

Maneuver through gridlock to the efficient frontier



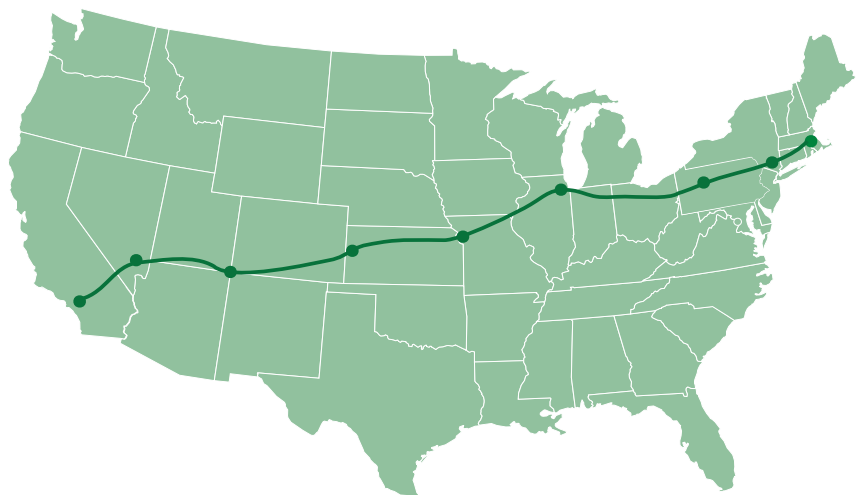
Adapt to Today's Markets via Tactical Asset Allocation

Executive Summary: In the post-financial meltdown investment world, Strategic Asset Allocation continues to be the compass used to find "True North" for investors' portfolios. Yet volatility and uncertainty provide an avenue for those who understand that exploiting inefficiencies among different asset classes creates opportunity to add value on the way to their long-term investment objectives. When applied systematically, there are tactical maneuvers and tools that investors can use to negotiate the twists and turns of today's markets – while keeping tomorrow's destination in sight.

Times Change

Just a decade ago, planning a trip from Los Angeles to Boston usually required an Auto Club membership, a phone conversation, and a "TripTik" – a series of map sections with a yellow-highlighted route through each state. It's a pretty straightforward route, actually: four major highways, and you're there. But during your trip, if an accident, road work, bad weather, or other local conditions caused a setback, you had very little choice but to sit in traffic and wait for conditions to improve. In fact, you might have had to use a couple of quarters or a calling card for the pay phone to tell the Kennedys you'd be late for dinner.

In the age of technology and the Internet, the world is now a different place. Enter a couple of addresses on your smart phone, and you have an instant, turn-by-turn route, along with a pretty good estimate of the time it will take before you're enjoying that lobster dinner in Beantown. Want to stop off in Philly for a cheesesteak? No problem – you can instantly reroute your trip, and recalculate your arrival time. In fact, now you even have access to real-time weather and traffic conditions along the way – so you can avoid sitting in the middle of the Pennsylvania Turnpike in a blizzard, with the needle on empty. Times have certainly changed.



Change Is Good

Technology has also changed the investment world. Markets are interconnected, securities trade around the clock, individuals trade foreign currency and options from their kitchen tables, as high-velocity trading desks "flash trade" in nanoseconds, thousands of times per day. Add the speed that technology allows to uncertainty, and it's not unusual for markets to move 3% or 4% in a single trading session. Some asset classes that once performed, for the most part very differently from each other, now seem at times, to be more homogeneous and more highly correlated.

Despite being developed for a different, less sophisticated marketplace, in the 1950's and '60s – around the same era as our national highway system was introduced – Strategic Asset Allocation (SAA) became the core investment philosophy followed by most investment advisors. And without a doubt, just as our highway system is still critical to our ability to travel to any destination in the country, SAA still provides key infrastructure for long-term investors.

But just as the way we travel can be made better with tools that allow us to anticipate and react to constantly changing conditions, there are investment tools and strategies available today that enable us to adapt to inefficiencies on the road to better returns.

In the post-Lehman Brothers collapse world, many of the best minds in the market are concerned that equities – typically any portfolio's largest asset allocation – will have lower average returns over the next 10 years. In this environment, many investment advisors and savvy investors question the wisdom of using Strategic Asset Allocation as the sole strategy for navigating what's believed to be a continually volatile investment marketplace.

