

Beating Bridgewater's Big Bear Bet

A prominent [investment story](#) in last Friday's Wall Street Journal said that so far in 2010 Bridgewater Associates, a Connecticut-based hedge fund run by Ray Dalio, had racked up a 38% return.

But that's not what got our attention. What got our attention was the "hook" – the central idea that made the story worth the WSJ's time: that Bridgewater was a "Big Bear" and achieved its large return with a "wager that the U.S. economy would be in worse shape than many expected."

Being bearish is cool these days. If it's bearish, it sells. If it's bearish, it's important enough to spend time and resources reporting it.

Unfortunately, this entire premise – that it pays to be bearish, especially about the U.S. – is highly misleading. In reality, a "bullish bet" on the NASDAQ would have provided even better returns than Bridgewater over the past two years. Believe it or not, bullishness has been more rewarding than bearishness.

To be 100% clear, we like Ray Dalio and Bridgewater. We don't see eye-to-eye about the economy, but every so often a Bridgewater report finds its way into our inbox and we think they are well done and thoughtful. And according to the WSJ, Bridgewater has returned an average 18% annually over the past 10 years. We're impressed.

The WSJ story said that Bridgewater has been bullish Treasury bonds, long the Japanese yen, and long gold. These positions benefit when the Fed is highly accommodative. If another round of quantitative easing occurs, they should continue to perform well. But none of these trades has earned 38% by themselves, so Bridgewater's returns required some leverage, which was reported by the WSJ. Without knowing for sure, we will guess leverage of roughly 2:1 was necessary.

Either that...or the fund managers were very good at market timing.

The story said Bridgewater had a similar macro-view in 2009, when gold was up 40%. But bond yields rose and the yen was basically flat for the year. As a result, Bridgewater's returns in 2009 were only 2%.

So, how does this compare to a bullish bet on U.S. stocks – one that expected a rebound in economic growth and profits? In 2009, the S&P 500 was up 23.5%, without dividends, and so far in 2010, it's up 6.1%. Using leverage of 2:1 would have earned 47% in 2009 and 12.2% this year (before subtracting the cost of borrowing). Bridgewater wins over one year, but not two.

The NASDAQ has done even better. It was up 43.9% last year (without dividends) and is up 9.3% this year. The harsh truth is that even without leverage, the long-NASDAQ trade (the bullish America trade) would have beat Bridgewater over a two-year period.

And in the end it's hard to imagine how yen, gold, and Treasury bonds, which have paltry to non-existent, yields, will be able to beat US stocks in the years ahead. A 10-year Treasury bond yield of 2.5% equals a price-to-earnings ratio of 40. It's been a good 30-year run for the long Treasury investor, but history suggests it's about to come to an end.

The S&P 500 has a P-E ratio in the low teens today. And roughly 85% of S&P 500 companies reporting so far in the third quarter are beating earnings estimates. American companies are doing very well indeed.

A former boss used to say "my perception is your reality." Today, conventional wisdom is bearish and it wants that to be your reality. But the bearish thought process is ignoring the reality of positive returns for being bullish.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-25 / 9:00 am	Existing Home Sales - Sep	4,300 Mil	4.220 Mil	4.53 Mil	4,130 Mil
10-26 / 9:00 am	Consumer Confidence - Oct	49.9	51.8		48.5
10-27 / 7:30 am	Durable Goods - Sep	+2.0%	+5.3%		-1.5%
7:30 am	Durable Goods (Ex-Trans) - Sep	+0.5%	+0.4%		+1.7%
9:00 am	New Home Sales - Sep	0.300 Mil	0.299 Mil		0.288 Mil
10-28 / 7:30 am	Initial Claims - Oct 23	455K	444K		452K
10-29 / 7:30 am	Q3 GDP Advance	2.0%	2.9%		1.7%
7:30 am	Q3 GDP Chain Price Index	1.9%	2.2%		1.9%
8:45 am	Chicago PMI - Oct	58.0	57.0		60.4
8:55 am	U. Mich. Consumer Sentiment	68.0	68.5		67.9