

HOW BITX WORKS: THE BASICS

SUMMARY

- BITX is the first ETF to offer leveraged exposure to a cryptocurrency.
- Bitcoin futures have historically tracked physical Bitcoin well.
- BITX is structured as a traditional ETF.

On June 27, 2023, Volatility Shares introduced the 2x Bitcoin Strategy ETF (Ticker: BITX), the first leveraged crypto fund offered on an exchange in the U.S. This is an introduction to BITX's architecture and operational characteristics.

BITX IS A 2X LEVERAGED ETF

BITX is structured as a 2x leveraged, daily resetting, Exchange-Traded Fund or ETF. The Fund's investment objective is to deliver twice the daily performance of the short-term CME Bitcoin futures - specifically 2x the daily performance of the S&P CME Bitcoin Futures Daily Roll Index (Ticker: SPBTFDUE). This index tracks the performance of a rolling Bitcoin futures portfolio, rolled daily from the sooner-to-expire month one futures contract (M1) to the longer-to-expire month two futures contract (M2).

In addition to rolling futures forward, BITX also adjusts its holdings each day to maintain its daily 2x exposure, as well as adding or subtracting new futures to account for any new investments or redemptions from the fund.

BITCOIN FUTURES HAVE TRACKED SPOT BITCOIN WELL

When first introduced in late 2017 there was speculation that Bitcoin futures might fail to closely track Bitcoin's daily spot price. This speculation may have been fueled by the performance of VIX futures linked ETFs, that because of considerable contango in VIX futures, have historically shown imperfect correlation with the VIX index itself.

However, Bitcoin futures contango has remained substantially lower than VIX futures contango since their launch in 2017. This may be explained by the availability of the cash and carry arbitrage opportunity between Bitcoin and its futures – a relationship that does not exist between the VIX and its futures. Put simply, arbitragers and market makers can cost-effectively hedge their Bitcoin futures positions with spot Bitcoin. For example, arbitragers can buy \$1 of bitcoin for every \$1 of futures sold – or in the case of BITX, buy \$2 of Bitcoin for every \$1 of BITX sold. This cash and carry arbitrage is very common in the futures markets and helps explain how liquid futures can track their underlying so closely.

¹ Contango is the upward sloping price term structure in futures markets that can erode returns of long funds that roll futures forward. The VIX Index is a financial benchmark designed to be an up-to-the-minute market estimate of expected volatility of the S&P 500 Index and is calculated by using the midpoint of real-time S&P 500® Index (SPX) option bid/ask quotes. More specifically, the VIX Index is intended to provide an instantaneous measure of how much the market thinks the S&P 500 Index will fluctuate in the 30 days from the time of each tick of the VIX Index.

BITX STRUCTURE

BITX is registered under the U.S. Investment Company Act of 1940 just like most ETFs in the market. BITX will report gains/losses via IRS 1099 forms, will not issue K-1s, and BITX is not subject to non-resident withholding on publicly traded partnerships (PTPs). Lastly, BITX's annual fee is 1.85%, which is deducted daily (~0.005%) from the fund's assets.

CONCLUSION

BITX has been one of the most successful ETF launches of 2023, helped by the robust Bitcoin futures market, it's simple and highly regulated ETF structure, and deep liquidity. Bitcoin is highly volatile, and 2x exposure in this asset will not suit everyone's risk appetite.

Stay tuned for our follow-up articles, where we'll take a deeper dive into the risks and complexities of BITX and discuss how sophisticated traders are utilizing BITX in their trading programs.

This article is a summary of a blog published in August 2023 by Vance Harwood on Six Figure Investing.

ABOUT THE AUTHOR

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Stuart is a commodity trading specialist with more than 20 years' experience building and managing portfolios. Stuart holds a PhD in Economic History from the University of Cambridge, an MBA from the University of Surrey, and a B.Sc in engineering from the University of Cape Town. Stuart is also a CFA Charter holder.

DISCLOSURE

Past performance is not necessarily indicative of future results.

An investor should consider the investment objectives, risks, and charges and expenses of the fund carefully before investing. A preliminary prospectus which contains this and other information about the fund may be obtained by calling 866-261-0273. Read it carefully before investing.

Investing involves risk; Principal loss is possible. The fund does not directly invest in Bitcoin. The Fund presents different risks from other funds, may only be suitable for knowledgeable investors who understand the consequences of seeking daily (2x) investment results, including the impact of compounding on Fund performance. Investors in the Fund should actively manage and monitor their investments, as frequently as daily. An investor in the Fund could potentially lose the full value of their investment within a single day. The Fund does not invest directly in Bitcoin. Instead, the Fund seeks to benefit from increases in the price of Bitcoin Futures Contracts for a single day.