This Road Is Well-Traveled

The SAA doctrine is well known. In general, it uses the idea of the Efficient Frontier to determine the optimal portfolio mix for different levels of risk. A portfolio's risk-adjusted returns are maximized by combining low-correlation, expected return and standard deviation of return. The risk in a portfolio of diverse individual stocks will be less than the risk inherent in holding any one of the individual stocks (provided the risks of the various stocks are not directly related – a key assumption).

For a well-diversified portfolio, the risk – or average deviation from the mean – of each stock contributes little to portfolio risk. Instead, it is the difference – or covariance – between individual stocks' levels of risk that determines overall portfolio risk. As a result, investors benefit from holding diversified portfolios rather than individual stocks.

SAA establishes and adheres to a proportional combination of assets based on expected rates of return for each asset class. For example, if stocks have historically returned 10% per year and bonds have returned 5% per year, a mix of 50% stocks and 50% bonds would be expected to return 7.5% per year. Once the allocation is determined, the portfolio is rebalanced periodically to maintain the predetermined allocation – regardless of short-term market conditions. So, like a good road map, SAA helps identify the final destination – and potentially, the best way to get there.

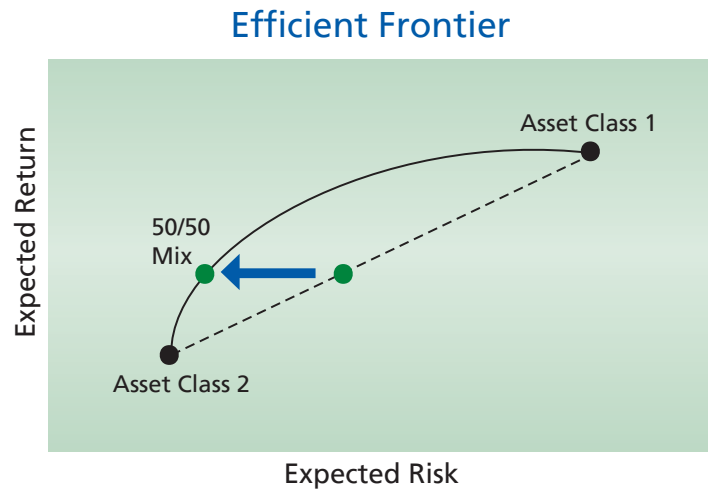
Car Fires and Detours

In the words of John Maynard Keynes: "The market can stay irrational longer than the investor can stay solvent." If you're a long-term investor navigating today's volatile markets, you can't predict the next "flash crash" oil spill, sovereign debt crisis, or bear market in China.

You also can't change your destination overnight. But you can change your route overnight, using tactical management to capture short-term directional trends to help enhance returns and reduce short-term risk.

Tactical Asset Allocation (TAA) broadly refers to active strategies that seek to enhance portfolio performance by opportunistically shifting or "tilting" the asset mix in a portfolio in response to changing patterns of returns and risk.

In the long run, a Strategic Asset Allocation strategy may be rigid enough to leave some shorter-term opportunities on the side of the road. Therefore, investors who use TAA occasionally engage in short-term, tactical deviations from the mix in order to capitalize on unusual or exceptional investment opportunities. This flexibility allows those same investors to leverage economic conditions that are more favorable for one asset class than for others – returning to their preset allocation when their desired short-term profits have been achieved. Keep in mind, however, that strategies like this demand some discipline, and the ability to recognize when to short the long-term asset position.



Drive Yourself or Hire a Car

Whether you are an active investor that has the time and resources to drive the tactical decisions in your portfolio, or an investor that prefers to leave the navigation to someone else, implementing some form of tactical allocation strategy can assist you on the road to your final destination.

Driving Yourself: How to Apply TAA to Your Portfolio

TAA strategies are not new. Although they were traditionally associated with allocating positions between two asset classes – typically shifting between stocks and bonds – recently, more complex TAA strategies have been successfully tested and implemented.

