

## New funds offer way to short income trusts: Hedging the trust boom

By: Carrie Tait

As the income trust market expands and matures, it is becoming easier to short sell trusts, creating another way for investors to make money in the sector.

Up until recently, short selling trusts -- betting that the units would fall in value -- was a struggle because it was difficult to find units to borrow. But as the confusion over tax laws is clarified, as trusts become more liquid, and as big institutions, such as pension funds, get into the trust market, the pool of units available to borrow is getting deeper.

And now two firms are diving in, offering investors funds that short trusts.

Front Street Capital closed a \$ In-million initial public offering for its Front Street Long/Short Income Fund on Monday. The closed-end fund trades now on the Toronto Stock Exchange.

It can go up to 50% short, but Gary Selke, Front Street's president, expects that the fund will be 85% long and 15% short. Front Street is a firm known for managing hedge funds and resource funds.

Gluskin Sheff + Associates Inc., a Toronto-based firm that has ridden the income trust boom the past few years, launched its GS+A Income Trust Hedge Fund on May 1. For accredited investors only, it currently has \$35-million in assets under management, and expects to run market neutral, said fund manager Brad Dunkley.

Sophisticated investors have been quietly shorting trusts for years, but now, as the sector expands and valuations balloon, there's more opportunity to short.

"What we found," Mr. Selke said, "is that the retail investors have been, generally speaking, treating these securities as a fixed income, or as a yield substitute," rather than common equities. But because income trusts, according to Mr. Selke, are nothing more than high-yielding common equities, subject to the same economic speed bumps, they're just as likely to fall when the economic cycle turns. The difference is, when they're overpriced, they have further to fall.

Added to that, he said income trusts are "punished much more severely" when they cut their distributions because of the view that income trusts are fixed-income securities, obliged to payout a steady, predictable stream of cash.

Even though Mr. Selke views income trusts and common equities as one and the same, shorting income trusts isn't perfectly straightforward.

"You have to pay anywhere from 1% to as high as 3% to borrow [units] for a year," Mr. Dunkley said. On a large-cap common stock, that number can drop as low as 5/8 of a percent, he added.

In addition to being more expensive to borrow, investors shorting trust units have to cover the distributions paid over the period they've borrowed the units.

That's where long/short pairs come into play. A number of funds shorting trusts have long positions to offset the distributions they have to cover on the short side. Trusts in similar markets but with notable spreads between unit price -- are also paired long and short, fund managers said.

"[Shorting trusts] is an area where we intend to get bigger because it's an area where we think there are some incredible disparities in valuations," said Ron Mayers, a hedge fund manager at Genoa Capital Inc., which has been shorting trusts for about two years.

But as more funds get into the shorting game, it is once again becoming difficult to find units to borrow. "If a lot of people started to do this, the space could get very crowded," Mr. Mayers said.

Added Mr. Dunkley: "I haven't had any problems [finding borrow] until now -- but it's just starting."

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