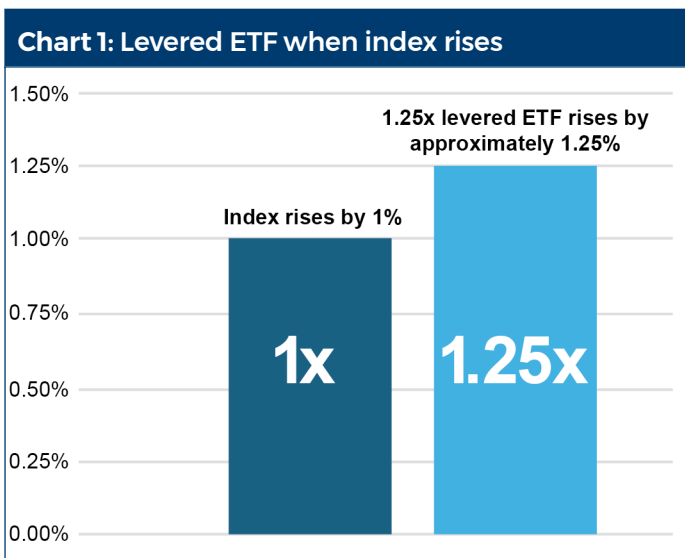
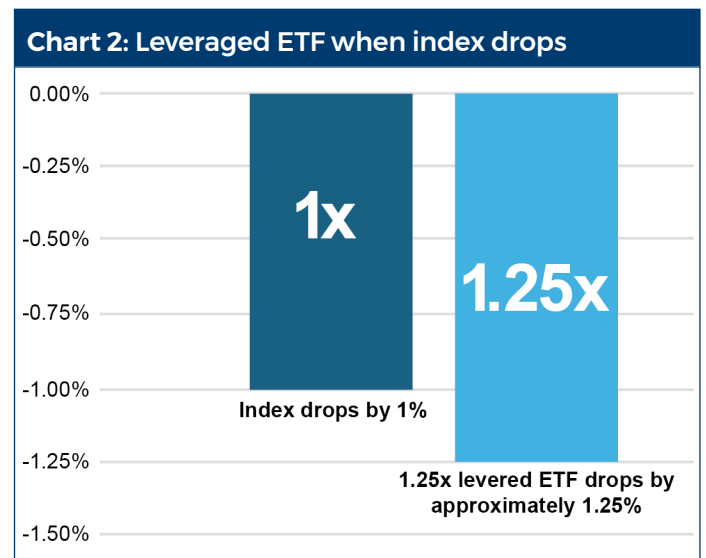


Adding Leverage to ETFs

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 while providing a cushion for risk when combined with complementary strategies.