Bitcoin and Bitcoin futures are relatively new investments. They are subject to unique and substantial risks, and historically, have been subject to significant price volatility.

Compounding Risk. The Fund has a single day investment objective, and the Fund's performance for any other period is the result of its return for each day compounded over the period.

Leveraged Correlation Risk. Several factors may affect the Fund's ability to achieve a high degree of leveraged (2x) correlation with the Index, and there is no guarantee that the Fund will achieve a high degree of correlation.ch day compounded over the period.

Rebalancing Risk. If for any reason the Fund is unable to rebalance all or a portion of its portfolio, or if all or a portion of the portfolio is rebalanced incorrectly, the Fund's investment exposure may not be consistent with the Fund's daily investment objective.

Bitcoin is a new technological innovation with a limited history. There is no assurance that usage of Bitcoin will continue to grow. A contraction in use of Bitcoin may result in increased volatility or a reduction in the price of Bitcoin, which could adversely impact the value of the Fund.

Futures Contracts Risk. Risks of futures contracts include: (i) an imperfect correlation between the value of the futures contract and the underlying asset; (ii) possible lack of a liquid secondary market; (iii) the inability to close a futures contract when desired; (iv) losses caused by unanticipated market movements, which may be unlimited; (v) an obligation for the Fund to make daily cash payments to maintain its required margin, particularly at times when the Fund may have insufficient cash; and (vi) unfavorable execution prices from rapid selling.

Liquidity Risk. The market for the Bitcoin futures contracts is still developing and may be subject to periods of illiquidity.

Collateral Investments Risk. The Fund's use of Collateral Investments may include obligations issued or guaranteed by the U.S. Government, its agencies, and instrumentalities, including bills, notes and bonds issued by the U.S. Treasury, money market funds and corporate debt securities, such as commercial paper.

Subsidiary Investment Risk. Changes in the laws of the United States and/or the Cayman Islands, under which the Fund and the Subsidiary are organized, respectively, could result in the inability of the Fund to operate as intended and could negatively affect the Fund and its shareholders.

Active Management Risk. The Fund is actively managed, and its performance reflects investment decisions that the Sub-Adviser and Adviser make for the Fund.

Non-Diversification Risk. The Fund is classified as “non-diversified” under the 1940 Act. As a result, the Fund is only limited as to the percentage of its assets which may be invested in the securities of any one issuer by the diversification requirements imposed by the Internal Revenue Code of 1986, as amended.

Reverse Repurchase Agreements Risk. The Fund may invest in reverse repurchase agreements. Reverse repurchase agreements are transactions in which the Fund sells portfolio securities to financial institutions such as banks and broker-dealers and agrees to repurchase them at a mutually agreed-upon date and price which is higher than the original sale price.

New Fund Risk. As of the date of this prospectus, the Fund has no operating history and currently has fewer assets than larger funds.

Tax Risk. The Fund intends to elect and to qualify each year to be treated as a RIC under Subchapter M of the Code. As a RIC, the Fund will not be subject to U.S. federal income tax on the portion of its net investment income and net capital gain that it distributes to Shareholders if it satisfies certain requirements of the Code. If the Fund does not qualify as a RIC for any taxable year and certain relief provisions are not available, the Fund’s taxable income will be subject to tax at the Fund level and to a further tax at the shareholder level when such income is distributed. Commodity

Commodity Regulatory Risk. The Fund’s use of commodity futures subject to regulation by the CFTC has caused the Fund to be classified as a “commodity pool” and this designation requires that the Fund comply with CFTC rules, which may impose additional regulatory requirements and compliance obligations.

Authorized Participant Concentration Risk. Only an authorized participant may engage in creation or redemption transactions directly with the Fund. The Fund has a limited number of institutions that act as authorized participants on an agency basis (i.e., on behalf of other market participants).

The value of an investment in the Fund could decline significantly and without warning, including to zero. You should be prepared to lose your entire investment within a single day. The Shares will change in value, and you could lose money by investing in the Fund. The Fund may not achieve its investment objective.

Futures generally are volatile and are not suitable for all investors.

Shares are not FDIC insured, may lose value, and have no bank guarantee.

All supporting documentation will be provided upon request.

Foreside Fund Services, LLC is the distributor of the BITX ETF.

One may not directly invest in an index.

QUESTIONS?

- Call us: **+1-866-261-0273**
- Email us: **contact@volatilityshares.com**
- Sign up for Insights and Announcements: **volatilityshares.com**