russell 2000. An investor can use inverse ETFs to short sectors, such as technology or healthcare. There are inverse products for international stocks and emerging markets. And, there are even inverse commodity ETFs such as short gold, oil, and silver.

With so many choices available, investors can easily take a short position in every major asset or index. Plus, these ETFs can be used to increase profits or protect existing positions.

Keep in mind, buying an inverse ETF is just like buying any other stock. Just put in your order through your online or personal broker and you're good to go.

Let's look at an example of how lucrative a bearish ETF can be.

Bearish ETF Example

All you need to do to see the power of bearish ETFs is to look at this example from 2008-2009.

Remember, this was when the Financial Crisis was in full swing. Banks were failing. Real estate was plunging. Investors were running scared.

But... what if instead of selling out your stock portfolio for a loss during that volatile period, you invested in a bearish market ETF. Let's say you picked the most popular inverse ETF out there, **ProShares Short S&P 500** (SH).

SH is highly liquid and trades as much or more than most stocks. In fact, at the time of this writing, it was averaging over 3 million shares traded per day. And, it was readily available back in 2008.

Let's say... when things started getting dicey with real estate in 2007, you decided to take a short position in the market. So, at the start of 2008, you allocated a portion of your portfolio to SH at $50 per share.

Check out the chart below...

Do you see the profits you would have raked in had you held your position through the Lehman collapse in October? How about the gains you could have made when unemployment shot through the roof in early 2009?

At either point you could have sold your SH shares for $90.

That's an 80% gain!

Think of how much better your portfolio would have looked if you had pulled in 80% on a position while everyone else was running for the hills. I'm fairly certain you wouldn't have complained.

A Final Word

That's all there is to it. It's simply that easy to go bearish on the market using ETFs.

Inverse ETFs are one of the great financial products of the last decade. They've provided a cheap and easy way for anyone wanting to go short the market.

No longer is going short limited to the realm of the professional trader. Now, any investor or trader who so desires can take an inverse position on the market, a sector, a country, or even a commodity.

Don't be afraid to use bearish ETFs to increase your profits. Or, you can use them to help you sleep at night - knowing you're portfolio is hedged should the markets take a turn for the worse.

No matter how you use them, just remember that you have the tools to go short using bearish ETFs.

Sincerely,

Robert Morris, Senior ETF Strategist
ETF Trading Research