

Spotlight

Spotlight - Quality's Crushin' It

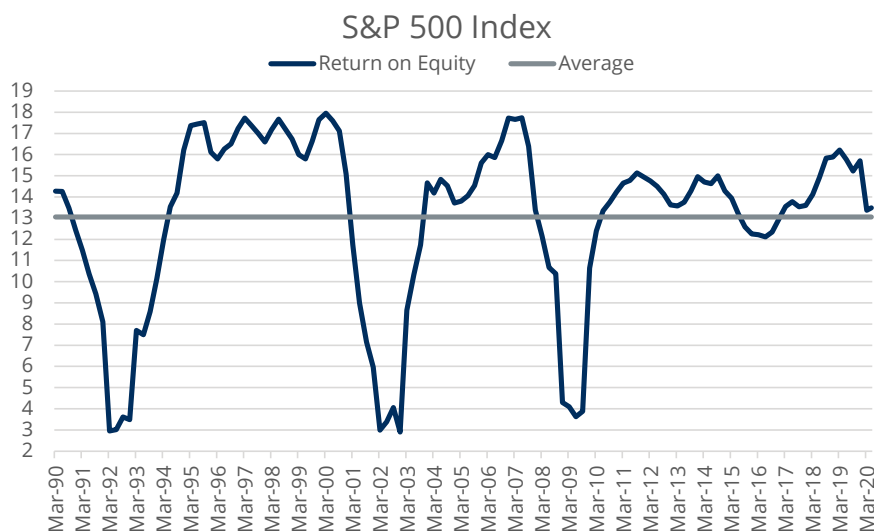
There are many terms to describe the recent outperformance of quality as an investment theme, with one of the most apt being "crushin' it." While some of the comments are bit unsavory, Urban Dictionary defines "crushin' it" as "excel beyond all foreseen abilities. To wildly surpass any goal or expectation." That hyperbole may not be seen in most financial communications, but the highest quality companies in the S&P 500 have outperformed the S&P 500 by 3.9% since markets peaked on February 19, 2020 as investors have favored firms with strong profitability and low leverage.

Why is this the case? As seen in prior downturns, firms with greater debt levels have significantly underperformed those with less debt due to concerns about their solvency. This dynamic has been particularly acute today because of the uncertainty related to future cash flows, and the ability of some companies to service the sizable debt they have taken on in recent years.

Will the Market have a Quality Problem?

- Even before the worst of the earnings contraction is taken into account, stocks are exhibiting a quality problem. Thanks to declining margins, the return on equity (ROE) of the S&P 500 fell nearly 15% in the first quarter. This was the largest drop since the Global Financial Crisis. Profit margins fell by over 14%, but still remain well above average.
- Considering that interest rates will remain low and the Fed is supporting credit markets, companies, especially investment grade ones, should not have problems increasing leverage, which will help support ROEs, assuming that margins can improve. However, as displayed below, history suggests there remains plenty of room for ROEs to fall further. This implies investors may continue to bid up share prices of stocks with high profitability as quality across the market may become scarcer without a sharp recovery in sales growth.

THE ROE OF THE S&P 500 FELL SHARPLY IN Q1

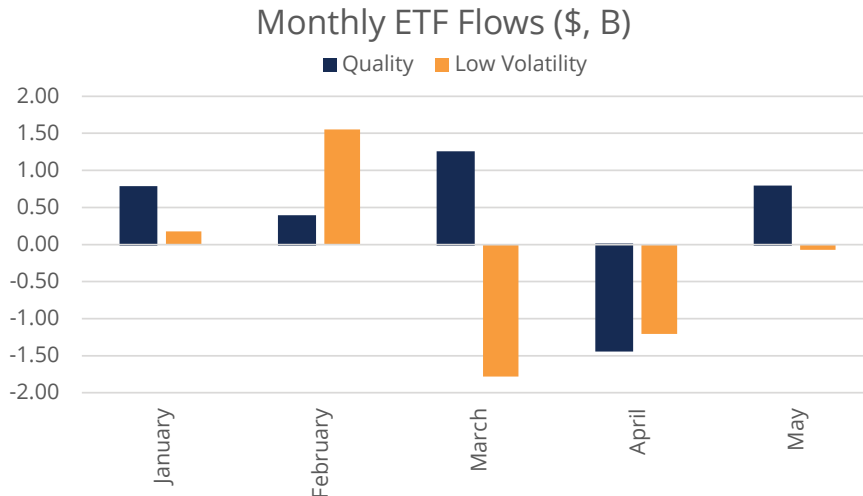


Source: Bloomberg Finance, L.P., as of May 31, 2020. Past performance is not indicative of future results. One cannot invest directly in an index.

Flows are Following Quality's Strong Performance

- Quality's over 14% return over the last year makes it the best performing factor, beating the market by nearly 3.2%, as investors have quickly learned that the factor offers attractive attributes, in both bull and bear markets, helping to drive inflows of \$5.9 billion over that timeframe.
- While conviction across the broader equity ETF landscape was mixed in May, investors added another \$0.8 billion to quality funds. Year-to-date, quality's taken in \$1.7 billion. At the same time, they redeemed \$1.3 from low/minimum volatility ETFs as investors look to another approach to bolstering portfolios that may have better upside potential, especially with the recent cyclical tilt across stocks gaining greater attention.

QUALITY'S SEEN CONSIDERABLE INFLOWS



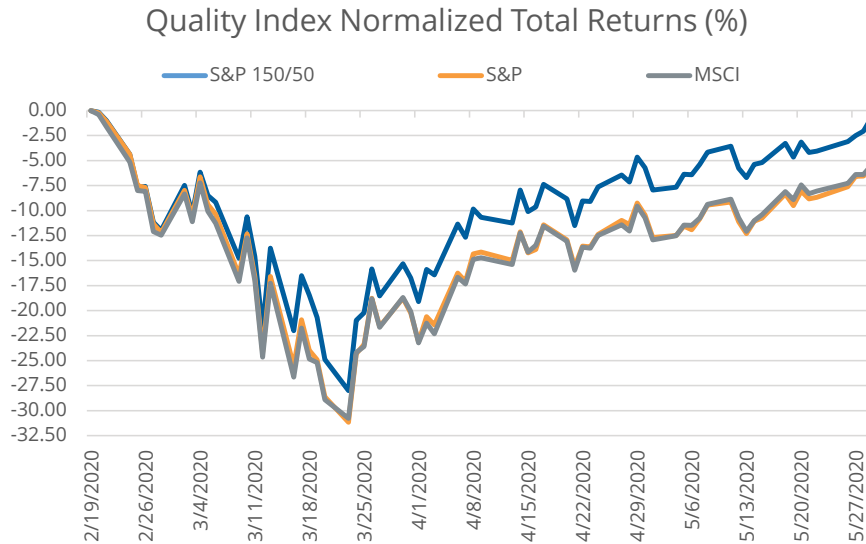
Source: Bloomberg Finance, L.P., as of January 1, 2020 to May 31, 2020. Data represents the monthly net flows of U.S.-listed Quality and Low (and Minimum) Volatility ETFs. Past performance is not indicative of future results.

Maximize Quality Your Exposure

In general, high quality companies have low levels of debt, low accruals, and boast strong profitability. Conversely, low quality companies have high debt loads, high accruals, and are relatively unprofitable. This year, being long high quality and short low quality has paid off handsomely, as investors flock to what they consider to be safer assets, but with an upside bias. Since February 19, 2020 the highest quality companies in the S&P 500 have beaten the lowest quality ones in the S&P 500 by over 8.0%.

- Investors have a range of products available to them that offer exposure to high quality stocks, with each defined in unique ways. The two largest ETFs track indices developed by MSCI and S&P Dow Jones. While there are nuances in how quality is defined, there are more similarities between the two than differences. Each offers exposure to the highest quality companies by overweighting them relative to their market capitalization weights.
- As its name implies, the S&P 500 150/50 Quality 0.30% Decrement Index offers 150% exposure to high quality stocks, balanced with negative 50% exposure to low quality ones. Consistent with academic research, an approach introducing the ability to short the junkiest stocks offers advantages because it maximizes exposure to the intended investment. Recent market action shows us the "proof is in the pudding", and that quality continues to "crush it," as the approach has outperformed the S&P 500 by over 8.8% since February 19.

