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By Brian Ponte | April 30, 2025

With ETF Innovation, Think About Investors, Not the 'Boogeyman'

So far this year, issuers have launched at least 18 leveraged or inverse ETFs and about a dozen options-writing strategies, data shows.

The number of ETFs on the market has exploded in recent years — and many of the new products are niche or complex raising questions about the drivers of innovation in the booming market, industry executives say.

During the first three months of this year, 228 ETFs launched, compared to 168 during the first quarter of 2024, Morningstar Direct data shows. This year's new fleet includes 18 leveraged or inverse ETFs and 11 options-writing strategies that have so far recorded zero or negative net flows.

Recent launches include leveraged bets on single stocks like GameStop and strategies aiming to bring traditionally illiquid assets, such as private credit, to a broader audience through the ETF wrapper.

REX Shares and Tuttle Capital Management this month launched an ETF that will offer double the daily returns of popular meme stock GameStop. The ETF came in response to GameStop "adding Bitcoin to its balance sheet" signaling "adaptability and growth potential," REX Chief Operating Officer Scott Acheychek said in the announcement.

Complex products, particularly leveraged or inverse funds, are "almost never ... an appropriate retail investment," said Corey Frayer, director of government affairs at the Consumer Federation of America.

High fees, volatility drag from daily rebalancing, and general long-term underperformance relative to standard indexes make it "hard to see ... how that is anything more than the kind of speculative investment that doesn't really serve long-term savings," he said.

Complex products are typically far more expensive than their simpler counterparts.

For example the $253 million iShares Large Cap Deep Buffer ETF tracks the S&P 500 index while offering investors 15% downside protection in exchange for a 5% cap on returns. That ETF carries a 50-basis-point fee. The $558.9 billion iShares Core S&P 500 ETF, meanwhile, charges 3 bps.

By contrast, the best-selling ETFs to debut in the first quarter are significantly cheaper.

Vanguard's $948 million 0-3 Month Treasury Bill ETF, which pulled in $560 million in net inflows between its Feb. 7 launch and March 31, costs 7 bps, according to Morningstar. Schwab Asset Management's $164 million Core Bond ETF, which also launched in early February, has garnered $139 million in inflows through March 31 and charges 16 bps.

"Everything has to work for the investor. It has to do that thing," said Alex Morris, president and CIO of F/m Investments. Managers should seek to solve "actual problems in your portfolio," rather than inventing a "new boogeyman for you to be worried about," he added.

In 2022, F/m launched a suite of 10 single-Treasury ETFs. The U.S. Benchmarks series now has $7 billion in assets. Then, two years later, the firm rolled out its U.S. Credit series, a trio of ETFs that now represent $344 million.

The development process for those ETFs involved financial academics and former central bankers and was aimed at "distilling market noise" and providing cleaner beta, Morris said.

However, specialized funds may be targeting different end users than do core ETFs, said Brian Moran, CEO of FLX Networks.

Not every ETF is designed for traditional, advisor-led asset allocation models, he said.

Instead, highly thematic or tactical ETFs might appeal to the "large amount of investors" who operate outside the advisory channel and look for "interesting, timely, very personalized investments," Moran said.

Sophisticated institutional investors, like hedge funds, might use such niche ETFs tactically as a "mechanism to add alpha," rather than as core holdings, he said.

Still, the push into complexity creates hurdles, particularly within the traditional advisor channel.

"Advisors don't want to sell something that they do not fully understand," said Scott Smith, director of advice relationships at Cerulli Associates.

Getting any new ETF onto wealth platforms also requires clearing significant hurdles related to assets, track records and trading volumes, Moran said.

With thousands of ETFs already vying for attention, platforms are not "begging asset managers for new product," he noted. Asset managers need a differentiated value proposition and the financial runway to support a fund through its potentially lean early years, he added.

Assets remain concentrated, Moran notes. The seven largest ETF issuers represent roughly 90% of total ETF assets, while the top 10 active managers account for nearly 70% of active ETF assets, according to FLX data.

Such dynamics mean firms outside the leading group must "go an extra step" to make their case, Moran noted.

Even if niche funds find an audience, their economics differ.

High fees, sometimes exceeding 100 bps, can make them profitable "cash cows" for issuers, even if their assets are lower, said F/m's Morris.

Structural shifts like potential ETF share class approvals and the growing use of 351 conversions — which let investors defer taxes by transferring assets to a corporation in exchange for stock, rather that cash — could further influence product strategy, executives said.

The long-term advancement of technology like direct indexing also potentially challenges the necessity of fund wrappers altogether, FLX's Moran said.

Asset managers must be able to clearly articulate why or when the product can help investors, F/m's Morris said.

"You can build it, and they will come if you can say, 'Here's an identifiable problem. ... I can solve it, and I can articulate it to you readily and simply'," he said.

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