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Bearish ETFs enjoy bumper inflows

By Ajay Makan in New York

Exchange traded funds in the US that act as a bet against the S&P 500, the New York stock index, have enjoyed bumper inflows as investors try to benefit from falling asset prices.

The so-called "inverse" ETFs, which track a basket of underlying assets such as equities and commodities, but aim to yield the opposite return, took in net flows of $890m in August and $885m in September.

Those two months marked the second- and third-highest months of net inflows ever, with more than double the average monthly inflow since 2008, show data from XTF, which tracks the ETF industry.

Among the most popular funds were the Proshares short S&P 500 ETF, which aims to yield the opposite of the daily return of the S&P 500. The fund took in $635m between July and September, when its share price rose 13 per cent, as the S&P 500 declined 14.3 per cent during the third quarter.

The use of such ETFs is growing as they have advantages over buying options and futures to hedge risk during extreme market volatility.

It comes despite the risk that they can underperform the markets they track due to being reset on a daily basis and are leveraged.

"Inverse funds are a cheap and efficient way to manage risk," said Bryce James, chief executive of Smart Portfolios, who has used such products to hedge risk.

Whereas brokers require clients to sign authorising papers before buying options positions, individual investors can buy into inverse ETFs immediately on an exchange. Unlike options or futures, the ETF does not expire, which is attractive for investors who may wish to remain flexible about exiting such trades.

“The volatility in today’s market can make these products very attractive to manage risk on any portfolio,” said Benjy Schwartz, chief market strategist at Lightspeed Financial, a retail broker, adding that client interest had jumped in recent months.

But the increased popularity of inverse ETFs, as well as leveraged ETFs, which yield a return of two or three times underlying assets, is raising concern because of the complexity of the products.

A key issue is that such funds “reset” daily and can therefore erode returns over time as the ETF is constantly rebalanced. Inverse funds have been known to yield negative returns over extended periods, even if the assets the fund is tracking fall in value.

That complexity has led BlackRock, whose iShares suite of ETFs is the most popular in the US, to rule out offering inverse or levered products altogether. Some retail brokers in the US, such as Edward Jones, refuse to invest in such products on clients’ behalf.

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