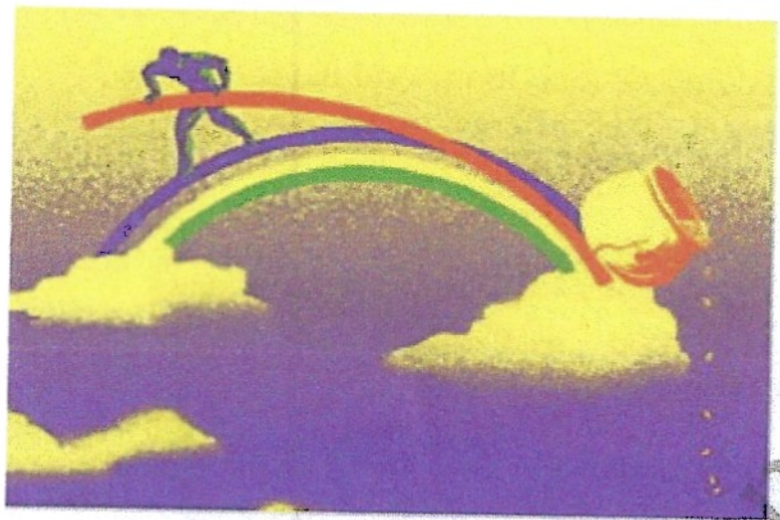
3-29-25

WSJ Print Edition

image



ALEX NABAUM

How to Make 267%, Or Lose 90%, on Treasurys

THE INTELLIGENT INVESTOR |

JASON ZWEIG

Be careful with funds that magnify market swings

If you'd bought the leading exchangetraded fund investing in long-term U.S. Treasury bonds at its peak in August 2020, you'd have lost 41.3% by now—even after reinvesting your interest income.

Two ETFs that amplify the daily returns on long-term Treasurys make that wild performance look tame.

Over the same period, the Direxion Daily 20+ Year Treasury Bull 3X Shares ETF, which seeks to triple the daily return of a long-term Treasury bond index, lost 90.2%, according to FactSet. Its mirror-image fund, Direxion Daily 20+ Year Treasury Bear 3X Shares, which aims to deliver three times the *opposite* of the long-term bond's daily return, gained 266.6%. +

Even if you are an adrenaline addict, you'd better understand what you're in for before you try funds like these.

Officially, "ETF" stands for exchange- traded fund—a tool that makes investing simple. This subset of ETFs, though, is so sensitive to market moves that the acronym should stand for "extra-touchy funds." They are anything but simple.

Extra-touchy funds come in two basic forms: leveraged and inverse.

As of the end of February, according to Morningstar, 316 leveraged or inverse ETFs held a total of $115.6 billion in assets, up from 183 such funds with $54.4 billion at the end of 2020.

Leveraged funds use total-return swaps or other derivatives to amplify the daily returns of an index, a basket of securities or even a single stock. Leveraged ETFs can aim to deliver twice or even triple the daily return of the underlying asset, turning a 1% market rise into a 2% or 3% gain; they also magnify losses the same way.

Inverse funds seek the opposite of an asset's daily return. Depending on how they're structured, they can turn a 1% daily loss into a 1%, 2% or 3% gain; conversely, they can turn a 1% market gain into a loss of 1% or more.

How touchy are leveraged and inverse funds? As of the end of February, according to data from LSEG Lipper, the bullish Direxion longterm Treasury ETF finished dead last among all domestic long-term fixed-income funds for the trailing three months and the past one, two, three, five and 10 years. But it also topped the charts for the prior month and the year to date.

For the prior month and the year to date, its bearish sibling finished last among all domestic long-term bond funds. But the bearish Treasury fund beat every other competitor over the trailing three and five years. Over different measurement periods, funds like these can generate explosively different results.

What drives this wild volatility? Imagine two ETFs. One tracks an index directly, without leverage. The other, which is leveraged, seeks to triple the daily return of the index.

You've invested $100 in each fund, although the leveraged fund gives you $300 in exposure.

Now, to use an extreme example, let's say the index gained 5% yesterday and loses 5% today.

Your stake in the first fund would have been worth $105 at yesterday's close. After today's 5% loss, you'll have 95% of $105, or $99.75.

The leveraged fund tripled yesterday's 5% gain, pushing the value of your position up to $115 and your exposure to the index up to $345. That means today's 5% drop in the index takes $17.25, or 5% of $345, off yesterday's closing value of $115. That leaves you with $97.75.

To get back to your $100 starting point, you need a 0.25% gain in the unleveraged fund but a 2.3% gain in the leveraged fund. Of course, if the market went up 5% two days in a row, you'd be far ahead in the leveraged fund. Depending on the path of the market's changes from day to day, the leverage can enrich you or leave you surprisingly deep in the hole.

That example ignores expenses, which are much higher on leveraged funds. Also, the more volatile the underlying index is and the longer the volatility lasts, the wider the gap is likely to grow between the index's returns and the performance of the leveraged fund.

In a "trending" or repeatedly rising (or falling) market, you can make a ton of money on such funds. In a jagged market with uneven ups and downs, anything can happen.

Here's why all that math matters: Getting double or triple the *daily* return of an index doesn't mean you will outperform the index twofold or threefold in the long run.

"If somebody doesn't understand that longer holding periods are unpredictable, they shouldn't be trading these funds," says Douglas Yones, chief executive of Direxion.

"The volatility of holding longer term is extremely amplified, both up and down," he adds. To manage that risk, "you need to look at it every single day."

No one really knows whether individual investors are significant buyers of extra-touchy funds, or whether all the financial advisers using them in so-called tactical portfolios fully understand how they work.

"If you get a whipsaw market, you could find a lot of your profits eaten away or your losses amplified because of the pattern of returns," says Elisabeth Kashner, director of ETF research and analytics at Fact-Set. "You have to get the overall direction right, and you have to get the path of travel right."

Good luck with getting both those things right. And, if you turn out to be wrong, leveraged funds will magnify your mistake.

one page only