

Daily leverage and long-term investing using leveraged exchange traded funds

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This paper explores the potential of leveraged Exchange Traded Funds (ETFs) for long-term investors and lifecycle portfolios. Conventionally, leverage can increase welfare by enabling strategies that match the risk appetite of risk-tolerant investors, or by increasing financial wealth exposure to compensate for the illiquidity of human capital. We find ETFs to be suitable for both purposes with a caveat: secondary risks associated to ETFs make it worthwhile only if the investor is sufficiently risk-tolerant. We also solve static and dynamic portfolio optimization problems taking leverage costs into account. We show that the optimal leverage target decreases with leverage costs, and find closed form expressions for welfare gains of relaxing leverage constraints and welfare losses related to the leverage costs in comparison to an idealized Merton world.