By either applying active management or implementing a single fund “buy and hold” solution, here are a few possible ways that tactical tilts may be applied to a portfolio to help in an effort to mitigate market inefficiencies:

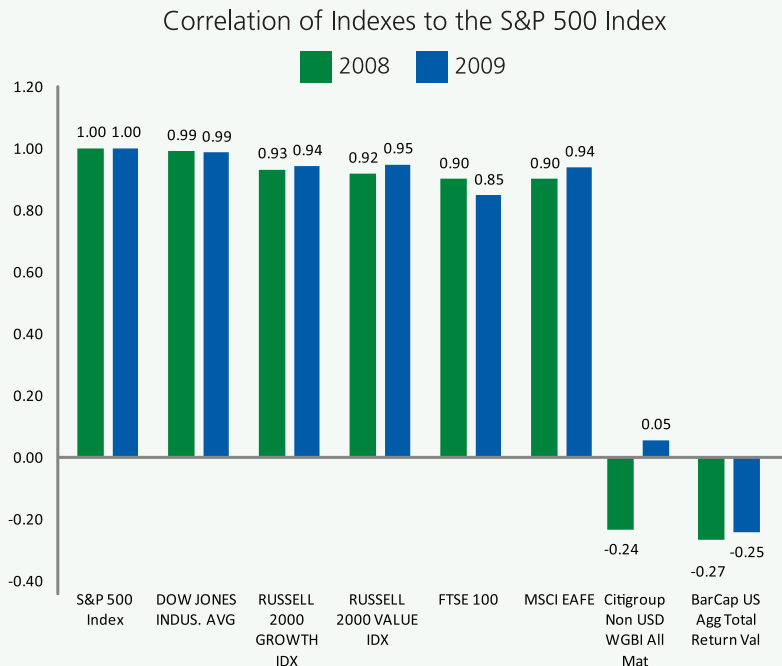
1. Incorporate extended asset classes, including alternatives like real estate and commodities

These alternative asset classes have the potential to:

- provide additional risk-adjusted returns over time to a diversified portfolio;
- offer low correlation to stocks and bonds;
- serve as an effective hedge against inflation; and
- provide greater diversification and the potential to enhance all asset allocation models.

Traditional Asset Classes Provide Inadequate Diversification

As you can see, during the 2008/2009 financial crisis, almost anywhere you invested would have been highly correlated, which is why you may want to consider alternatives.



Source: Bloomberg. The above indexes were selected to represent a broad array of asset classes. The chart above represents correlation numbers of traditional asset class indexes to the S&P 500 Index, including the Dow Jones Industrial Average (to represent US Large Cap Equities), the Russell 2000 Value and Growth Indexes (to represent US Growth and Value investments), the MSCI Europe Ex UK and the FTSE 100 (to represent continental Europe Investment), the NIKKEI 225 and MSCI Pacific ex Japan (to represent Asia Pacific Investment), MSCI Emerging Markets Index (to represent Emerging Markets investments), the BarCap US Inflation Linked Bond Index (to represent US Bonds investment), and the Citigroup Non USD Global Bonds Index (to include Global Bonds investment). The Non-Traditional Indexes represented include the Morgan Stanley Commodity Related Index and the Dow Jones Equity REIT index. This correlation is shown for the last rolling 10 years through 12/31/2009.

2. Consider short positions (in addition to long positions) in order to take advantage of trends or to hedge risk

SAA only allows for long positions, which provide returns when stocks appreciate. If investors have learned anything over the past 10 years, it's that markets move in both directions. Whether using margin, or securities with built-in short exposure, the ability to profit – or to hedge against losses – in down markets is what separates the most successful investors from all the rest.

Example: Hedging

Let's say you are happy with the recent performance of your portfolio; however, you are now anticipating a market correction and are concerned about losing recent gains. You may initially be inclined to sell portfolio holdings and move to a cash position; however, you are well aware of the disadvantages of this market-timing approach – including the possibility of incurring capital gains taxes and the prospect of missing out on future rallies.

Solution: Consider applying a hedge

Hedging is the strategy of purchasing an inversely correlated investment to reduce the risk of adverse price movements.

A hedge can help to protect your gains and reduce volatility in a declining or volatile market. In the above instance, it can provide you with the ability to stay long and still profit if the market continues to rally without having to incur taxable gains. In this case, the short position is acquired using a leveraged monthly bear 2x (inverse) mutual fund.

