Adding Leverage to ETFs

July 15, 2025

Levered ETFs have gained considerable attention in recent years as investors seek ways to boost returns without dramatically altering their core portfolio. While high leverage may evoke concerns about volatility and risk, modest leverage—typically around 25%—presents a more measured approach that can align well with long-term investing goals. This level of leverage can enhance returns in rising markets.

Chart 1: Levered ETF when index rises

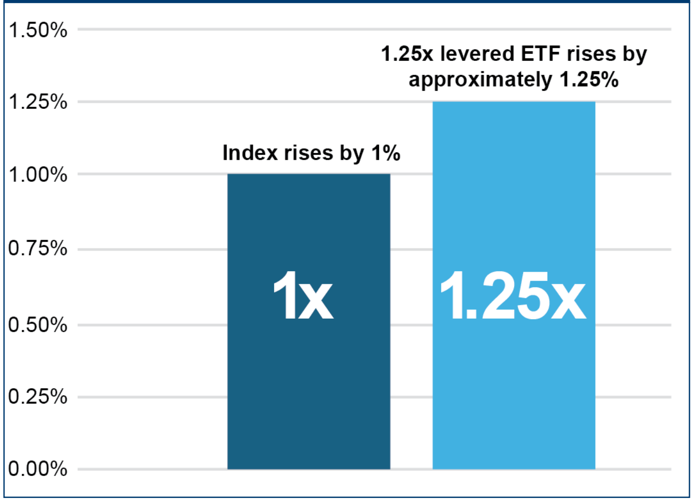
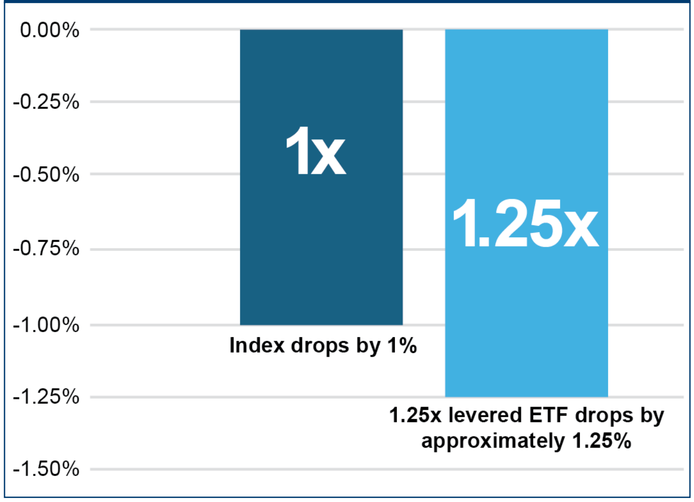


Chart 2: Levered ETF when index drops



The above illustrations are provided for Educational Purposed Only. The examples are provided solely to demonstrate the concept of a 1.25x modest leverage and does not represent actual investment outcomes or fund behaviour of any entity or security discussed.

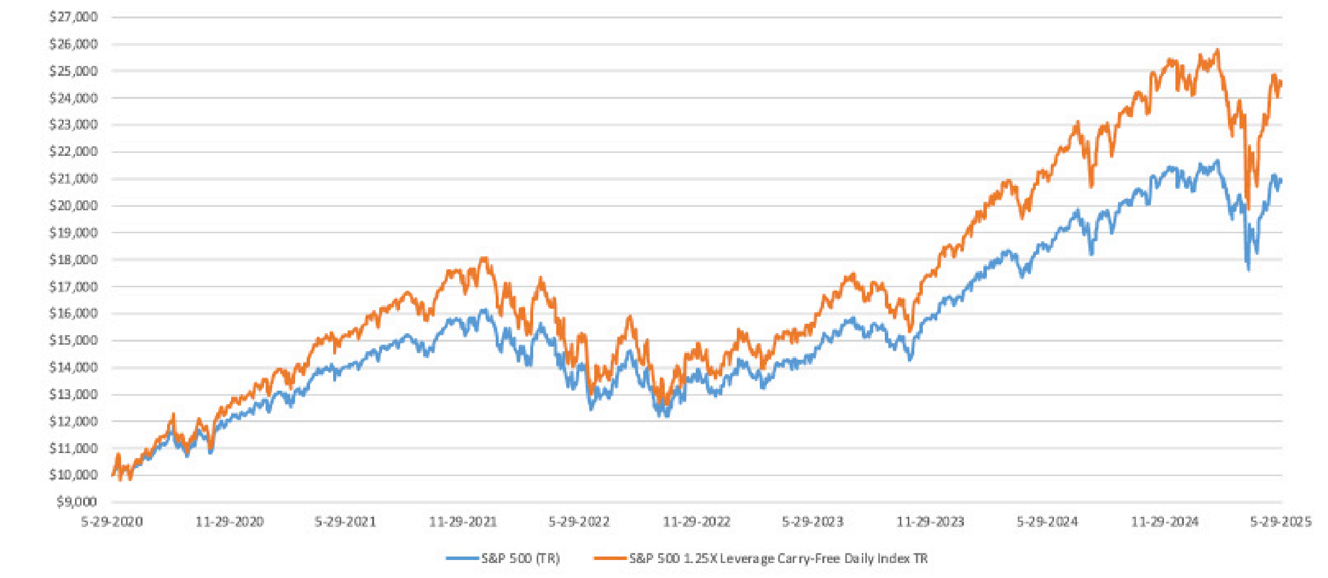
Why Modest Leverage?

