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FUND VIEW- Inverse funds help investors profit from declines

By Cal Mankowski

NEW YORK, Aug 10 (Reuters) –

Investment products that make it easy to go "short" and help investors benefit from falling prices are suddenly in demand as market volatility has risen. In a short sale of a stock or bond, an investor borrows a security and sells it, and then profits by buying it later at a lower price. But if the price rises, the short seller loses money. Short selling individual stocks or bonds in a brokerage account can be complicated, but mutual funds and exchange-traded funds offered by several companies are making the process relatively simple. ProFunds Group offers a family of 52 ETFs called ProShares which provide magnified or short exposure to various market indexes including industry sectors.

The ProShares ETFs recently passed the milestone of gathering \$7 billion of assets in just over a year after launch. For example, the ProShares UltraShort Financials ETF <SKF.A> has notched highs as financial stocks have stumbled. The fund aims to double the inverse of the daily performance of the financial sector. Since early February, the UltraShort Financials ETF is up about 31 percent.

Exchange-traded funds trade continuously on exchanges like a stock, and are bought and sold through brokers. Assets of U.S.-listed exchange-traded funds totaled about \$482 billion at the end of July, according to a report by State Street Corp.

Barclays Global Investors, the largest player in ETFs, said it appears that all of their iShares fixed income ETFs have been getting net inflows from July 27 through Aug. 9, an especially volatile period.

"There is certainly a flight to safety," said a spokeswoman who asked not to be named.

In that period, the iShares ETF based on the Russell 2000 index <.RUT> of small-cap stocks has had the largest inflows of the company's ETFs, roughly \$5.8 billion.

Rockville, Maryland-based Rydex Investments offers a traditional open-end mutual fund that seeks to double the inverse of the Russell 2000 index of small-cap stocks.

RUSSELL INDEX LAGS

With the Russell 2000, after years of beating large-cap indexes, suddenly lagging, the inverse mutual fund has done well. Since mid-July, the fund is up around 18 percent while the Russell 2000 is down about 8 percent.

The fund is one of several inverse mutual funds offered by Rydex. The company has filed with regulators to offer inverse ETFs.

One of the advantages of "inverse" funds is that they make short-selling simple. For one thing they make it possible to get around rules against short selling in retirement accounts.

Some experts say that many investors have a natural disinclination to bet on a market decline.

"We have seen a lot of people staying the course on the long side but there has also been a decent contingent of shareholders shifting to the short side," said Jim King, director of portfolio management at Rydex. "It's only been a couple of weeks since we went from the euphoria of setting new highs."

King said that Rydex has not seen much of a pickup of activity in its fixed income funds. He said people tend to use fixed income funds for longer-term strategies.

"At this stage, using inverse products or hedging with these funds will probably not save too many people," said Pran Tikku, a financial planner in Waltham, Massachusetts.

Tikku, who heads Peak Financial Management Inc., said most of the meltdown is probably over so it is probably too late to think about going short.

He said another couple of percentage points of decline will get the stock market to a 10 percent downward correction, a percentage that some market watchers consider a healthy pullback from frothy levels.

"We see that fundamental economics are pretty strong, corporate profits are healthy, unemployment is low, inflation is reasonably low and interest rates are low," Tikku said. "Our view is that it's a normal correction and people with long-term horizons shouldn't worry about it too much."

(Reporting by Cal Mankowski, Wall Street Desk; editing by Gary Crosse; Reuters Messaging: