

Once Bitten Twice Shy

COMMODITIES AND YOUR STRATEGY IN 2014

Most advisors with high-net-worth clients know the value of diversification using commodities. They also know that 2013 was not a great year for the asset class in general. As the end of Q1 2014 approaches, with equity markets struggling to break through an all-time peak, you face the challenge of getting cash off the sidelines and into strategies that provide non correlating returns, while providing downside protection.

Many are still feeling the sting of their commodity investments' lackluster performance in 2013 and as a result, are apprehensive about the asset class. But maybe the asset class isn't the problem.

NOT ALL COMMODITIES ARE CREATED EQUAL –

We often hear investors refer to commodities as if they are all the same, in terms of their performance characteristics. Similar to the way we hear remarks about the “stock market” – as if all stocks are either up or down. Just as there are many different types of stocks, sectors and indexes that perform independently of each other, individual commodities' performance is no different.

A closer look into commodity performance for 2013 would reveal that although some individual commodities experienced significant draw-downs, others performed quite well. Gold, silver, corn, wheat, and sugar which all experienced double digit declines. Crude, natural gas and cotton provided modest gains.

The chart below illustrates the performance of numerous commodities annually since 2008. In fact, in each year, there are a number that return positive performance and several that don't.

Calendar years 01/01/2004 - 12/31/2013

2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
59.44% Sugar	82.55% NG	80.88% Corn	76.65% Wheat	9.15% Sugar	153.14% Copper	91.55% Cotton	14.62% H. Oil	19.19% Wheat	26.23% NG
41.30% Copper	62.39% Sugar	47.68% Wheat	74.15% Soybeans	5.77% Gold	128.20% Sugar	83.21% Silver	10.06% Gold	16.70% Soybeans	12.64% Cotton
36.96% H. Oil	52.48% Gasoline	46.40% Silver	60.75% H. Oil	-10.65% Corn	93.31% Gasoline	51.75% Corn	9.34% Gasoline	12.11% NG	7.19% Crude Oil
33.61% Crude	41.29% H. Oil	37.20% Copper	57.22% Crude	-19.29% Soybeans	77.94% Crude	46.68% Wheat	8.15% Crude	8.28% Silver	1.10% H Oil
21.44% Gasoline	40.48% Crude	23.15% Gold	54.11% Gasoline	-23.01% Silver	54.22% Cotton	33.61% Soybeans	2.78% Corn	8.00% Corn	0.88% Gasoline
14.86% Silver	39.79% Copper	13.65% Soybeans	30.98% Gold	-24.87% NG	48.16% Silver	29.96% Copper	-9.94% Silver	6.96% Gold	-7.01% Copper
5.54% Gold	29.20% Silver	3.69% Cotton	21.04% Cotton	-27.92% Cotton	46.70% H. Oil	29.52% Gold	-13.92% Soybeans	4.27% Copper	-8.30% Soybeans
-0.65% NG	21.04% Cotton	0.02% Crude	18.80% NG	-30.99% Wheat	24.36% Gold	20.17% H. Oil	-17.82% Wheat	4.04% H. Oil	-15.89% Sugar
-16.77% Corn	17.92% Gold	-6.87% H. Oil	16.72% Corn	-45.57% H. Oil	6.99% Soybeans	19.18% Sugar	-21.35% Copper	9.34% Gasoline	-22.20% Wheat
-18.44% Wheat	12.11% Soybeans	-8.96% Gasoline	14.65% Silver	-53.53% Crude	1.84% Corn	18.38% Gasoline	-27.46% Sugar	-7.09% Crude	-28.26% Gold
-31.08% Soybeans	10.33% Wheat	-19.96% Sugar	6.14% Copper	-56.53% Copper	-0.89% NG	15.17% Crude	-32.15% NG	-16.27% Sugar	-35.92% Silver
-40.36% Cotton	5.37% Corn	-43.88% NG	-7.91% Sugar	-57.36% Gasoline	-11.34% Wheat	-21.18% NG	-36.61% Cotton	-18.15% Cotton	-39.56% Corn

The S&P GSCI® is a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities. The above listed commodities represent some of the individual components of that index. They qualify for inclusion in the S&P GSCI on the basis of liquidity and are weighted by their respective world production quantities.

So the individual commodity performance matters. But what's more important to recognize, is that trying to pick which individual commodity will perform well in a given year is a difficult task, even for a professional commodities trader. The key is gaining exposure to a range of commodities so that you are able to have exposure to those that perform well, offsetting the performance of those that don't— simple asset allocation, within this class. An allocation to just gold or silver in 2013 would have left you deeper in the red than if you also had exposure to crude or natural gas.



STRATEGY MATTERS

Most traditional commodity funds rely on long-only exposure. This limits their potential because investors can only benefit when commodity prices rise. Long-only commodity strategies have shown to be unpredictable over time because:

- Commodity returns are typically cyclical and revert to the mean
- Individual commodities may perform independently of others in different market environments, and;
- Significant drawdowns² and high volatility can be damaging to the long-term performance of a portfolio.

This table shows the performance of two of the major long-only commodity indices (S&P GSCI and Dow Jones UBS) over the past ten years. Along with modest performance, they have exhibited high volatility and steep drawdowns.

Performance Metrics of Long-Only Commodity Indices (2004 – 2013)

	S&P GSCI INDEX	DJ UBS COMMODITY INDEX
ANNUALIZED RETURN	0.71%	0.87%
ANNUALIZED STANDARD DEVIATION ¹	24.76%	18.44%
MAXIMUM DRAWDOWN ²	-71.40%	-56.89%

Source: Bloomberg. Date range: 1/1/2004 – 12/31/2013. One can not invest directly in an index.

IF YOU CAN'T BEAT 'EM, JOIN 'EM.

Commodities still offer potential risk-adjusted returns over time in a diversified portfolio, but a long-only approach to this asset class is limiting.

Commodities have always been inherently vulnerable to cyclicity, and volatility. So why stay in a long-only strategy? Instead, how about a more tactical approach to commodity investing that has the ability adjust to price trends, seek to limit their downside risk?

The Direxion Indexed Commodity Strategy Fund allows investors to take advantage of rising commodity prices, and to preserve capital by going flat (to cash) when individual commodities are experiencing downward trends. Therefore, it seeks to potentially provide commodity investment returns with lower risk characteristics than long-only commodity strategies.

¹Standard Deviation – A measure of the dispersion of a set of data from its mean. The expected return of an asset, less the rate of return on a risk-free asset. This rate is denominated by the risk of that asset, which is expressed as the standard deviation of returns.

²Drawdown – The peak-to-trough decline during a specific record period of an investment, fund or commodity. A drawdown is usually quoted as the percentage between the peak and the trough. Diversification does not ensure profit or protect against loss.

Disclosures and Risks

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. To obtain a prospectus, please visit www.direxioninvestments.com or contact Direxion at 800.851.0511. The prospectus should be read carefully before investing. Investing in funds that invest in specific industries or geographic regions may be more volatile than investing in broadly diversified funds.

Investing in funds that invest in specific industries or geographic regions may be more volatile than investing in broadly diversified funds. The use of leverage by a 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.

Direxion Funds Risks - 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.