Leveraged ETFs Explained: How They Work, Risks, and Benefits

EDUCATION | DATE: OCTOBER 3, 2025

Read Online

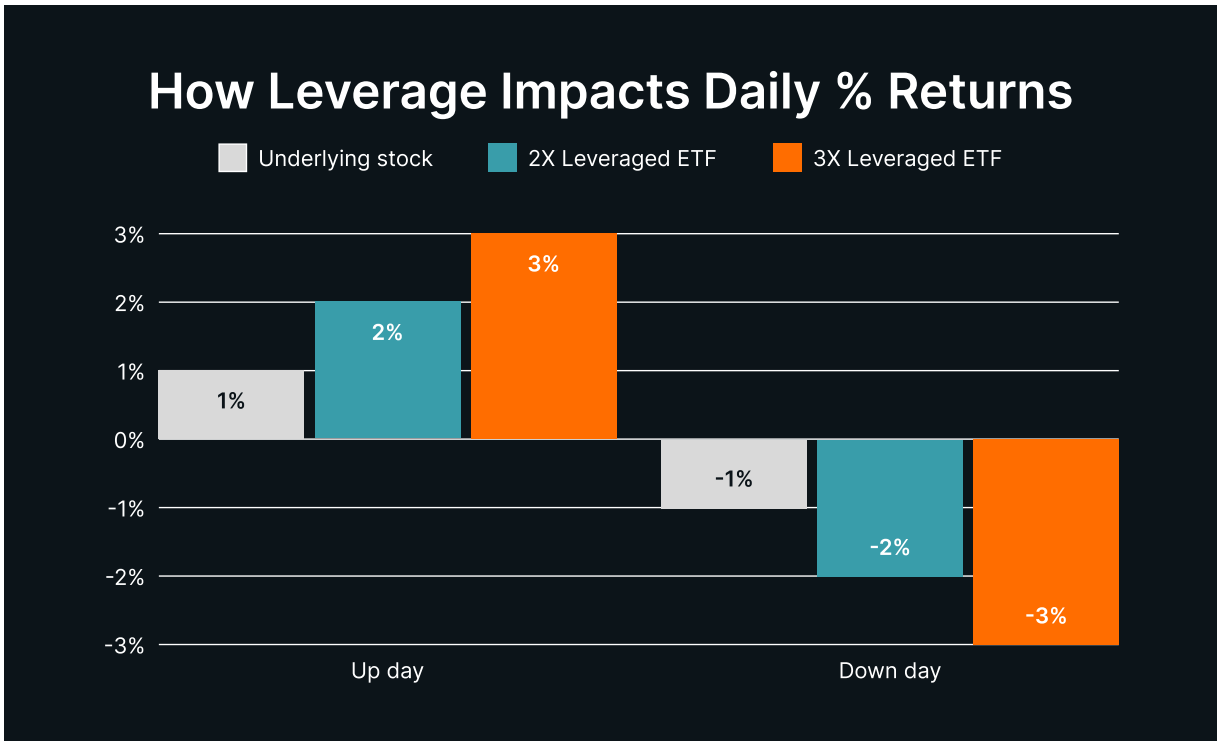
Leveraged ETFs aim to give investors amplified exposure to daily market moves – without needing margin accounts. They may suit experienced traders who want short-term, tactical exposure to an index, stock, or other asset. This guide explains what leveraged ETFs are, how they work, and their potential risks and benefits. It also covers fees, daily rebalancing, and compounding, and how these funds compare with traditional exchange-traded funds.

What are leveraged ETFs?

A leveraged ETF is an exchange-traded fund that aims to multiply the daily return of an underlying index or asset. Common targets are 2x or 3x the day's price move. Unlike traditional ETFs, leveraged ETFs don't usually hold the securities directly. Instead, they typically use derivatives like total return swaps with counterparties to reach the stated leverage.

A swap lets the fund exchange cash flows based on the underlying asset's daily return. That creates leveraged exposure without owning the asset. It also makes it easier for the fund to reset exposure back to the target leverage multiple each day.

Magnified returns may raise the reward potential – but also the risk. Small moves could produce large gains or losses when leverage is involved.



Graphics are illustrative, shown before fees and expenses.

How do leveraged ETFs work?

The goal is to deliver the daily target multiple return before fees and costs. For example, if the index rises 1% today, a 2x fund aims to rise about 2% today. If the index falls 1% today, a 2x fund aims to fall about 2% today.

