

Devoted to information and portfolio strategies for the high relative strength asset class

Relative Strength measures...

the price performance of a stock versus a market average or universe of stocks. A stock's relative strength can improve if it rises more than the market in an uptrend, or goes down less than the market in a downtrend.

What's Hot...And Not

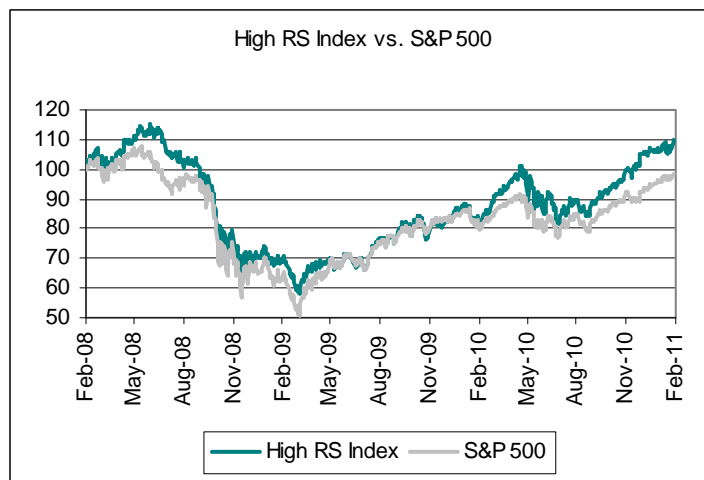
Asset Class Performance			
	12 Months	6 Months	1 Month
REIT stocks ³	37%	13%	3%
Commodities ⁵	35%	29%	4%
Russell 2000 (small stocks)	32%	23%	0%
Nasdaq Composite Index	26%	21%	2%
Emerging-markets stocks ²	22%	13%	-3%
Gold ¹	20%	13%	-5%
S&P 500-stock index	19%	17%	3%
Dow Jones Industrial Average	17%	13%	3%
U.S. corporate junk bonds ⁶	15%	8%	2%
European stocks ⁴	15%	13%	5%
Emerging-markets bonds ⁷	12%	1%	-1%
Crude oil ¹⁰	10%	13%	3%
U.S. investment-grade bonds ⁹	8%	1%	-1%
Long-term Treasuries ¹¹	4%	-7%	-4%
U.S. dollar ⁸	-4%	-5%	-2%

¹PowerShares DB Gold, ²iShares MSCI Emerging Markets ETF, ³iShares DJ U.S. Real Estate Index, ⁴iShares S&P Europe 350 Index, ⁵Green Haven Continuous Commodity Index, ⁶iBoxx High Yield Corporate Bond Fund, ⁷JP Morgan Emerging Markets Bond Fund, ⁸PowerShares DB US Dollar Index, ⁹iBoxx Investment Grade Corporate Bond Fund, ¹⁰PowerShares DB Oil, ¹¹iShares Barclays 20+ Year Treasury Bond

This is a great time to be an investor. Never before has it been easier for investors to invest in the strongest trends wherever they might be found in the world. Relative strength offers an ideal framework for allocating among those trends. **Markets are global and your portfolio should be too.**

High RS Asset Class

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 2/3/2011:



"High RS Index" is a proprietary Dorsey, Wright Index composed of stocks that meet a high level of relative strength. The volatility of this index may be different than any product managed by Dorsey, Wright. The "High RS Index" does not represent the results of actual trading. Clients may have investment results different than the results portrayed in this index.

