

Direxion Commentary on FINRA Regulatory Notice 09-31

Most leveraged and inverse leveraged ETFs currently seek to magnify the daily return of their benchmarks on a daily basis. The returns of each such ETF for periods longer than one day are the compounded product of the ETF's daily returns within the relevant period, which is not the same as the product of the ETF's daily goal and the return of the benchmark for the relevant period.

In June 2009, FINRA issued Regulatory Notice 09-31 (the "Notice") regarding leveraged and inverse leveraged ETFs. The Notice seeks to increase awareness of the implications of the daily investment goals of these ETFs to help ensure that broker-dealers satisfy their regulatory duties when making recommendations involving such ETFs. Unfortunately, the Notice included the following language: "Inverse and leveraged ETFs that are reset daily typically are unsuitable for retail investors who plan to hold them for longer than one trading session...." We believe that this statement led to concern and confusion among many member firms and portions of the financial press as to what FINRA meant and, unfortunately, may have overshadowed the broader educational message of the Notice.

Direxion shares FINRA's desire to ensure that investors understand the implications of daily leveraged and inverse leveraged investment goals. FINRA's focus on daily compounding is understandable given the adverse implications of market volatility on the performance of leveraged and inverse leveraged ETFs, a point which the Notice highlights by citing the returns for two pairs of leveraged and inverse leveraged ETFs for the five-month period from December 2008 through the end of April 2009. This illustration is valuable because it demonstrates that leveraged and inverse leveraged ETFs may not provide intuitive returns through time. This is a point that Direxion has made repeatedly. Unfortunately, however, the Notice appeared to jump from an appropriate recognition that leveraged and inverse leveraged ETFs should not be expected to provide returns through time which are the product of the stated multiple and the return of the benchmark to an incorrect assertion that such products typically are unsuitable for investors who plan to hold them for more than a single day.

Determining the timing of a purchase or sale of a leveraged or inverse leveraged ETF is a decision to be made with an understanding of such ETF's goals and performance characteristics and in light of market conditions, risk tolerance and overall portfolio composition, among other factors. A rational investor, considering all of the relevant factors and with a full understanding of the ETF's operation and performance characteristics, may decide to hold such an ETF for periods longer (and perhaps far longer) than a single day.

For instance, for the four calendar months ended June 30, 2009, a period which substantially overlaps with the period cited by the Notice, the Direxion Daily Large Cap Bull 3X Fund (BGU), which seeks to provide 300% of the daily return of the Russell 1000 Index, gained a total cumulative return of 79.63%, which is only very slightly different from 300% of the 26.72% cumulative return of the Russell 1000 Index during that same period. Further, the Direxion Daily Large Cap Bear 3X Fund (BGZ), which seeks to provide -300% of the return of the Russell 1000

Index, declined to a cumulative return of 61.19% during that same period, which is far less than -300% of the index gain. In other words, daily compounding, which can have negative implications for fund performance, had little impact on the Bull ETF and a positive impact on the Bear ETF. A reasonable investor could have held each of the ETFs for the entire period.

Foreside Fund Services (“Foreside”), the distributor for Direxion, requested guidance from FINRA regarding the Notice’s statement which suggests that leveraged and inverse leveraged ETFs typically are not suitable investments for more than one trading day. Foreside sought to clarify that broker-dealers, in fact, were not precluded from recommending these ETFs to investors who would hold them for longer than one day, and that it remained the obligation of the broker-dealer to conduct a suitability analysis with respect to each investor and the ETF. On June 29, 2009, the Investment Company Institute (“ICI”) requested that FINRA withdraw the Notice and issue a new notice that recognizes that suitability determinations rest with member firms and provides guidance as to recommendations involving non-traditional ETFs.

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Symbol	As of 6/30/09	Since Inception (%) 11/5/08	Cumulative YTD (%)	Expense Ratio Gross (%)
BGU	NAV	-43.00	-7.20	.95
	MKT Close	-42.89	-6.69	
BGZ	NAV	-41.27	-39.47	.95
	MKT Close	-41.45	-39.85	

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. For the most recent month’s performance, please visit the funds’ website at www.direxionfunds.com.

On July 13, FINRA provided additional guidance in a podcast available at <http://www.finra.org/Industry/Subscriptions/P116101>, as of July 13, 2009. This podcast includes the following statement: “Leveraged and inverse ETFs can be appropriate if recommended as part of a sophisticated trading strategy that will be closely monitored by a financial professional. At times, this trading strategy might require a leveraged or inverse ETF to be held longer than one day.”

Based on these communications with FINRA and our review of applicable regulatory guidelines, we believe that the following standards apply to leveraged and inverse leveraged ETFs:

- (1) Determinations regarding suitability are required only if a FINRA-member firm or one of its registered representatives is making a recommendation with regard to the product.
- (2) The use of the word “typically” in the Notice, in conjunction with the phrase “plan to hold,” was meant to distinguish the numerically larger community of buy-and-hold investors from tactical investors who actively monitor and manage their portfolios and who are generally users of leveraged and inverse leveraged ETFs. FINRA is concerned that buy-and-hold investors should not use these products without proper education and an appropriate mindset with regard to the portion of their portfolio dedicated to such products.
- (3) There is no one correct holding period for leveraged and inverse leveraged ETFs, and such ETFs properly may be held by educated investors for days, weeks or even a month or more, depending on market conditions and an investor’s view and goals regarding the relevant market.

(4) Determinations regarding suitability should be based on the investor's knowledge of the particular characteristics of the ETFs at issue and whether the investor actively monitors and manages his or her portfolio, as well as the performance of the ETFs under varying scenarios and holding periods.

(5) Under appropriate circumstances, broker-dealers reasonably can conclude that it is suitable to recommend that an investor hold leveraged and inverse leverage ETFs for periods of longer than one trading session.

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An investor should consider the investment objectives, risks, charges, and expenses of Direxion Shares carefully before investing. The prospectus contains this and other information about Direxion Shares. To obtain a prospectus, please visit www.direxionshares.com. The prospectus should be read carefully before investing.

Shares of DirexionShares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Brokerage commissions will reduce returns. Market Price returns are based upon the midpoint of the bid/ask spread at 4:00 PM Eastern time (when NAV is normally determined), and do not represent the returns you would receive if you traded shares at other times. Fund returns assume that dividends and capital gains distributions have been reinvested in the Fund at NAV.

Investing in index funds may be more volatile than investing in broadly diversified funds. The use of leverage by a fund means the Funds are riskier than alternatives which do not use leverage. The ETFs are not suitable for all investors and should be utilized only by sophisticated investors who understand leverage risk, consequences of seeking daily leveraged investment results and intend to actively monitor and manage their investments. The Funds are not designed to track the underlying index over a longer period of time.

The risks associated with the funds are detailed in the prospectus which include: adverse market condition risk, adviser's investment strategy risk, aggressive investment techniques risk, counterparty risk, credit risk, daily correlation risk, daily rebalancing and market volatility risk, interest rate risk, inverse correlation risk, leverage risk, market risk, non-diversification risk, shorting risk, tracking error risk, debt instrument risk, regulatory risk, gain limitation risk, U.S. government securities risk, special risks of exchange-traded funds and Real Estate Investment Risk.

Short-term performance, in particular, is not a good indication of the funds' future performance, and an investment should not be made based solely on returns.

Forside Fund Services, LLC, Distributor for Direxion Shares.