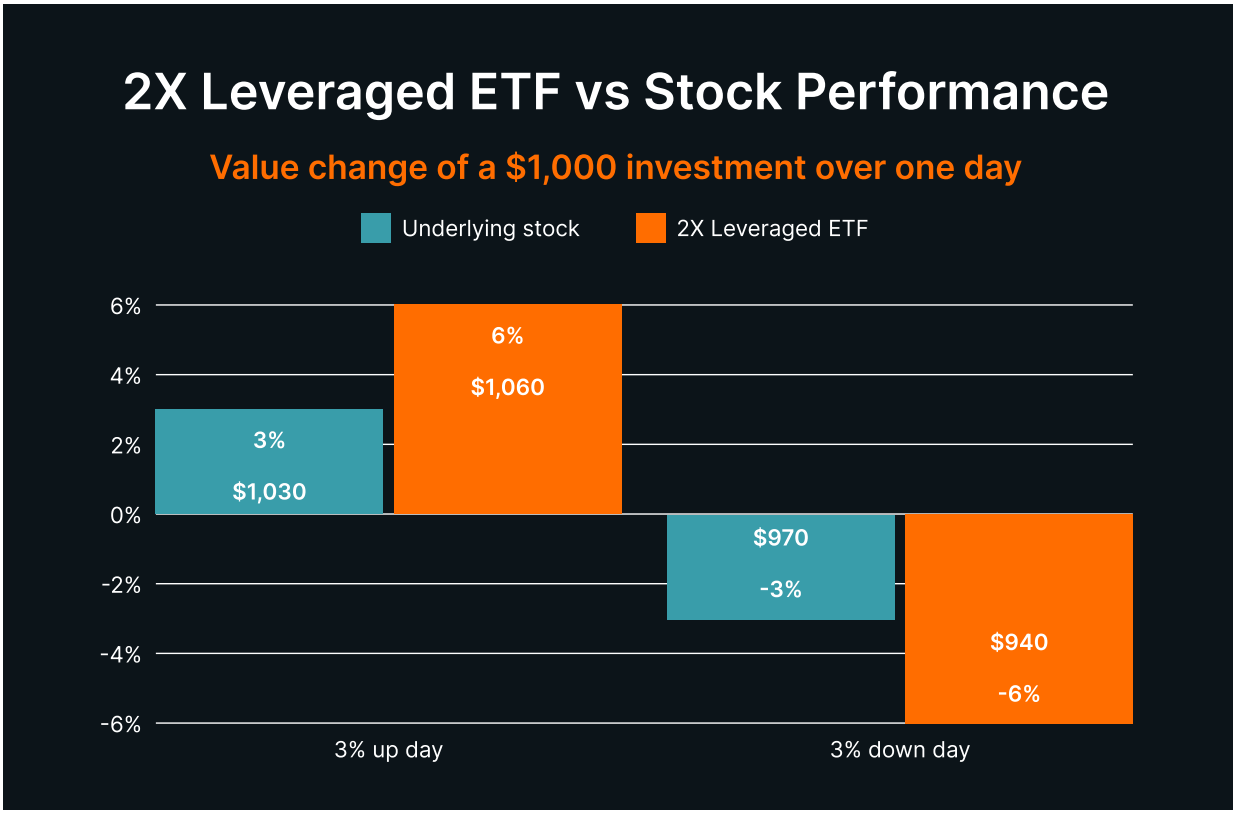
To do that, the fund holds cash or collateral and uses swaps to scale exposure up to the desired multiple. At the end of each trading day, it rebalances back to the target leverage. That daily reset keeps tomorrow's leverage on target – and it introduces "compounding effects" if you hold longer than a day. More on compounding later.

Because exposure is reset daily, a leveraged ETF won't simply deliver "2x or 3x" over weeks or months. The path of returns also matters. Trends and volatility change the outcome.

2x Leveraged ETF: a worked example

A 2x leveraged ETF tracks a stock. If the stock rises 3% in a day, the ETF aims for about +6% that day. If the stock falls 3%, the ETF aims for about –6%. Leverage works both ways: daily gains may double, but so could daily losses.

Now, assume you invest $1,000 in the ETF. A 3% move higher for the stock might take your position to about $1,060 (6%). On the other hand, a 3% move down might take it to about $940 (-6%). That is the appeal and the trade-off. You get magnified exposure to today's move.



Graphics are illustrative, shown before fees and expenses.

Leveraged ETFs vs traditional ETFs

Traditional ETFs track an index or asset by directly holding the underlying securities. They're usually designed for long-term investors who want low-cost, diversified exposure to a particular investment or sector. Their prices generally stay close to the fund's NAV because of a process called **creation and redemption.**

Here's how that works. Large market firms called authorised participants (APs) can deliver a set of the underlying securities to the ETF in exchange for new shares. That's called **creation**. They can also return ETF shares to the issuer and take back the underlying securities. That's called **redemption**. If the ETF's market price drifts away from its NAV (net asset value), APs step in to create or redeem shares. This process helps keep the ETF's price close to its NAV.

