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Heads You Lose, Tails You Lose: The Strange Case of Leveraged ETFs

INVESTOR ALERT

FAIR Canada Calls Upon Regulators to Take Action to Protect Investors

FAIR Canada issued a report today describing the hazards of investing in leveraged and inverse ETFs for periods longer than the daily performance that these funds promise. The 9 page report describes the growth of these very popular products in both the U.S. and Canada and how they pose threats to the health of investor portfolios.

LEVERAGED AND INVERSE ETFS ENDANGER INVESTOR HEALTH
The longer you hold a leveraged or inverse Exchange Traded Fund (ETF), the greater the likelihood that you will lose money, regardless of which direction you bet. For the 12 months ending March 31, 2009, the S&P/TSX index of gold-mining stocks was up 1%. The Horizons BetaPro Bear+ ETF lost 87%. The Bull+ fund lost 46%.

These were not anomalies. Four of the nine pairs of Horizons BetaPro's leveraged ETFs with at least a year-long track record lost money in both their bull and bear versions for the 12 months ended March. At least one member of virtually all of the other pairs suffered from significant tracking errors.

A VERY RAPIDLY GROWING AND POPULAR INVESTMENT PRODUCT
Leveraged and inverse ETFs are the most rapidly growing segment of the market. Thirty-two Canadian funds, offered only by Horizons BetaPro, have pulled in $2.1 billion in investor dollars in the past 26 months and show up daily in the lists of top performing and most actively traded stocks. In addition, Canadian investors are purchasing U.S. leveraged ETF products. Offered by Rydex, ProShares and Direxions, these funds have attracted a total of US $33.2 billion in assets in the past

three years.

ADVERTISING AND PROSPECTUS DO NOT CONVEY THE TRUE RISKS OF LEVERAGED ETFS

"Come on" advertising campaigns on both sides of the border encourage investors to chase that popularity and past performance. Leveraged ETF funds actually deliver their promised daily performance, but their marketing material omits performance data for longer periods. Boilerplate risk disclosure in the prospectus does not come anywhere close to conveying the true risks associated with speculating in these very powerful investment vehicles, and the high probability of losing money if they are held longer term.

FAIR CANADA CALLS UPON REGULATORS TO TAKE ACTION TO PROTECT INVESTORS

1. Immediately require all leveraged and inverse ETF products offered in Canada to file a new prospectus. The prospectus should have **bold front page disclosure**, in plain English, of the risks of holding these products for longer than a few days, particularly in volatile markets

2. Insist on prominent disclaimers on all leveraged/inverse ETF advertising, both print and broadcast, with an explicit warning: This product is not suitable for holding periods longer than a few days, and is not appropriate for virtually all retail portfolios. Disclosure should be provided on the relevant company websites. Marketing materials should include references to the actual performance of the bull and bear versions of the ETFs over a period of one year and since inception. Simplify tables to make tracking error, leverage and volatility risks much more transparent.

3. Warn registrants of the need to consider the suitability of these products for clients and to ensure that clients who trade the products understand the risks. Discount and execution-only brokers should communicate these risks to their clients.

4. Study and publish conclusions on the actual uses of leveraged and inverse ETFs before clearing new offerings for sale to retail investors. With the drumbeat of the new triple-leverage ETFs now heard in the U.S., such a study assumes much greater urgency.

CONCLUSION: NOT ALL PRODUCTS SHOULD BE SOLD TO ALL INVESTORS

Despite recent warnings in the financial press on both sides of the border, many investors are unaware of the perils of holding leveraged or inverse ETFs for periods longer than a few days. The biggest problem of leveraged ETFs is simple: over time, they often don't do what investors expect them to do.

One key lesson of the recent financial collapse is that markets do not self-regulate, and that less sophisticated investors must be protected from financial "innovations" that pose excessive risks to their savings while generating handsome returns for their sponsors. Just because something can be sold doesn't mean that it should be sold - at least not without appropriate safeguards and warnings.

Read full report on our website...

What are Leveraged and Inverse Exchange Traded Funds?

"Plain vanilla" Exchange Traded Funds are similar to index mutual funds in that they passively duplicate an index. Unlike mutual funds that are priced only at the close of market, ETFs trade like stocks. They have low fees and other advantages: diversification, tax efficiency, liquidity, transparency, and constant pricing information.

Leveraged ETFs offer twice (or even three times) the daily return of their underlying index. Inverse ETFs offer the opposite of the daily return.

Advantages of Leveraged ETFs

Easy, risk-limited access to leverage. Exposure to different markets. Useful tools for professional investors, for hedging or gaining quick exposure to markets. Very popular.

Disadvantages of Leveraged ETFs

Huge tracking errors over time. Relatively high fees. No transparency. Hugely influenced by both direction and volatility. Risks of counter-party defaults. Worsens market's end-of-day volatility.

FAIR Canada welcomes Steve Garmaise to the FAIR TEAM!

FAIR Canada is pleased to announce the latest addition to the FAIR Team: Associate Director, Steven Garmaise.

An investor, analyst and senior manager since 1983, Steve Garmaise has seen the best and worst of Bay and Wall Streets.

A director of research for nine years, Steve served as managing director and global head of equity research at RBC Capital Markets before joining Genuity Capital Markets as a founding partner and co-director of research.

Steve began in management at First Marathon Securities and then moved to Merrill Lynch as director of Canadian and deputy director of North American research.

Steve spent 14 years as a top-ranked analyst of the transportation and special situations sectors at Wood Gundy and First Marathon Securities. He has an MBA from the University of Western Ontario and received his Chartered Financial Analyst designation in 1986.

With a long-time interest in regulatory matters, Steve led internal and industry-wide efforts to adapt to the changing environment and adopt new regulations and policies. Steve served on the Board of the Toronto CFA Society in the early 1990s, where he founded and chaired the advocacy committee.

Steve is active in community affairs. He sits on the Board of Directors of the Toronto Public Library Foundation, where he founded and chairs the corporate committee. Steve also serves on the boards of the Tarragon Theatre and Toronto's Jewish Immigrant Aid Services.