

Levered Exchange Traded Funds (ETF) Lesson

Levered products are susceptible to something known as decay/beta slippage.

Let me explain:

Let's say you have a 2x levered ETF on an security (silver, gold, S&P500, whatever). If it rises 3%, this product will rise 6%. In the opposite case, if it falls 3% this falls 6%.

Let's say it rises 25% one day and down 20% the day after. A perfect double leveraged ETF goes up 50% the first day and down 40% the second day. On the close of the second day, the underlying asset is back to its initial price:

$$(1 + 0.25) \times (1 - 0.2) = 1$$

But the 2x levered ETF is:

$$(1 + 0.5) \times (1 - 0.4) = 0.9$$

You're actually down money. In an up-trending market with little volatility this can be of huge benefit because there will be a case in which the 2x levered ETF will actually give you more than 2x the returns but how often do we see something naturally continue to tick up without some bumps along the way?

Here's a good real-life example of where it works to your benefit:

UPRO is a 3x levered ETF on the S&P500... notice that in the last 5 years it has outperformed the market by more than 3x... its actually outperformed by 3.8x.

See image below:



Let's look at the opposite case. Here we have GLL (2x bear "inverse" levered ETF on Silver which means when Silver falls 1% this gains 2% and when Silver rises 1% this falls 2%)





See GLL should be down 8% or so, not roughly 25% which is a HUGE difference

We want to make a note on the above... PLEASE don't mess with these unless you know what the heck you're doing. We highly advise against new investors getting involved with these products. For example, let me just bring up the fine print the companies provide on these products:

"As a leveraged product, UPRO is not a buy-and-hold ETF; it's a short-term tactical instrument. Like many leveraged funds, it delivers its 3x exposure only over a one-day holding period. Over longer periods, returns can vary significantly from its headline 3x exposure to the S&P 500"