STRATEGIES FOR LEVERAGED ETF TRADING

WHAT WALL STREET DOES NOT WANT YOU TO KNOW

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Strategies for Leveraged ETF Trading

What Wall Street Does Not Want You to Know

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Integrative Research Study Goal

Very early right after the introduction of Leveraged ETFs in 2007/08 I started to invest in these double short and long ETFs. My investments in UYG and SKF never did as well as I expected, caused me to start thinking an old maxim of mine. Do the math.

Today, few years later I identified several opportunities to use these products correctly by timing and allocating my investments in LETFS properly.

Based on the general idea of “what these products are and what they are designed for” first I will give an overview about the Leveraged ETFs. Then, I will evaluate on double and triple leveraged ETFs on the principle how these products are structured which factors influence their movements and how they behave short and long term. Finally, based on these findings, actual “trends” and market volatility influencing “events”, I will try to construct arbitrage trading strategies using the “strength and weaknesses” of these products.

Introduction and Overview

Suppose you believe the market is going to go “crash”, what would you do?

The normal answer is: sell what you have and get out.

However, what if you have nothing to sell?

Until a couple of years ago, the answer would have been “Stay on the sidelines” for simple investors.

The sophisticated and the professionals always had plenty of avenues:

- Shorting the stock
- Buying put options
- Selling naked calls, etc.

The gap was narrowed with the arrival of leveraged and inverse ETFs[1] that allow even novice investors to short the market in a less risky way.

What are Inverse and Leveraged ETFs

Traditional ETFs track an index or basket in a one-for-one approach, they are basically passively managed. In contrast, leveraged and inverse ETFs are intraday traded, "exchange-traded derivative funds"[2] and shouldn't be confused with more-vanilla ETFs[3]. Leveraged ETFs require active management: this involves borrowing funds to purchase additional shares (bullish LETFs), or short-selling (bearish LETFs) and rebalancing the position on a daily basis.

At present, most levered ETFs are either 2X, 3X, -2X, or -3X, and therefore offer investors the chance to earn 2 or 3 times (and lose 2 or 3 times) the daily return of a simple long or short position in the index. These levered ETFs have leverage (borrowing) built into their structure, thus eliminating the need for investors to do their own borrowing

(margin, futures, swaps, etc.) or short-selling, but the leveraging process is built to achieve an objective quite different from that of the simple, classical ETF[4].

The Main Structure of a Leveraged/Inverse ETF

The structure of a traditional ETF and LETF are based on holdings transparency. One of the keys to being transparent is publishing all of the numbers required to calculate the fair value of a LETF every day. Six basics involved in the valuation LETF are published every day:

ETF Ticker Conventions	**Bloomberg**	**Google, Yahoo Finance**
1. Net Asset Value – NAV	ETFNV	ETF.NV
2 .Intraday Indicative Value – IV	ETFIV	ETF.IV
3. Total Cash - TC	ETFTC	ETF.TC
4. Estimated Cash - EU	ETFEU	ETF.EU
5. Shares outstanding - SO	ETFSO	ETF.SO
6. Accrued Dividends - DV	ETFDV	ETF.DV