LEVERAGED AND INVERSE ETFs 101

What is a leveraged ETF? A leveraged ETF is an exchange-traded investable product designed to use financial derivatives and debt to amplify the returns of an underlying index. While a traditional passive ETF typically seeks to track the total return performance, before fees and expenses, of its underlying index, a leveraged ETF may seek 2 times (2x) that return on a daily basis.

These ETFs are intended for use only by investors who:

- understand the risks of leverage and can accept substantial losses in short periods of time;
- understand the unique nature and performance characteristics of funds which seek daily leveraged investment results; and
- are knowledgeable investors and have time to manage positions frequently to respond to changing market conditions and fund performance.

These ETFs are not intended for use by investors who:

- cannot tolerate substantial or even complete losses in short periods of time;
- are unfamiliar with the unique nature and performance characteristics of funds that seek daily leveraged investment results; and
- are unable to manage a portfolio actively and make changes as market conditions and fund performance dictate.

Why invest in a leveraged ETF?

- Short-term trading seeking to amplify/capitalize on daily market movements.
- Can be used either as a hedging vehicle or in some arbitrage strategies.
- More efficient way of capital deployment to gain exposure.

The Effects

Leveraged ETFs need to reset their leverage to the market each night after close, potentially leading to a repeated process of buying higher highs and selling lower lows.

With the combination of daily compounding and a highly volatile index/asset, leveraged ETFs can result in longer-term returns that are less then 4 times the return of an unleveraged investment.

Managing Exposure in Everchanging Markets

Because leveraged and inverse leveraged funds are designed to track a multiple of the performance, or inverse of the performance, of their respective benchmark indexes, daily market fluctuations will cause the funds' net asset levels to rise or fall. These daily market fluctuations result in portfolio adjustments by the funds' investment adviser (ETFMG) to help achieve exposure levels for each leveraged and inverse leveraged fund at the correct multiple (i.e., 2x daily exposure).

Understanding the Impact of Seeking Daily Leverage on Long-Term Performance

A daily leveraged ETF's exposure is a product of its target magnification and its net assets. Favorable moves in the benchmark index push net assets higher, which translates into an increase in exposure by a multiple of the gain in its net assets. As such, unfavorable moves in the benchmark index lead to a decline in net assets, which results in a decrease of exposure in an amount which is a multiple of the decline in the net assets.

We recommend that prospective investors seek the advice of an investment professional before making an investment in ETFMG 2x Daily Leveraged ETFs.

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