

# Understanding leveraged and inverse products

Leveraged and inverse products (L&I Products) are derivative products structured as funds, and their shares/units are traded on The Stock Exchange of Hong Kong Limited (SEHK).

Unlike traditional index tracking exchange traded funds (ETF), L&I Products are often referred to as "daily" products since they aim to deliver a multiple of or a multiple of the opposite of the return of the underlying index on a daily basis only. Leveraged products seek to deliver a daily return equivalent to a multiple of the underlying index return. For example, when an investor buys a two-time leveraged product, and the underlying index moves up by 10% on a given day, the two-time leveraged product should deliver a gain of 20% on that day. While inverse products seek to deliver a daily return that is a multiple of the inverse underlying index return. For example, when an investor buys a two-time inverse product, and the underlying index moves up by 10% on a given day, the inverse product should deliver a loss of 20% on that day.

When L&I Products are held overnight, their return may deviate from and may be uncorrelated to the multiple of the returns of the underlying index.

L&I Products are different from conventional exchange traded funds. Here are the distinctive product features:

- **Leverage factor:** In Hong Kong, the leverage factor of L&I Products is subject to a cap. Leveraged products are subject to a maximum leverage factor of two times (2x), i.e. deliver a daily return equivalent to two times of the underlying index return. Inverse products are subject to a maximum leverage factor of two times (-2x), i.e. deliver a daily return equivalent to two times the inverse of the underlying index return.
- **Daily rebalancing:** To achieve their investment objectives, L&I Products have to rebalance their portfolio every day so that their leverage factor is maintained at its target level.

## What should you know about the L&I Products?

### What are they tracking?

The index that L&I Products track can be spot market index or futures index that uses different ways to measure return, e.g. price return, excess return and total return.

L&I Products may aim to deliver a multiple of or a multiple of the opposite of the return of its underlying index on a daily basis, but they may also track a leveraged or inverse index (i.e. an index that already incorporates the applicable leverage factor). You should refer to the offering documents for more information.

### How do they track an index and achieve their investment objectives?

- Swaps: The L&I Product pays the swap counterparties a fee, and the swap counterparties deliver to the L&I Product a multiple of or a multiple of the opposite of the return of the underlying index on a daily basis. The L&I Product is exposed to the credit and default risks of the swap counterparties.
- Futures: The L&I Product achieves its investment objective by investing in futures contracts. There are transaction costs on trading futures contracts. The L&I Product is exposed to the risk that the performance of the futures contracts may deviate from the L&I Product's investment objective.

### What are the risks associated with investing in L&I Products?

In addition to the risks specific to L&I Products, some common risks of ETFs are also applicable

### Where and how to trade?

L&I Products are listed and traded on the SEHK like stocks. You can buy and sell L&I Products through the licensed intermediaries (brokers and banks). Like trading any listed securities, trading of L&I Products is subject to transaction costs including the trading fee, trading tariff and transaction levy.

In view of the leveraged and/or inverse features of L&I Products and the additional leverage impact from margin financing, you are **not** advised to trade L&I Products on margin.

## Who should invest in L&I Products?

L&I Products target sophisticated trading-oriented investors who understand the nature of these products and the associated risks, and constantly monitor the performance of their holdings on a daily basis. Since L&I Products are designed for short-term trading or hedging and are not intended for holding longer than one day, they are not intended for buy-and-hold investors.

You should read the product key facts statement and the offering documents for all the necessary information to make an informed decision. You should also understand your investment objectives and risk tolerance before making investment decision on L&I Products

Source: The Chin Family

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