For illustrative purposes only



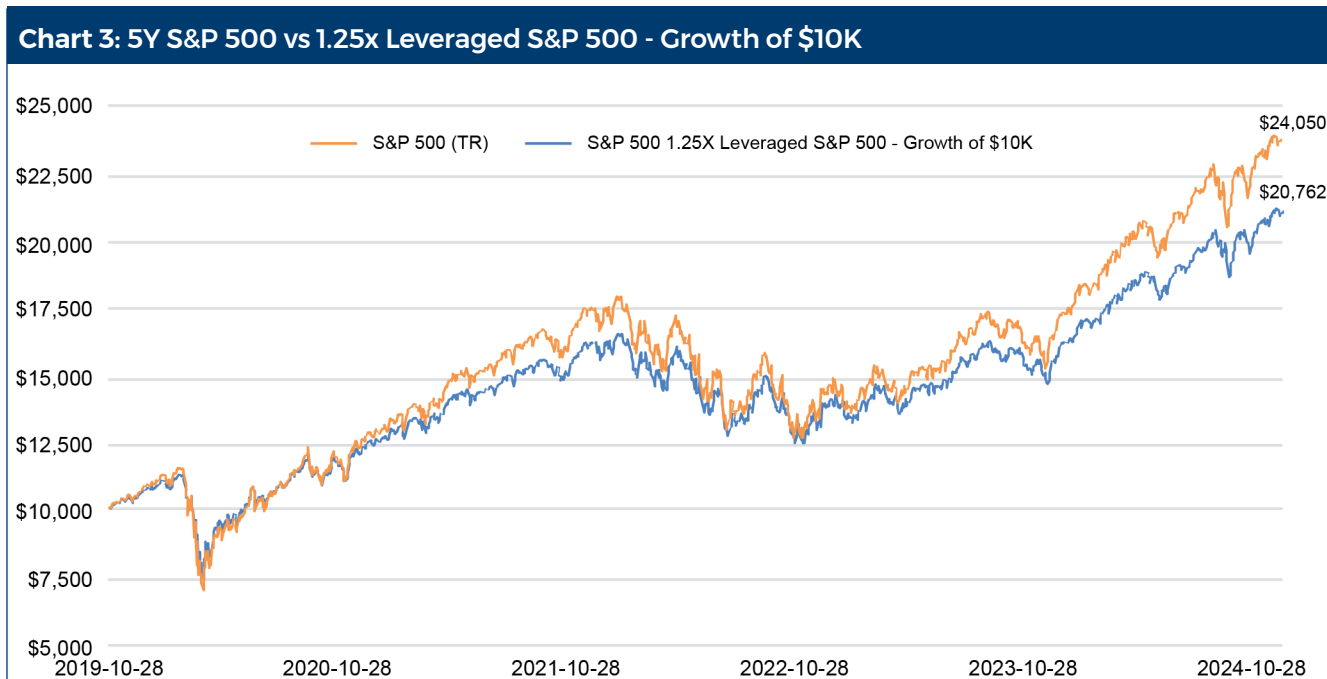
For illustrative purposes only

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®, compared to a hypothetical 1.25x daily levered S&P 500® ETF. As highlighted in Chart 3, the levered ETF outperforms the index.



Source: S&P Global, Evolve ETFs as at October 31, 2024

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).

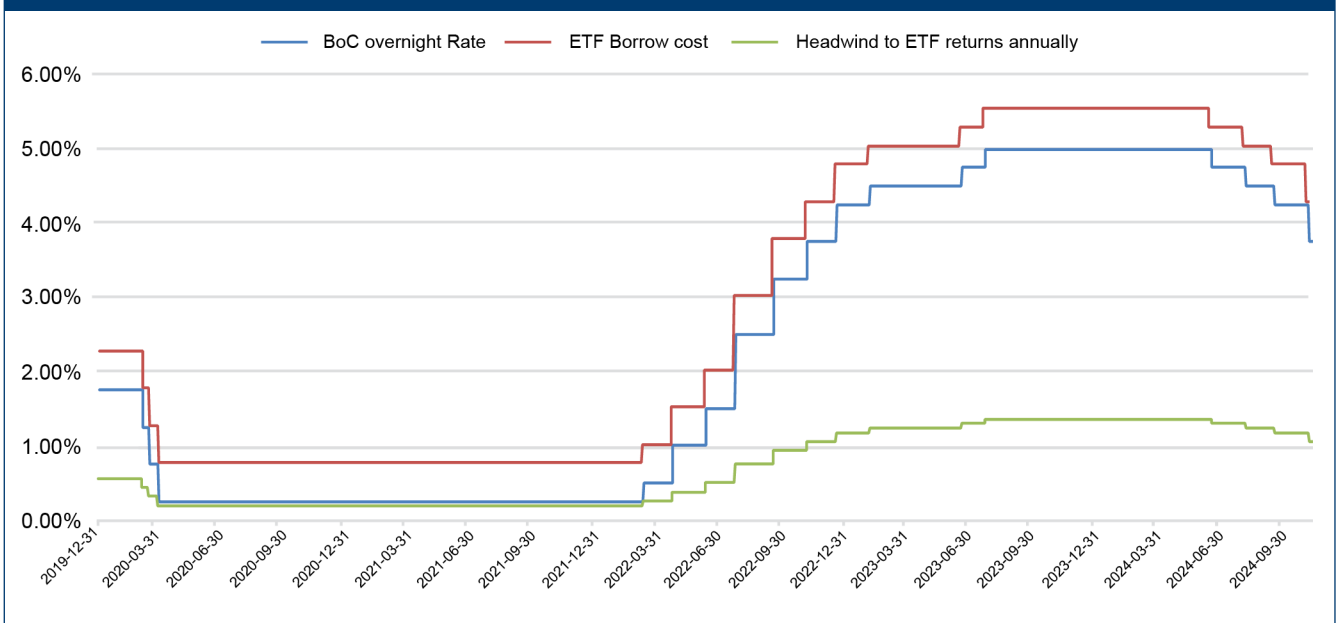
Leverage magnifies both gains and losses, which is why it’s often seen as a more aggressive, higher-risk strategy. However, in more stable industries that tend to have less aggressive drawdowns leverage can be particularly effective.

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. This cost to the investor and by extension the drag on returns is shown below.