Strategy in Action

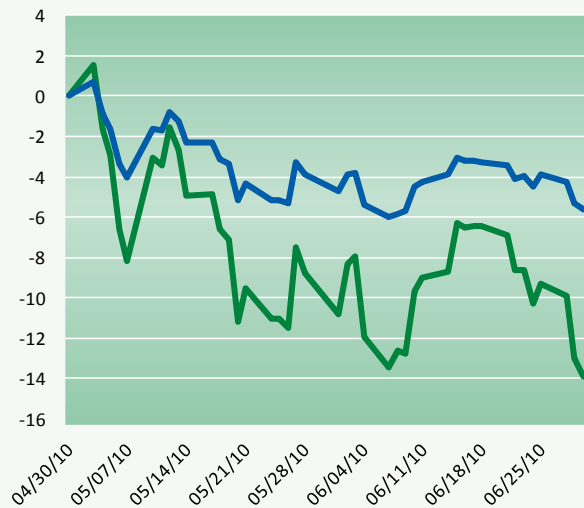
The chart below illustrates performance of two portfolios, one long only and one hedged during the period of 4/30/10 – 6/30/10 – a particularly volatile period in the equity markets.

Portfolio A Holdings: Long Only Portfolio

SPDR S&P 500	25%
iShares Russell 2000 Value Index Fund	25%
iShares Russell MidCap Index Fund	25%
iShares MSCI EAFE Index Fund	25%

Portfolio B Holdings: Hedged Portfolio

SPDR S&P 500	20%
iShares Russell 2000 Value Index Fund	20%
iShares Russell MidCap Index Fund	20%
iShares MSCI EAFE Index Fund	20%
Direxion S&P 500 Monthly Bear 2.0x*	20%



	Ulcer	Beta	Stdev	Total Return
Portfolio A	10.01	1.18	34.67	-13.89
Portfolio B	4.56	0.49	14.68	-5.59

Symbol	Fund Name	1 Yr	5 Yr	10 yr	S/I	Inception date
DXSSX	Direxion Monthly S&P 2x Fund	-41.05	-	-	-21.65	5/1/2006
SPY	SPDR S&P 500	14.89	2.25	1.34	8.03	1/29/1993
IWN	iShares Russell 2000 Value Index	24.30	3.42	8.22	9.14	7/24/2000
IWS	iShares Russell Mid Cap Index	24.44	3.95	-	8.06	7/17/2001
EFA	iShares MSCI EAFE	7.53	2.35	-	5.61	8/14/2001

*As of 9/30/2009, the investment objective of Direxion S&P 500 Monthly Bear 2.0x has changed from seeking daily investment results, before fees and expenses, of -250% of the price performance of its benchmark to seeking monthly investment results, before fees and expenses, of -200% of the price performance of its benchmark. The fund's gross/net expense ratio is 1.90%/1.90%. The performance data quoted represents past performance through 12/31/10; past performance does not guarantee future results; the investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost; current performance may be lower or higher than the performance quoted. Please call 800-851-0511 to obtain current month-end performance information. For additional information, see the fund's prospectus.

3. Apply leverage to make tactical shifts between asset classes to seek returns, reduce risk or both – without applying more capital

Example: Partial Leveraging

In this example, John has a bullish one-year outlook on stocks in the S&P 500® Index. He currently has a diversified portfolio containing a modest allocation to a popular S&P 500 mutual fund. He would like to increase his exposure to the index, but does not want to commit additional capital to invest.

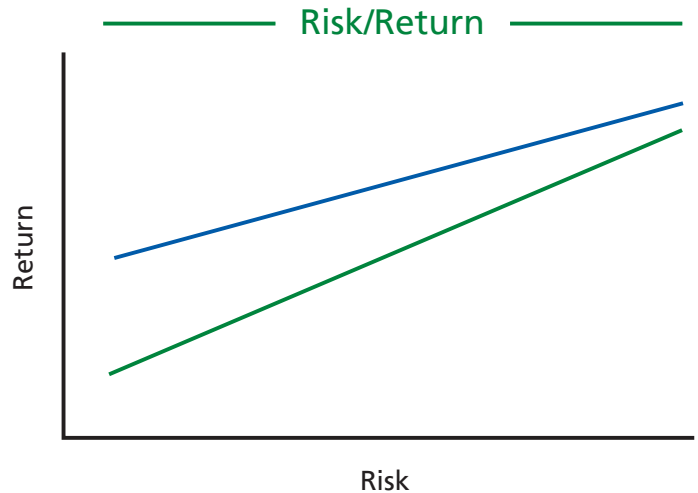
How may he accomplish this?

