Making Money Now: Hedging Your Bets by Shirley M. Mueller

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The market mostly goes down. Your portfolio does too. Only your cash and bonds are providing portfolio stability.

Does this sound familiar? Then you are due to learn some fancier footwork for a primarily down market. Enter the world of hedging, tailored by the individual investor to benefit himself. This isn't as difficult as it sounds, though it does take some basic knowledge.

Inverse exchange-traded funds are designed to perform opposite their benchmark. For example, SH is a Proshares fund that shorts* the S&P index, GSPC. When the S&P index goes down, SH goes up:

Those who expect the market to be down for a while can hedge their S&P funds equivalents with SH. One way to do this is to take a conservative bet and not hedge one for one, but hedge for a more modest amount such as one-half. For example, if Mr. Wise had 1,000 shares of the S&P index (or its equivalent), he might buy 500 shares of SH. If the S&P goes down 10%, Mr. Wise hasn't lost 10% of his S&P/SH portfolio—he's lost only 5%, because he hedged 1,000 shares of his S&P index with 500 SH. Depending on one's forecast for the market, an individual can hedge more or less.

Of course, investors own more funds than the S&P index in order to achieve diversification. Some examples are the NASDAQ, the Dow, the Mid plus
Small cap, as well as the Russell 2000 and international stocks. These broad allocations can be hedged too. A list of the exchange traded fund (ETF) ** possibilities for this purpose is below:

ETF	Ticker	Benchmark Index
Short QQQ	PSQ	Nasdaq-100
Short Dow 30	DOG	DJIA
Short MidCap400	MYY	S&P MidCap 400
Short SmallCap600	SBB	S&P SmallCap 600
Short Russell2000	RWM	Russell 2000
Short MSCI EAFE	EFZ	MSCI EAFE Index

(Source: A list of reverse exchange traded funds offered by ProShares, which offers still more options.)

The upshot of all this is that you can hedge your own portfolio. When the market tanks, the process of hedging protects your long positions and some money is made in spite of the downhill drag. Of course, when the market is up, short positions lose money. Need I say, "There is no reward without risk?" Still, the judicious use of this hedging technique with some accurate expectation of market moves can make this tactic profitable in mostly down markets.

*Short selling is the opposite of owning a stock outright. It is the process of selling a stock that is not owned, betting it will go down in price. The short seller borrows or rents the stock shares from her/his broker. Then, the stock can be purchased when the price goes down and the difference between the short sale cost and the lower purchase price is the return. However, there is a risk. If the stock goes up, not down, the short seller loses money. This risk can be limited by closing a position quickly after a stock begins to rise.

**Exchange traded funds (ETF's) are funds that track an index. Inverse ETF short the same index.