

### Long/Short Relative Value Strategy

Looking for a strategy for uncertain markets?

#### Scenario

Michael moved his clients' assets to cash during a recent market correction. While out of the market, a recovery took place leaving Michael reluctant to go long, for fear of buying in at the top of the market. Although Michael is uncertain about the general direction of the overall market, as an astute advisor, he has come upon some investment opportunities that he believes are sensible. Michael would like to have some selective participation in the market for his clients but wants to make sure they are protected against excessive market volatility.

What should Michael do?

#### Solution

A Long/Short Relative Value Strategy may make sense because such a strategy can be independent from the direction of the broader market.

A Long/Short Relative Value Strategy is used to take advantage of a perceived mismatch between the relative value of two investments. An investor creates a long position in the instrument deemed stronger and a short position in the instrument deemed weaker.

**Stronger Instrument = Long Position**

**Weaker Instrument = Short Position**

The performance of the aggregate position depends on the way the investments perform in relation to each other. In a basic Long/Short Relative Value strategy, an investor expects, "A" (stronger position) to outperform "B" (weaker position), which may mean one of the following scenarios would occur:

#### Potentially Profitable Scenarios

	Long Position in A		Short Position in B		Aggregate Position
A & B rise, but A more than B:	Gain	>	Loss	=	Gain
A & B fall, but A less than B:	Loss	<	Gain	=	Gain
A rises, but B falls:	Gain	+	Gain	=	Gain

#### Managing Volatility

The volatility of a Long/Short Relative Value strategy can be controlled by evaluating the correlation of the positions to each other. By pairing instruments which have high correlations and allocating similar amounts to each instrument, (one long and one short) a strategy should have lower volatility. If the target securities are not highly correlated, the strategy will be more volatile. In a Long/Short strategy, volatility will increase as correlation decreases, and as allocations become less equal.

**High Correlation + Equal Inverse Allocation = Low Volatility**

## Strategy in Action

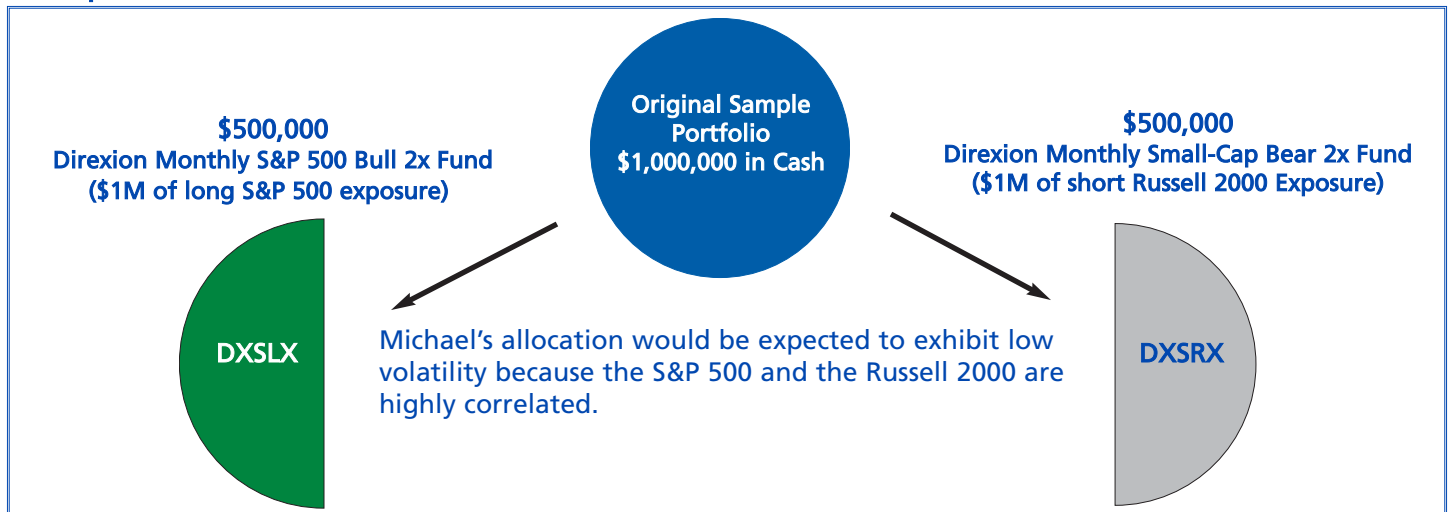
Michael has been hearing many market commentators calling for large caps to outperform small caps. He has done some research of his own and agrees with this thesis. However, Michael is hesitant to buy large cap stocks because he is uncomfortable with the downside risk and he knows his clients would be unhappy if he were to buy into the market just before a downturn.

Given his uncertainty about the direction of the markets and his relative expectations for large caps versus small caps, what should he do? Michael might consider the following:

### Investment Tool Tip

Direxion's Correlation Calculator (available at [www.direxionfunds.com](http://www.direxionfunds.com)), can be used to measure correlation, volatility and performance. This easy to use tool will display the correlation of investments within your portfolio. This tool can be extremely helpful in determining which investments would be ideal as you consider implementing a Long/Short Strategy.

### Example:



## The Take-Aways

A Long/Short Relative Value Strategy:

- May be appropriate when an investor is unsure of general market direction and is therefore willing to sacrifice some potential gains
- Allows for less dependency on the performance of the overall market
- Will generally lag in a strong rising market
- May potentially reduce volatility

To learn more about this and other useful strategies that can be implemented using Direxion's Monthly Leveraged Index Funds, please contact Direxion at 877-437-9363 or visit [www.direxionfunds.com](http://www.direxionfunds.com).

*An investor should consider the investment objectives, risks, charges, and expenses of the Direxion Funds carefully before investing. The prospectus contains this and other information about Direxion Funds. To obtain a prospectus, please contact the Direxion Funds at (800) 851-0511. The prospectus should be read carefully before investing.*

*Investing in index funds may be more volatile than investing in broadly diversified funds. The use of leverage by a mutual fund increases the risk to the fund. The more a fund invests in leveraged instruments the more the leverage will magnify gains or losses on those investments.*

The risks associated with the funds are detailed in the prospectuses which include Adverse Market Conditions Risk, Adviser's Investment Strategy Risk, Aggressive Investment Techniques Risk, Commodities Risk, Concentration Risk, Counterparty Risk, Credit Risk, Currency Exchange Rate Risk, Debt Instrument Risk, Depository Receipt Risk, Early Close/Trading Halt Risk, Emerging Markets Risk, Equity Securities Risk, Foreign Securities Risk, Gain Limitation Risk, Geographic Concentration Risk, Interest Rate Risk, Intra-Calendar Month Investment Risk, Inverse Correlation Risk, Leverage Risk, Lower-Quality Debt Securities, Market Risk, Market Timing Activity and High Portfolio Turnover, Monthly Correlation Risk, and Negative Implications of Monthly Goals in Volatile Market.

Date of first issue: May 8, 2007 Distributor: Rafferty Capital Markets, LLC.

**direxion**