REBALANCING GEARED FUND POSITIONS

Most geared (leveraged and inverse) funds are designed to provide a multiple (for example, a "fund multiple" of 2x or -2x) of an underlying index return on a daily basis, before fees and expenses. Over time, the returns of these funds may be greater or less than the index return times the fund multiple, primarily due to the effects of daily compounding.

Geared funds are most often used as short-term tactical tools. Investors who want to hold them for longer periods should consider a rebalancing strategy to seek returns over time that are close to the fund multiple times the index return.[1] Rebalancing involves periodically adding to, or subtracting from, fund positions to realign exposure to the underlying index. **Note that rebalancing can entail transaction costs and tax consequences that should be considered when determining a rebalancing strategy.**

The following three steps show a trigger-based rebalancing technique that applies to all geared funds.

1. **Monitor the Gap.** Monitor the difference between the unleveraged (1x) index return and the geared fund return.

   Gap = Index Return – Fund Return

   If the Gap reaches a certain level over your holding period (e.g., you might use ±5% or ±10% as a trigger), you may choose to rebalance. Our example at the right shows a Gap of +15% between an index return (+5%) and the return of a related inverse fund (-10%).

2. **Calculate your rebalance trade.** If the index return is greater than the fund return, you may choose to add to your fund position. If the index return is less than the fund return, you may choose to decrease your position. In our example, the Gap is +15%, so you would increase your inverse fund position to rebalance. To calculate your trade in dollars—regardless of the fund multiple—use the following formula:

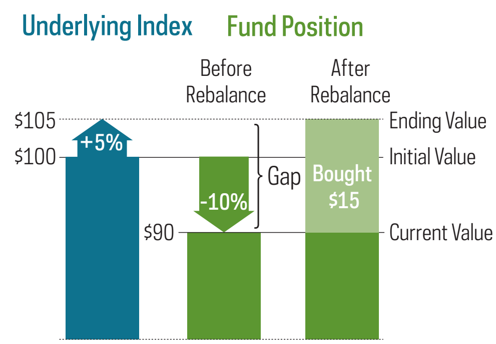
   Trade $ = Initial $ x (1+ Index Return) – Current $

   In our example, take the initial position ($100), multiply it by 1.05, and subtract the current position ($90), to get +$15. Add $15 to your position, and you are realigned to the index price (at $105) with the desired exposure.

3. **Repeat.** Continue to monitor the Gap and rebalance according to your rebalancing strategy (see other side).

[1] Joanne M. Hill and Solomon G. Teller, "Rebalancing Leveraged and Inverse Funds," *Eighth Annual Guide to Exchange Traded Funds & Indexing Innovations, Institutional Investor Journals* (Fall 2009): 67-76. Hill is an employee of ProShares | ProFunds.

Rebalancing an Inverse Fund Position



For illustrative purposes only. One cannot invest directly in an index.

This chart shows the returns of an inverse fund and its underlying index over an unspecified time frame. Each started at $100. Over time, the index returned 5% and the inverse fund returned -10%, yielding a +15% Gap.

To calculate the rebalance trade, apply the formula:

Trade $ = $100 x (1+ 0.05) – $90
Trade $ = $105 – $90
Trade $ = $15

The fund investor must add $15 to his current position of $90 so that his dollar exposure is realigned to the ending index price of $105.

Note: Investors in geared funds rebalance by withdrawing capital on investment gains and adding capital on investment losses. By rebalancing, investors reposition their dollar exposure to the index to target cumulative returns that are consistently close to the index return times the fund multiple.

Determining Your Rebalancing Strategy

Rebalancing can be an effective strategy for geared fund investors seeking to achieve returns over time that are consistently close to the fund multiple (e.g., 2x or -2x) times the index return.

There are two common approaches to designing a rebalancing strategy: trigger-based (see other side) and calendar-based. No matter which rebalancing method you choose, you need to monitor your fund positions carefully.

- **Trigger-based.** This approach activates rebalancing each time the Gap between the index return and the fund return reaches a specific threshold (e.g., ±5% or ±10%).
- **Calendar-based.** This approach entails rebalancing at set time intervals (e.g., weekly, monthly or quarterly). Calendar-based strategies are generally less tuned to market conditions than trigger-based strategies are—they can lag in responding to volatile market conditions and require more trading in low volatility periods. In effect, a calendar approach ignores the size of the Gap between the index return and the fund return, which should be monitored carefully.

Factors That Affect Rebalancing Frequency

For any geared fund rebalancing strategy, it is critical to monitor your fund positions frequently. How often you may need to implement a rebalancing trade is influenced by the characteristics of the fund and the index, as well as by market conditions.

- **The Fund Multiple.** The higher the fund multiple (e.g., 3x versus 2x), the more frequently you will generally need to rebalance. In addition, an inverse fund requires more rebalancing compared to a corresponding leveraged fund (e.g., -2x versus 2x) because it moves in the opposite direction of the underlying index each day. (See our example on other side.)
- **Volatility.** A leveraged or inverse fund based on an index with higher volatility (such as the NASDAQ-100) may require more frequent trades to rebalance than one based on an index with lower volatility (such as the S&P 500).
- **Percentage Trigger.** A larger percentage trigger implies that fewer trades may be required over time. All other factors being equal, a percentage trigger of ±10% will require less rebalancing than one of ±5%, although the size of your trades may be larger.

Rebalancing: Practical Considerations

1. Evaluate the potential benefits of rebalancing against all related transaction costs and tax consequences.
2. Rebalancing may entail adding to your fund position. Do you have available cash?
3. Monitor your geared fund positions frequently, no matter how often you intend to rebalance.
4. Be aware that rebalancing can reduce both the negative and the potential positive effects of daily compounding.

   For example, in low volatility up- or down-trending markets, daily compounding can enhance the potential returns of geared funds. In such circumstances, a rebalancing strategy may result in underperformance compared to fund positions that have not been rebalanced, even though you may have achieved returns that are closer to the index return times the fund multiple.

This information is provided to illustrate the mechanics of a rebalancing strategy for geared funds. It is not intended as investment advice. Returns are not intended to show actual or future fund performance. There is no guarantee that rebalancing will help you achieve your investment objective or prevent investment losses.

Geared ProShares ETFs and ProFunds seek returns that are a multiple or inverse multiple (e.g., 2x or -1x) of the return of an index or other benchmark (target) ***for a single day,*** as measured from one NAV calculation to the next , before fees and expenses. Due to the compounding of daily returns, the returns of these funds over periods other than one day will likely differ in amount and possibly direction from the target return for the same period. These effects may be more pronounced in funds with larger or inverse multiples and in funds with volatile benchmarks. Investors should monitor geared fund holdings consistent with their strategies, as frequently as daily. Geared funds each entail certain risks, which may include risk associated with the use of derivatives (swap agreements, futures contracts and similar instruments), imperfect benchmark correlation, leverage and market price variance, all of which can increase volatility and decrease performance. ProShares are generally non-diversified. For more on correlation, leverage and other risks, please read the prospectus. There is no guarantee any fund will achieve its investment objective.

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