



The Impact of Changing Market Exposure on Leveraged Index Fund Performance



Know When to Hold 'Em; Know When to Fold 'Em

The aggregate return of an investment over a particular holding period depends, in part, on whether an investor decides to expose investment gains from early in the period to investment performance later in the period.

Consider Mary and Tom, who each put \$100 in an equity investment, which proceeds to gain 25% per year for each of the subsequent five years. Mary does not touch her investment, while Tom decides to remove his gains at the end of each year. As a consequence, Tom starts each year with \$100 in the investment.

	Mary: Invests \$100 in Year 1. Leaves principal invested through Year 5.			Tom: Invests \$100 in Year 1. Each year, he withdraws his gains.	
	Return	Principal & Gains		Return	Gains
Year 1	25%	\$125	Year 1	25%	\$25
Year 2	25%	\$156	Year 2	25%	\$25
Year 3	25%	\$195	Year 3	25%	\$25
Year 4	25%	\$244	Year 4	25%	\$25
Year 5	25%	\$305	Year 5	25%	\$25
Mary's Account Balance, Year 5:		\$305	Tom's Account Balance, Year 5:		\$125
Mary's Total Investment Gains:		\$205	Tom's Total Investment Gains:		\$125

Because Mary left her gains in the investment, and because the investment continued to appreciate, she benefited from gains on her gains (commonly referred to as “compounding”) and ends up with more money at the end of Year 5—\$205 in investment returns versus Tom’s \$125. Although Mary’s decision proved wise because of the security’s favorable performance, if the market had declined in the later years, Tom would likely have had better returns than Mary because her gains were exposed to market risk throughout the holding period.

In essence, Mary’s passivity allowed her market risk to increase, while Tom’s withdrawals reduced his risk. Decisions on how to modify a portfolio in response to gains (or losses) have enormous implications for investment performance. Unfortunately, the ultimate wisdom of such decisions can be evaluated only in hindsight.

Leveraged Index Funds respond to gains by becoming more aggressive, while they respond to losses by becoming more defensive. In markets which are directional, this can be an advantage; in markets which lack direction, this can be a disadvantage.

Leveraged Index Funds

Direxion's Leveraged Index Funds seek to provide **monthly** returns which are a multiple of the returns of the relevant benchmark. In practice, this means that Leveraged Index Funds react to gains by increasing market exposure and react to losses by decreasing market exposure.

Why? Unlike Tom and Mary, who likely make decisions based on some combination of rational thinking and emotions, a Leveraged Index Fund's exposure is a product of its target magnification and its net assets. Favorable moves in the benchmark push net assets higher, which translates into an increase in exposure by a multiple of the gain in net assets. Conversely, unfavorable moves in the benchmark lead to a decline in net assets, which results in a reduction of exposure in an amount which is a multiple of the decline in the net assets.

In essence, Leveraged Index Funds respond to gains by becoming more aggressive, while they respond to losses by becoming more defensive. In markets which are directional, this can be an advantage; in markets which lack direction, this can be a disadvantage.

The following scenarios illustrate how a 2x Leveraged Index Fund performs in various market scenarios.

Scenario 1: Market Trends Steadily

If the benchmark moves in a direction favorable to the fund (meaning up for a bull fund and down for a bear fund) in a linear trend, the fund's gain for the period may be larger than the product of: (a) the index move; and (b) the fund's stated exposure rate. This is because the fund's assets rise in response to index moves favorable to the fund. As a consequence, market exposure rises, which amplifies gains on the subsequent favorable index movements.

Index Value	Index Monthly Return	Index Total Return	Index Total Return X 2.0	2x Bull Fund Monthly Return	Fund NAV	Total Fund Return
100					\$20.00	
105	5.00%	5.00%	10.00%	10.00%	\$22.00	10.00%
110	4.76%	10.00%	20.00%	9.52%	\$24.10	20.48%
115	4.55%	15.00%	30.00%	9.09%	\$26.29	31.43%
120	4.35%	20.00%	40.00%	8.70%	\$28.57	42.86%
125	4.17%	25.00%	50.00%	8.33%	\$30.95	54.76%

Return Difference: 4.76%

Perhaps surprisingly, the fund's loss for a period may be less than the product of: (a) the index move; and (b) the fund's stated multiple or beta if the benchmark moves in a direction unfavorable to the fund (meaning down for a bull fund and up for a bear fund), but does so in a linear trend. This is because the fund's assets decline in response to index moves unfavorable to the fund and, as a consequence, market exposure declines, which reduces the impact of subsequent unfavorable index movements.

Index Value	Index Monthly Return	Index Total Return	Index Total Return X 2.0	2x Bull Fund Monthly Return	Fund NAV	Total Fund Return
100					\$20.00	
95	-5.00%	-5.00%	-10.00%	-10.00%	\$18.00	-10.00%
90	-5.26%	-10.00%	-20.00%	-10.53%	\$16.11	-19.47%
85	-5.56%	-15.00%	-30.00%	-11.11%	\$14.32	-28.42%
80	-5.88%	-20.00%	-40.00%	-11.76%	\$12.63	-36.84%
75	-6.25%	-25.00%	-50.00%	-12.50%	\$11.05	-44.74%

Return Difference: 5.26%

Scenario 2: Market is Volatile

In markets in which there are no clear trends, the impact of monthly rebalancing is harmful to performance over time. In essence, the fund follows a momentum strategy, which responds to gains by increasing exposure and responds to losses by decreasing exposure at the end of the month. This is not helpful in a market which lacks direction. A gain leads to increased exposure in advance of a loss, which then leads to decreased exposure in advance of a gain, and so on. Seeking leveraged monthly returns in such a market without active monitoring and management may negatively impact performance. At the end of the period, the fund has a loss when it might be expected to have provided a return of 0.00%. The loss is a consequence of the application of the monthly leveraged model to a period of significant volatility.

Index Value	Index Monthly Return	Index Total Return	Index Total Return X 2.0	2x Bull Fund Monthly Return	Fund NAV	Total Fund Return
100					\$20.00	
95	-5.00%	-5.00%	-10.00%	-10.00%	\$18.00	-10.00%
100	5.26%	0.00%	0.00%	10.53%	\$19.89	-0.53%
105	5.00%	5.00%	10.00%	10.00%	\$21.88	9.42%
100	-4.76%	0.00%	0.00%	-9.52%	\$19.80	-1.00%
95	-5.00%	-5.00%	-10.00%	-10.00%	\$17.82	-10.90%
100	5.26%	0.00%	0.00%	10.53%	\$19.70	-1.52%

Return Difference: -1.52%

Decisions on how to modify a portfolio in response to gains or losses in Leveraged Index Funds are of significant importance. Direxion Funds are powerful investment vehicles for investors who are looking to gain magnified exposure to the markets. We strongly urge investors to continuously monitor their positions to determine if market activity has caused them to become over- or underexposed to the given index in which they are invested. In order to remain aligned to the desired exposure, overexposed investors should consider taking some money off the table, and underexposed investors should consider additional investments. This strategy is especially important in volatile markets. These funds must be watched closely to ensure that the portfolio's exposure levels are in line with its desired objectives.

Direxion Funds encourages all potential investors to thoroughly read the prospectus to gain a full understanding of each fund's objectives and associated risks. For more information, please visit www.direxionfunds.com or call 877.437.9363.

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 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.

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