



Understanding Leveraged and Inverse ETFs, Investment Options that Need Comprehensive Knowledge Before Making Investment Decisions

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The Securities and Exchange Commission, Thailand (SEC)

Over the years, investment products have been continuously developed to meet investors' needs with diverse objectives, strategies and risk appetites. Investors may already be familiar with stocks, mutual funds, and exchange-traded funds or "ETFs." At present, specialized ETFs, namely **leveraged and inverse ETFs (L&I ETFs)**, which are designed to provide either a multiple or the opposite of the investment return of a given index or benchmark on a daily basis are also available for investing.

Although L&I ETFs have already been offered for sale and traded in many countries, providing investors with additional tools for investment portfolio management, the products are considered more complex with higher risks involved, compared to traditional ETFs. Investors should, therefore, understand the products' features, return-generation mechanism as well as key risks involved before making investment decisions. In Thailand, the L&I ETF trading was introduced into the market in September 2025.

How do leveraged and inverse ETFs differ from traditional ETFs?

An ETF or exchange traded fund is a mutual fund whose units are listed and traded on the stock exchanges. Investors can buy and sell these units during the trading day, the same way individual stocks are traded. ETFs may adopt actively or passively managed investment policies.

While both leveraged and inverse ETFs fall under the category of ETFs, their objectives for return-generation are different from traditional ETFs, i.e. they aim to achieve target returns on a daily basis.

Leveraged ETFs seek to deliver "multiples" of the daily performance of the index or benchmark they track. For example, a 2x (two times) leveraged ETF seeks to double the daily performance of an index or a benchmark. If the underlying index rises by one percent on a particular trading day, the 2x leveraged ETF will deliver approximately two percent return, or if the index falls by one percent, the 2x leveraged ETF will generate around a minus two percent return before fees and expenses.

Inverse ETFs, on the other hand, aim to provide the opposite of the daily performance of a target index or benchmark. For instance, if the underlying index declines by one percent on a particular trading day, a minus one (-1x) inverse ETF is designed to deliver approximately one percent return before fees and expenses. Certain types of inverse ETFs may adopt leveraged inverse investment

strategy to multiply the opposite of a benchmark's or an index's daily performance, e.g., minus two times (-2x), depending on the funds' policies.

As shown in the examples above, some may understand that if one buys and holds a 2x leveraged ETF for several weeks, the return should double the underlying index's performance. However, that may not be the case. The L&I ETFs are designed to achieve their stated performance objectives on a daily basis (**daily return**), not the multiple of the index's total return over the longer holding period. The L&I ETFs rebalance their portfolios at the end of each trading day (**daily reset**). So, if an L/I ETF is held beyond a day, the fund's return, compounded from the daily new settlement price, will be a cumulative of daily leveraged returns of the fund, depending also upon the sequence of the up and down movements of its underlying index. The fund's performance over a longer holding period, therefore, can deviate significantly from having cumulative returns of the fund over the holding period multiplied by 2x, -1x, or -2x leverage factors. The deviation can be further magnified during volatile market conditions.

Why are L&I ETFs riskier than traditional ETFs?

In addition to the risks from market fluctuations, L&I ETFs utilize complex investment mechanisms and instruments more than traditional ETFs. Most funds employ derivatives such as futures contracts or swaps to deliver amplified or inverse returns relative to the underlying indices to achieve their target objectives.

Leverage factors can magnify both potential gains and losses of the funds. Furthermore, if the fund's investment units are held more than one day, its compounded return based on daily portfolio rebalances (daily reset) and sequence of up and down movements of the underlying index can cause the fund's longer-term performance to diverge significantly from the multiple (whether it be 2x, -1x, or -2x) of the underlying index's total return over that same period. The discrepancy becomes more apparent during volatile market conditions. Other factors include the fund's fees and expenses, management efficiency as well as risks associated with derivative instruments employed.

It should also be noted that the fund's market price may differ from its net asset value (NAV) and the bid-ask spreads of intraday trading of the fund should be taken into consideration as well.

As illustrated above, L&I ETFs are high-risk products generally designed for short-term investment or risk management. They are, therefore, not suitable for long-term buy-and-hold investment strategy without close monitoring of their performance. Investors in these funds should be ready to accept higher risks than investing in traditional ETFs.

Rules and regulations vary from country to country.

Investments in L&I ETFs are allowed in many jurisdictions. Nevertheless, the governing rules and regulations vary across jurisdictions, depending on the context of each market. In some jurisdictions, both indices and single stocks are allowed to be used as benchmarks or the funds with multiple levels of leverage are permitted to be offered. In others, certain restrictions are imposed to help mitigate potential risks to investors.

An appropriate regulatory framework is, therefore, an important factor contributing to a more balanced approach to making additional investment options available and protecting investors.

How does the SEC regulate L&I ETFs?

In Thailand, the Securities and Exchange Commission (SEC) has nurtured development of a wide range of investment products to provide more options for investors and strengthen the competitiveness of the Thai capital market. Along with such endeavors, investor protection measures proportionate to the product's risk levels have also been taken.

Key regulatory provisions are as follows:

- The **underlying benchmarks allowed for the L&I ETFs are indices only**. Those funds that track single stocks have not yet been permitted, to prevent investment concentration risk.
- The multiple **is limited to a maximum of two times** (e.g., 2x, -1x, -2x).
- **Asset management companies (AMCs) are required** to disclose information on the product's characteristics, investment strategies, instruments employed, related fees, risks, warnings and to provide a **performance simulator** that will help investors understand the impacts of the underlying index/benchmark movements on the performance of the fund.
- **Securities companies providing trading services are required** to have in place appropriate procedures to ensure that investors have sufficient knowledge and awareness of risks associated with investments in the funds and that salespeople have proper knowledge and understanding for the provision of related services.

Before investing in L&I ETFs, a comprehensive understanding of the product is required.

The L&I ETFs have become an additional tool that enables investors to adopt a more diversified investment strategy. However, due to the instrument's greater complexity and higher risk, compared to traditional ETFs, the consideration for making investment decisions should not be confined only to an opportunity for higher investment gains, but comprehensively to the fund's return-generation mechanism, consequences of daily portfolio rebalances, as well as market volatility risks.

Before making investment decisions, investors should thoroughly study the fund's prospectus and fund factsheets to understand its investment policy and associated risks and assess whether the

product is suitable for their investment objectives, holding period, and risk tolerance. “Smart investing starts with a thorough understanding of the product you choose to invest in.”