CURRENT SECTOR SKEWS ARE CONSIDERABLE



Source: Bloomberg Finance, L.P., as of May 31, 2020. S&P 150/50 represents the S&P 500[®] 150/50 Quality 0.30% Decrement Index, S&P represents the S&P 500 Quality Index, and MSCI represents the MSCI USA Quality Index. Index descriptions presented under Definitions below. Past performance is not indicative of future results. One cannot invest directly in an index. Short-term performance may often reflect conditions that are likely not sustainable, and thus such performance may not be repeated in the future.

Implementation Ideas

- **The Direxion S&P 500 High minus Low Quality ETF (QMJ)** is the only ETF that offers investors long exposure to high quality stocks, with short exposure to low quality stocks helping to drive outperformance relative to the S&P 500 by 6.4% since its launch on February 5, 2020.

Index Descriptions

- **MSCI USA Quality Index:** The MSCI USA Quality Index is based on the MSCI USA Index, its parent index, which includes large and mid-cap stocks in the US equity market. The index aims to capture the performance of quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity, stable year-over-year earnings growth and low financial leverage.
- **S&P 500 Quality Index:** The S&P 500[®] Quality Index is designed to track high quality stocks in the S&P 500 by quality score, which is calculated based on return on equity, accruals ratio and financial leverage ratio.
- **S&P 500 Quality - Lowest Quintile Index:** The S&P 500[®] Quality - Lowest Quintile Index is designed to measure the performance of the 100 lowest-ranked stocks in the S&P 500 based on quality score. Quality scores are calculated based on return on equity, accruals ratio, and financial leverage ratio.
- **S&P 500 150/50 Quality 0.30% Decrement Index:** The S&P 500 150/50 Quality 0.30% Decrement Index seeks to measure the performance of a portfolio of long positions in high quality stocks and short positions in low quality stocks, as determined by S&P Dow Jones Indices, LLC. To this end, the Index consists of a portfolio that has 150% long exposure to the S&P 500[®] Quality Index and 50% short (or inverse) exposure to the S&P 500[®] Quality - Lowest Quintile Index.
- **S&P 500 Index:** Standard & Poor's[®] selects the stocks comprising the S&P 500[®] Index on the basis of market capitalization, financial viability of the company and the public float, liquidity and price of a company's shares outstanding. The Index is a float-adjusted, market capitalization-weighted index.

An investor should carefully consider a Fund's investment objective, risks, charges, and expenses before investing. A Fund's prospectus and summary prospectus contain this and other information about the Direxion Shares. To obtain a Fund's prospectus and summary prospectus call 866-476-7523 or visit our website at direxion.com. A Fund's prospectus and summary prospectus should be read carefully before investing.

Market Disruptions Resulting from COVID-19. The outbreak of COVID-19 has negatively affected the worldwide economy, individual countries, individual companies and the market in general. The future impact of COVID-19 is currently unknown, and it may exacerbate other risks that apply to the Fund.

Shares of the Direxion Shares are bought and sold at market price (not NAV) and are not individually redeemed from a Fund. Market Price returns are based upon the midpoint of the bid/ask spread at 4:00 pm EST (when NAV is normally calculated) and do not represent the returns you would receive if you traded shares at other times. Brokerage commissions will reduce returns. Fund returns assume that dividends and capital gains distributions have been reinvested in the Fund at NAV. Some performance results reflect expense reimbursements or recoupments and fee waivers in effect during certain periods shown. Absent these reimbursements or recoupments and fee waivers, results would have been less favorable.

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Direxion Shares Risks- Investing involves risk including possible loss of principal. The Fund's investment in derivatives may pose risks in addition to, and greater than, those associated with directly investing in or shorting securities or other investments. There is no guarantee that the investment strategy will be successful in identifying high and low quality stocks. Many factors can affect a stock's quality and performance, and the impact of these factors on a stock or its price can be difficult to predict. Quality stocks may underperform while non-quality stocks may perform well. There is no guarantee that the returns on the Fund's long or short positions will produce positive returns, and the Fund could lose money on either or both Fund's long and short positions. The Fund is also subject to Market Disruption Risk. Please see the summary and full prospectuses for a more complete description of these and other risks of the Fund.

Distributor: Foreside Fund Services, LLC.