Harry's Take

October 25, 2022

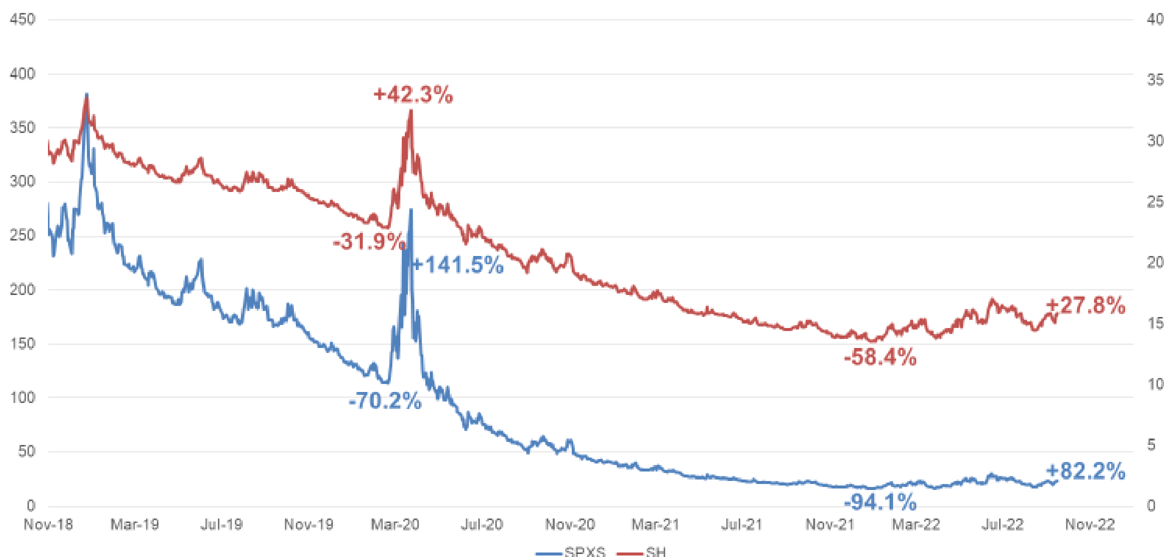
Comparison of Triple-Short SPXS on S&P 500 With Single-Short SH

I often get questions about how the short ETFs do vs. the actual stock indices. Do they correlate well? And the answer to that is yes, they do. In the past, I have measured things like SH vs. short S&P 500, and there is a very close relationship. So, don't worry about buying SH to short the S&P 500 (or PSQ to short the Nasdaq 100), especially for a crash that is likely to last just 1.5–2.5 years.

But the next question I often get is "How do the triple short indices hold up?" The answer is more complex, and the bad news is that they DO NOT correlate consistently at all! But the good news is that they work much better when the stock market is going down, i.e., in their direction up, being short.

Here's the analysis on how the triple-short ETF SPSX works compared with the single-short SH.

Inconsistent 3X Short SPXS vs. SH Returns, at 1.6X to 3.4X: Better When Up



Source: Investing.com

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In the first phase of this chart, from early 2019 into COVID, when stocks were strongly up, SPXS was down (because it is short when stocks are up) 70.2% while SH was down 31.9%. So, that was 2.2X the loss on SPXS, not 3X. That would have been better relatively for the triple short, if you were wrong.

In the second phase, during the short COVID crash in early 2020, in the right direction for being short (i.e., down), SPXS was up 141.5% while SH was up 42.3%. In that case, SPXS did a little better than 3X, at 3.4X. Hence, it would have worked even more to your advantage when stocks crashed, as expected.

In the third phase, the next bull run from that crash bottom into January 1, 2022, SPXS was down 94.1% and SH was down 58.4%. In that case, SPSX was down only 1.6 times SH… Well, that would have been to your advantage if you had been short the 3X and were wrong! You would have lost, but the loss would have been less compared with the gains if you had been right.

Then, in the final and present phase, from January 1 of this year into recently, when stocks finally went down strongly, SPXS was up 82.2% while SH was up 27.8%, or exactly 3X, as expected.

You can come to two important conclusions here:

- When you are right and short, the triple-short SPXS works at 3X and maybe even a bit higher, as it did 3.4X in the second short crash phase above, and
- When you are wrong and short, and stocks rally instead, you get punished between 1.6X and 2.2X in these examples above, which means less than 3X the loss, which is also relatively to your advantage!

Thus, these 3X ETFs look to be a good vehicle for shorting in a reasonable period, like 6–18 months or so, as they tend to work 3X or better when you're right and stocks fall, but they don't tend to fall or go against you as hard when you are wrong.

Hence, a good strategy can be to use the 3X short ETFs, like SPXS, TZA (Russell 2000), or SQQQ (Nasdaq), in smaller percentages in your portfolio, say 10% (30% net short at 3X) to 40% (120% net), and then be long Treasury bonds by adding TLT or ZROX (about 1.6X leverage through 25-year duration vs. 20-year TLT) for the other 60% to 90%. You obviously can use any combination of these percentages, depending on your risk tolerance, and even have an allocation to cash to take advantage of unexpected opportunities that pop up.

Harry

Got a question or comment? You can contact us at info@hsdent.com.