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## Will being a bear pay off in 2012?

John Shmuel Jan 27, 2012 – 2:36 PM ET



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There's no doubt last year was a great time to be a bear. If you started the year with gold and bonds and picked up defensive stocks before they became overpriced, you likely ended the year on a high compared to investors who took a more bullish position on equities.

The S&P/TSX Composite finished the year down 11%, U.S. markets were flat after nearly touching bear market territory and European stocks also had investors growling.

Naturally, many investors are wondering if it will pay to be a bear again this year.

"I'd say investors asking that question are being human," said Murray Leith, vice-president and director of investment research at Odlum Brown Ltd. "They're feeling most comfortable with the asset classes that worked in the recent past. Bonds did better than stocks last year, and gold hung in there pretty nicely."

But investors who go all in on a bear portfolio this year risk being trampled, Mr. Leith added. "I think this is the wrong trade."

Last year's bear plays benefited from record stock market volatility amid a backdrop of global uncertainty. In the opening months of 2011, a wave of unrest struck the Middle East and North Africa and oil prices spiked as a result. In March, Japan was rocked by a devastating earthquake and tsunami, dealing a blow to the country's automotive manufacturing industry.

Spiking bond yields in Europe raised fears that the eurozone faced a very real possibility of breaking up. And in August a downgrade of U.S. sovereign debt by Standard & Poor's sent markets into another tailspin.

The bears argue that, nearly a month into 2012, nothing's changed.

"The people I speak to tell me that the extreme volatility and general market weakness last year was the aberration," said David Rosenberg, chief economist at Gluskin Sheff + Associates. "I'm actually wondering if it isn't the opposite: That last year was normal

and [the rally] we saw in 2009 and 2010 was the aberration.”

Mr. Rosenberg, a noted bear among economists, said investors this year need to focus on quality since the global economic environment will likely keep throwing surprises at the markets.

“Balance sheet quality becomes so much more important in cycles like these,” he said. “We have already seen the amount of AAA-rated government paper plunge 70% in the past three years from US\$19-trillion to US\$6-trillion. As such, emphasis on good quality corporate bonds in non-cyclical sectors, attractive spreads, high net free cash flow yields, low debt ratios, high liquidity ratios and light refinancing calendars make prudent sense.”

It also helps that it's never been easier to bet against the stock market because of the introduction of bear exchange-traded funds such as AdvisorShares Active Bear ETF (HDGE/NYSEArca).

During the volatile months of August and September, when spiking European bond yields drove market fear to its highest level since the financial crisis of 2008, the Active Bear ETF did its job, hitting a high of US\$32.50 (it is now trading in the more subdued US\$22 range).

Yet another factor in the bear's favour is that unlike last year corporate earnings are more often missing their estimates than beating them, based on the third of the S&P 500 companies that have already announced their earnings.

“Compared to consensus one month into the quarter, 42% are missing, 19% are in line, and 39% are beating,” said UBS strategists Thomas Doerflinger and Jonathan Golub in a note this week. “In Q3 the ratio was 29%/23%/48%. Many companies report weak demand, in many cases tied to inventory corrections that are expected to continue in Q1 but hopefully end by mid-year if not sooner.”

That said, most fund managers are still bullish on stocks this year — and a blistering January on the stock markets helped reinforce their belief. The Dow Jones Industrial Average is now within a stone's throw of regaining its post-financial crisis high of 12,810 in April 2011.

“The odds are good that stocks rise this year, and the catalyst that is going to drive the market higher is the United States,” Mr. Leith said. “It's been a long time since people talked about the dreaded double-dip. And the reason it's not coming is because the U.S. has actually been a beneficiary from the problems in Europe and the slowdown in China.”

Mr. Leith points out that the problems in Europe have caused a flight to safety that has driven U.S. interest rates lower, and consumers and businesses are benefitting from cheaper and more readily available credit. Meanwhile, the slowdown in China is helping moderate commodity prices, which is also a plus for the U.S.

Even Europe's STOXX 600 index, which weighs the continent's biggest companies, is up 20% from its lows in October last year and many analysts think Canadian stocks will recover as well.

Robert Floyd, president and lead manager at BirchLeaf Investments Inc., echoes Mr. Leith's bullish outlook for stocks this year, but says his firm is primarily favouring Canadian stocks.

“I'm certainly a lot more bullish than I have been in the past,” he said. “You look at the Canadian stock market, and it was pushed down fairly aggressively last year. You're going to get some fairly decent returns — double-digit returns — for 2012. The U.S. stock market is in a similar position.”

Mr. Floyd added that some of the worst-case scenarios regarding Europe's debt crisis, such as Greece leaving the eurozone, have already been priced into the market and don't give bears the ammunition they had last year.

But at least one analyst believes retail investors should worry more about covering all their bases rather than wondering if they should be bulls or bears.

“People should have more diversity in their portfolio, and they should especially be diversifying outside of the country,” Mr. Leith said. “Investors need to take advantage of a dollar that's near par. That means things like buying global multinationals, of which there are many fine companies in the United States. Basically, diversification is key.”

## **THE EASY BEAR**

*ETFs/funds for the negative investor*

Pimco StocksPlus Trust Short Strategy (MUTF:PSSAX) — This fund's approach involves shorting the S&P 500 and then investing those proceeds in intermediate- and short-term bonds to provide income for investors.

AdvisorShares Active Bear ETF (HDGE/NYSEArca) — This ETF shorts 20 to 50 U.S. stocks (the number varies because the ETF is actively managed). It targets companies that have poor earnings quality, accounting problems or earnings events that could hit share prices.

Federated Prudent Bear (MUTF:BEARX) fund — Another fund that focuses on shorting the market, BEARX holds short-term liquid securities such as money market funds, U.S. Treasuries or government agency securities for liquidity purposes and to cover

outstanding short positions.

Grizzly Short (MUTF:GRZZX) — This fund's stocks are chosen from domestic common stocks that have a market capitalization of more than US\$1-billion. The fund only chooses stocks that demonstrate high liquidity.

Posted in: Investing Tags: Bears, Bonds, David Rosenberg, Equities, Europe, Gold, Murray Leith, Robert Floyd, S&P/TSX Composite Index, Stocks, Yields



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