Leveraged ETFs follow the same creation and redemption process, but the assets inside the fund are different. Instead of holding the securities directly, leveraged ETFs use swaps with counterparties (and cash collateral) to amplify daily returns. They are generally designed for short-term, tactical use. The daily reset, higher fees, and path dependency change how returns behave over time.

The table below lists the key differences between traditional and leveraged ETFs:

Feature	Traditional ETFs	Leveraged ETFs
Aim	Track and match the performance of a stock, index, or asset.	Amplify daily returns of a stock, index, or asset.
Holding period	Typically more suitable for long-term investing.	Designed for short-term trading (often a day or less).
Fund manager strategy	Directly holds securities in the fund.	Uses derivatives like swaps to create leverage.
Risk level	Typically lower risk because there's no leverage involved.	Typically higher risk due to leverage.
Fees	Typically lower.	Can be higher because of derivative and may leverage costs.

Daily rebalancing and compounding

Leveraged ETFs aim to reset exposure at the end of each day to maintain their stated leverage (e.g., 2x). This daily reset introduces something called **compounding** – and its effect depends on the **path** of returns.

- **Steady uptrend:** compounding may **boost** returns beyond a simple multiple.
- **Steady downtrend:** compounding may **reduce** losses versus a simple multiple (because losses apply to a shrinking base).
- **Choppy or sideways market:** compounding may erode returns. Traders often call this "volatility drag".

Compounding example 1: Steady uptrend

Assume a stock gains 1% each day for ten straight days. A 2x leveraged ETF rebalances daily to keep exposure on target. Each day's 1% gain applies to a larger base, so the compounded return may exceed a simple "1% × 10" add-up. The 2x ETF compounds on that growing base at roughly twice the daily rate. That means its 10-day result may end up above twice the stock's 10-day return.

Compounding example 2: Steady downtrend

Now assume a stock loses 1% each day for ten straight days. A 2x leveraged ETF again resets daily. Each day's 1% loss applies to a shrinking base, so the 10-day result ends up slightly better than a simple "1% × 10 × 2" calculation. Compounding on a smaller base cushions the losses compared with a straight double of the stock's decline.

Compounding example 3: Alternating days (volatility drag)

Now assume the stock alternates between +1% and –1% each day for ten days. The stock ends nearly flat, because each gain is offset by the next loss. The 2x ETF still resets daily. But in this path, compounding works against it. The fund takes larger percentage moves on a changing base, and the alternating swings chew into the value. That's volatility drag.

Key point: The daily reset is the feature that makes leveraged ETFs track today's move. It's also why multi-day outcomes can differ from a simple "2x over time".

When might investors use leveraged ETFs?

Leveraged ETFs may suit the below uses:

- **Tactical trading:** Express a short-term view on a stock or index.
- **Hedging:** Use inverse or short leveraged products to hedge near-term risk (where available and appropriate).
- **Event-driven exposure:** Earnings weeks, macro data releases, or set windows where you may want amplified daily exposure.

They're less suitable for buy-and-hold investors. The daily reset, higher fees, and path dependency may make long holding periods harder to manage. If you plan to hold Leveraged ETFs for longer, you must understand compounding risk and total costs.

Risks and benefits of leveraged ETFs

Potential benefits

- **Magnified daily returns:** They may double or triple gains from short-term moves.
- **No margin account needed:** You can buy and sell on an exchange like a regular ETF.
- **Tactical flexibility:** They may help with quick trades, hedging, or speculation

Possible risks

- **Magnified losses:** Even small market drops may lead to large losses.
- **Path risk:** Choppy markets can erode value through volatility drag.
- **Counterparty exposure:** Swap-based structures involve counterparties; funds mitigate this with collateral and limits, but the risk exists.

Sizing and discipline matter. Set exits, and treat leverage with respect.

FAQs

Do leveraged ETFs always hit the exact multiple each day?

They aim to, but actual results can differ due to fees, costs, and market factors. Under normal conditions, short-term tracking is usually close.

Can a leveraged ETF go to zero?

In extreme scenarios, severe adverse moves could result in very large losses. While trading halts and rebalancing aim to manage risk, your capital is at risk.

Are leveraged ETFs only for day trading?

They are generally designed for short-term use. Some investors may hold them for longer with strict risk controls, but compounding and costs can make that challenging.

Do all providers use the same derivatives?

No. Many rely on total return swaps. Some may use other derivatives in limited roles. The core objective is the same: target a daily multiple.

What fees do leveraged ETFs charge?

Leveraged ETFs charge an annual management fee, called the expense ratio. This fee may be higher than for traditional ETFs because of derivative, leverage, and rebalancing costs. The fee is taken from the fund's net asset value (NAV) each day, which is designed to reduce returns over time.