\$100,000 of John’s portfolio is invested in a popular S&P 500 mutual fund. By repositioning \$20,000 of the S&P 500 Fund’s assets to a Leveraged S&P 500 Bull 2x Fund, \$40,000 of additional exposure is created. The total exposure to the S&P 500 Index has now increased from \$100,000 to \$120,000 without adding more capital.

Using leveraged funds allows for improved diversification because it generates beta in excess of allocated assets. Stated differently, the capital freed up as a result of using the leveraged funds can be employed to:

- permit higher allocations to asset classes already in the traditional portfolio which have low correlations to equities and fixed income securities; and
- allocate capital to asset classes that were not previously represented.

This approach is one that has increasingly found favor with institutional investors. The augmented diversification is used to seek improvements in risk-adjusted returns – essentially extending, changing, and improving the Efficient Frontier by moving it higher on the return axis, without a commensurate increase in risk, as is shown graphically above. This higher position on the graph indicates that for each given level of risk, there is a higher expected return.



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A note about using leveraged mutual funds:

Why use leveraged mutual funds instead of margin?

Buying on margin can be used to implement a partial leveraging strategy; however, there are advantages to using leveraged mutual funds that should be considered:

- Expenses: Leveraged mutual funds may be a cheaper alternative than purchasing on margin.
- Margin calls: If the market moves away from a position bought on margin, the investor may have to provide additional capital to cover the loss. This is known as a “margin call”. An investor in a leveraged mutual fund will not receive a margin call.
- Limited loss potential: When purchasing on margin, an investor can potentially incur losses that exceed their initial investment. Investors can never lose more than their initial capital when investing in leveraged mutual funds.
- Transaction fees: When buying on margin, transaction fees are associated with most underlying investments. Direxion does not impose transaction fees, which allows advisors to move freely into and out of positions without incurring transaction costs. Internal expenses will apply, as stated in the fund’s prospectus.

Research has shown that more than 90% of the volatility in a portfolio’s return is attributable to the portfolio’s asset allocation decision over time. Use of leverage to achieve efficient beta and increased diversification allows for alpha opportunities while keeping the investor’s risk level constant. In essence, “head room” is generated in the risk budget. The remaining risk budget can be spent through over- or under-weighting specific asset classes.

Hiring The Car

If you're an investment advisor or investor who believes in Modern Portfolio Theory, but aren't happy with how it's been working for the last decade or more, considering tactical asset allocation strategies like these, as part of your overall strategy may appeal to you. If you don't have the time or resources to actively manage a tactical strategy, consider a single fund solution. There are both alternative-class mutual funds and alternative-strategy mutual funds that incorporate tactical solutions.

The **Direxion Wilshire Dynamic Fund** is a single-fund solution for investors seeking a traditional asset allocation fund that automatically adjusts to short-term trends.

Financial professionals can use the Wilshire Dynamic Fund as:

- A core portfolio holding for those who employ "core + satellite" strategies;
- The baseline allocation in a client's portfolio (while other more narrowly focused investments can be used to seek additional non-correlated returns); or
- A tracking portfolio for those advisors who wish to benchmark their own modeling and measure the value of the tactical overlay applied by Wilshire.

This paper was prepared by Direxion Funds. Direxion offers investment professionals and investors the means to seek improved risk-adjusted returns in various market conditions, through a diverse suite of tactical investment products. Our line-up of products complement your core investment strategies, with flexible, focused investment options to manage and capitalize on volatility and risk – without sacrificing performance. Should you wish to obtain any further information about Direxion, please contact us at info@direxionfunds.com, visit www.direxionfunds.com, or call 1.877.437.9363.

An investor should consider the investment objectives, risks, charges, and expenses of the Direxion Funds carefully before investing. The prospectus and summary prospectus contain this and other information about Direxion Funds. To obtain a prospectus or summary prospectus, please contact the Direxion Funds at 800.851.0511. The prospectus or summary 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, Depositary 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.



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