Chart 4: Leverage Cost for Investors

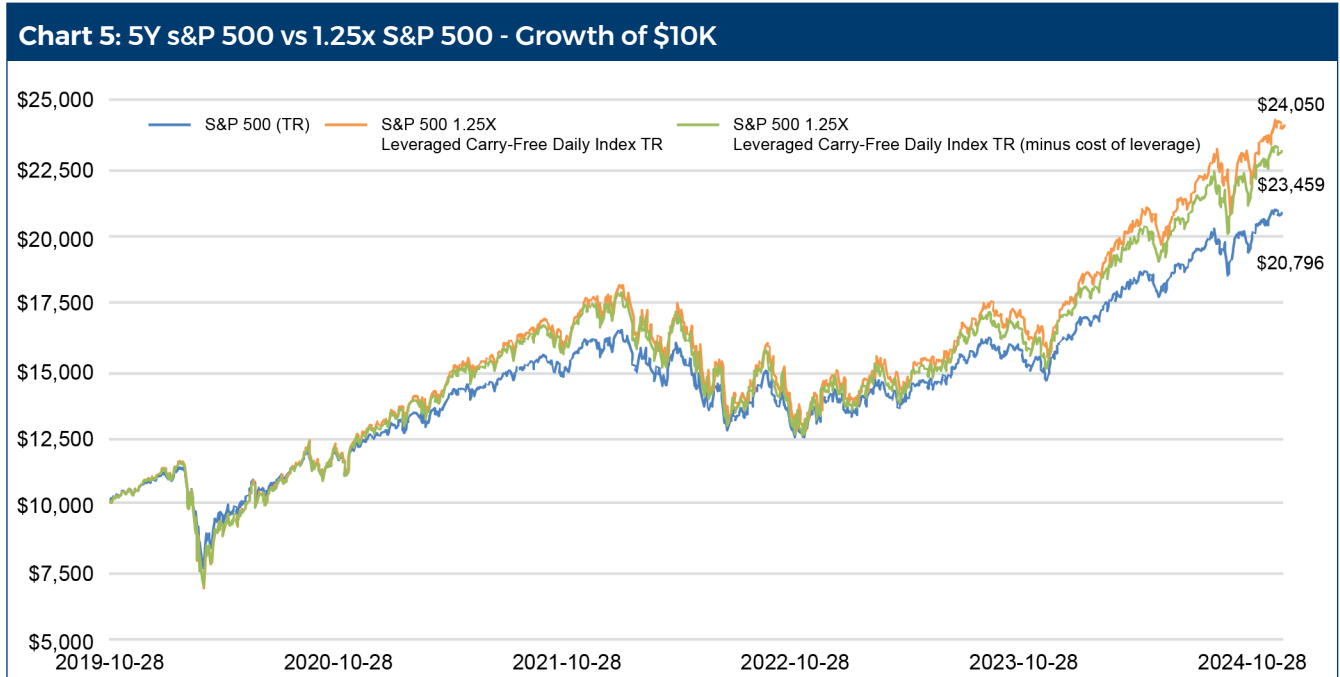


Source: Bloomberg as at October 31, 2024

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.

To illustrate, the chart below compares the returns of the S&P 500® compared to a 25% levered version (after accounting for the cost of borrowing). As you can see, even with the costs of leverage accounted for, the levered S&P 500® outperforms the non-levered equivalent.



Source: S&P Global, Evolve ETFs as at October 31, 2024

Disclaimer

Certain statements in this document are forward-looking. Forward-looking statements (“FLS”) are statements that are predictive in nature, depend upon or refer to future events or conditions, or that include words such as “may,” “will,” “should,” “could,” “expect,” “anticipate,” “intend,” “plan,” “believe,” or “estimate,” or other similar expressions. Statements that look forward in time or include anything other than historical information are subject to risks and uncertainties, and actual results, actions or events could differ materially from those set forth in the FLS. FLS are not guarantees of future performance and are by their nature based on numerous assumptions. Although the FLS contained herein are based upon what Evolve Funds Group Inc. and the portfolio manager believe to be reasonable assumptions, neither Evolve Funds Group Inc. nor the portfolio manager can assure that actual results will be consistent with these FLS. The reader is cautioned to consider the FLS carefully and not to place undue reliance on FLS. Unless required by applicable law, it is not undertaken, and specifically disclaimed that there is any intention or obligation to update or revise FLS, whether as a result of new information, future events or otherwise.

Commissions, trailing commissions, management fees and expenses all may be associated with exchange traded funds (ETFs) and mutual funds. Please read the prospectus before investing. ETFs and mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

Leverage increases risk.

Investors should monitor their holdings, as frequently as daily, to ensure that they remain consistent with their investment strategies.

Evolve ETFs

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