Leverage Shares offers a range of 2x daily leveraged single-stock ETFs covering popular US names like Nvidia, Tesla, Palantir, Coinbase, and more. These trade on US exchanges like stocks, offering easy access to short-term tactical exposure.

Key takeaways

- Leveraged ETFs aim to amplify daily returns using derivatives such as swaps.
- Daily rebalancing helps keep leverage on target and introduces compounding effects.
- Trends can help. Chop can hurt. The return path matters with leveraged ETFs.
- Leveraged ETs may suit short-term, tactical traders. They're typically less suitable for buy-and-hold investors.

Disclosure

INVESTMENT INVOLVES SIGNIFICANT RISK. The Fund does not invest directly in the underlying stock. Investing in the Fund involves a high degree of risk. As with any investment, there is a risk that you could lose all or a portion of your investment in the Fund.

An investor should carefully consider a Fund's investment objective, risks, charges, and expenses before investing. A Fund's prospectus and summary prospectus contain this and other information about Themes ETFs. To obtain a Fund's prospectus and summary prospectus call 886-584-3637 or visit leverageshares.com/us/. A Fund's prospectus and summary prospectus should be read carefully before investing.

Because of daily rebalancing and the compounding of each day's return over time, the return of the Fund for periods longer than a single day will be the result of each day's returns compounded over the period, which will very likely differ from 200% of the return of the underlying stock over the same period. The Fund will lose money if the underlying stock performance is flat over time, and as a result of daily rebalancing, the underlying stock's volatility and the effects of compounding, it is even possible that the Fund will lose money over time while the underlying stock's performance increases over a period longer than a single day.

The Fund is not suitable for all investors. The Fund is designed to be utilized only by knowledgeable investors who understand the potential consequences of seeking daily leveraged (2X) investment results, understand the risks associated with the use of leverage and are willing to monitor their portfolios frequently. The Fund is not intended to be used by, and is not appropriate for, investors who do not intend to actively monitor and manage their portfolios. For periods longer than a single day, the Fund will lose money if the underlying stock's performance is flat, and it is possible that the Fund will lose money even if the underlying stock's performance increases over a period longer than a single day. An investor could lose the full principal value of his/her investment within a single day if the price of the underlying stock falls by more than 50% in one trading day.

Some funds have risks associated with a limited operating risk of less than 1 year.

Investment in leveraged products may be subject to higher volatility. Fund does not directly invest in the underlying stock. An investment in the Fund involves risk, including the possible loss of principal. The Fund is non-diversified and includes risks associated with the Fund concentrating its investments in a particular industry, sector, or geographic region which can result in increased volatility. The use of derivatives such as futures contracts and swaps are subject to market risks that may cause their price to fluctuate over time. Risks of the Fund include effects of Compounding and Market Volatility Risk, Inverse Risk, Market Risk, Counterparty Risk, Rebalancing Risk, Intra-Day Investment Risk, Daily Index Correlation Risk, Other Investment Companies (including ETFs) Risk, and risks specific to the securities of the Underlying Stock and the sector in which it operates. These and other risks can be found in the prospectus.

Shares of ETFs are bought and sold at market price (not NAV) and are not individually redeemed from

the Fund. Brokerage commissions will reduce returns. The market price returns are based on the official closing price of an ETF share or, if the official closing price isn't available, the midpoint between the national best bid and national best offer ("NBBO") as of the time the ETF calculates current NAV per share, and do not represent the returns you would receive if you traded shares at other times. NAVs are calculated using prices as of 4:00 PM Eastern Time. Indices are unmanaged and do not include the effect of fees, expenses, or sales charges. One cannot invest directly in an index.

This information is not an offer to sell or a solicitation of an offer to buy shares of any Funds to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction.

Themes Management Company LLC serves as an adviser to the Themes ETFs Trust. The funds are distributed by ALPS Distributors, Inc (1290 Broadway, Suite 1000, Denver, Colorado 80203). ALPS is not affiliated with any mentioned entity. Client brokerage services not offered by ALPS. Please see third part site for more information about any mentioned services. Themes ETFs are not sponsored, endorsed, issued, sold, or promoted by these entities, nor do these entities make any representations regarding the advisability of investing in the Themes ETFs. Neither ALPS Distributors, Inc, Themes Management Company LLC nor Themes ETFs are affiliated with these entities. Themes Management Company LLC and Leverage Shares are affiliates that are under common control. Themes Management Company and Leverage Shares have entered into a licensing agreement in which Leverage Shares licenses the trademark LEVERAGE SHARES ™ to Themes Management Company LLC for use in financial services in the United States.