Modest leverage involves borrowing a portion of the investment amount—typically 25%—to increase the total capital deployed in a portfolio. This allows investors to amplify their returns by gaining more exposure to market movements than the initial capital would otherwise allow. Unlike higher levels of leverage, which may increase volatility, modest leverage is designed to strike a balance between risk and reward.

In a scenario where interest rates are relatively low or lowering, the cost of borrowing is manageable, making this strategy attractive for risk-conscious investors seeking an edge in their portfolios. In a rising market, the leverage cost can often be offset by enhanced returns; however, it's important to remember that while leverage can amplify gains, it also magnifies losses in downturns.

Below is the 5-year price return of the S&P 500® Index, compared to the S&P 500 1.25x Leverage Carry-Free Daily Index. As highlighted in Chart 3, the levered Index outperforms the S&P500® Index. This illustrates how daily leveraged strategies can potentially amplify index returns in trending markets, though they may also increase risk.

Chart 3: S&P 500 1.25x Leverage Carry-Free Daily



Source: S&P Global as at May 30, 2025,

The S&P 500 1.25x Leverage Carry-Free Daily Index reflects 125% of the return (positive or negative) of the S&P 500 on a daily basis. The S&P Carry-Free Leveraged Indices are designed to generate a multiple of the underlying index return, without taking into account the cost of borrowing capital to generate the excess index exposure.

The S&P 500® Index is a widely followed benchmark of U.S. large-cap equities, representing 500 of the largest publicly traded companies and covering approximately 80% of the available market capitalization.

How do Levered ETFs work?

Levered ETFs use financial leverage to amplify returns by borrowing additional capital to invest in more assets than the original investment amount. Here's a simplified breakdown:

1. Initial Investment: Suppose you invest $100 in a levered ETF.
2. Leverage Application: The ETF uses leverage (in this case, 25%) to borrow an additional $25. This allows the fund to invest a total of $125 in assets, even though you only invested $100. So, $100 buys $125 worth of exposure to the underlying assets.
3. Collateral: The original $100 investment serves as collateral for the $25 borrowed.
4. Cost of leverage: ETFs pay an institutional cost of leverage which is typically the overnight rate plus a spread.
5. Impact on Returns (assuming no leverage cost for simplicity): If the value of the underlying assets increases by 10%, the $125 worth of assets would grow by $12.50 (10% of $125). This means your original $100 investment would now be worth $112.50 (a 12.5% return). However, the same leverage also amplifies losses. If the underlying assets fall by 10%, your $125 worth of assets would lose $12.50, reducing your $100 investment to $87.50 (a 12.5% loss).

Leverage magnifies both gains and losses, which is why it's often seen as a more aggressive, higher-risk strategy. However, in more stable industries that tend to have less aggressive drawdowns leverage can be particularly effective.

How the Cost of Leverage Affects ETF Returns

Levered ETFs must pay a borrowing rate on the levered portion of the portfolio. The cost of leverage is paid directly out of the Net Asset Value (NAV). This means that the impact of leverage expenses is embedded in the fund's returns.

Let's assume the cost of this leverage is the Bank of Canada overnight rate + 0.55%. As the Bank of Canada increases rates, the cost of this leverage (and the drag on returns) increases. In contrast, as rates come down, the cost decreases. Given the current path of interest rates in Canada, levered ETFs should become cheaper for investors.

Does the Benefit of Leverage Outweigh the Cost?

The answer to this question will ultimately depend on the return profile of the underlying holdings. In positive markets, the enhanced return typically more than covers the additional cost of leverage. Having said that, in declining markets the cost of leverage works against investors.

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Leverage increases risk.

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