Sector & Capitalization Snapshot

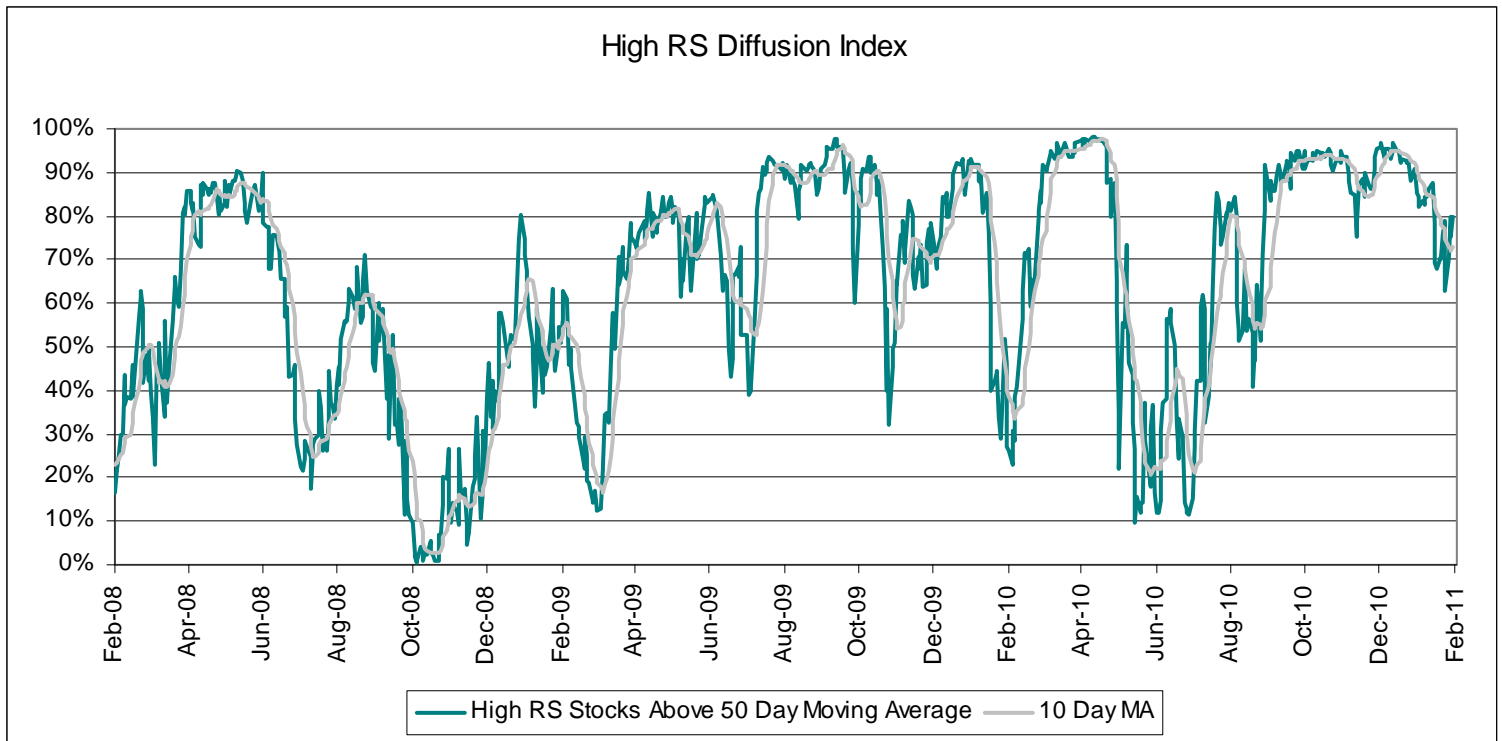
As of 2/3/2011

Performance by Sector			
S&P 500 GICS Sector	12 Month	6 Month	1 Month
Materials	31%	26%	2%
Energy	30%	32%	8%
Industrials	29%	19%	5%
Consumer Discretionary	28%	20%	0%
Technology	24%	20%	5%
Telecommunications	20%	12%	-4%
Financials	16%	11%	2%
Consumer Staples	9%	8%	-1%
Utilities	7%	4%	1%
Health Care	1%	9%	1%

Performance by Capitalization			
S&P Mid-Cap	12 Month	6 Month	1 Month
S&P Mid-Cap	31%	22%	2%
S&P Small-Cap	31%	21%	0%
S&P Large-Cap	19%	17%	3%

High RS Diffusion Index

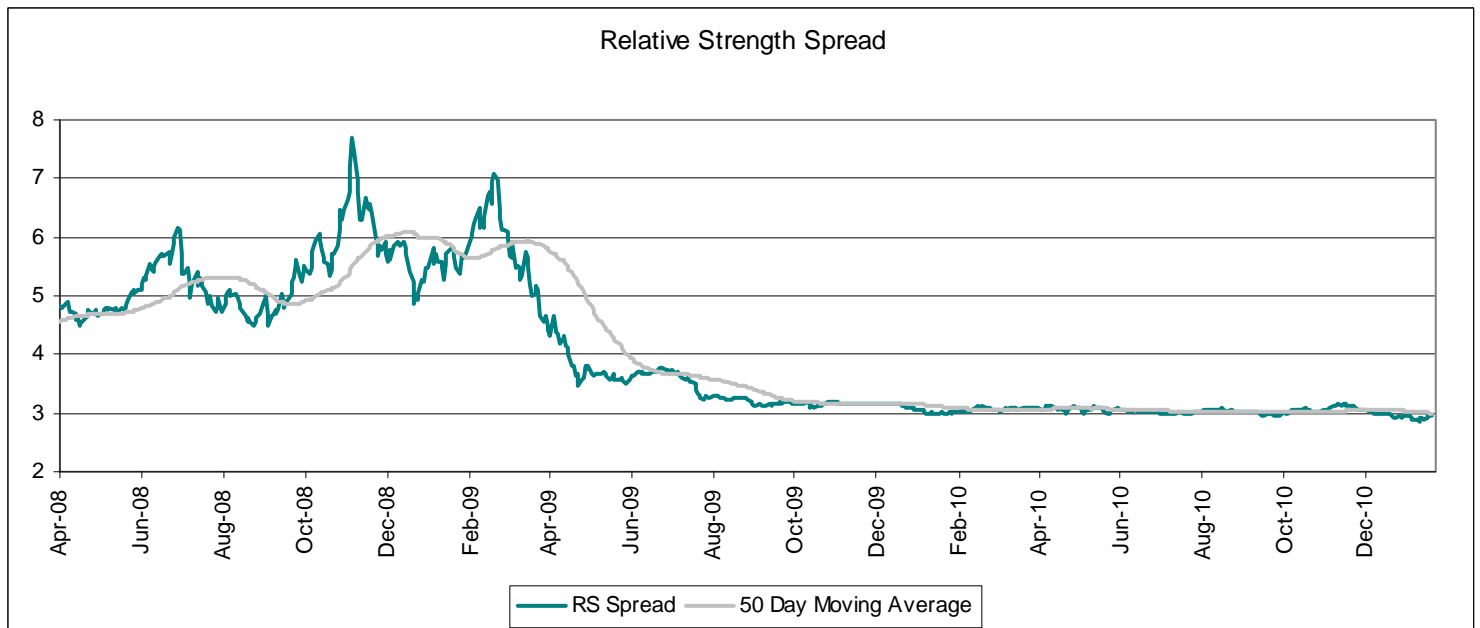
As of 2/3/2011:



The one-day measure of this index has risen to 80% after falling to 68% on January 21.

RS Spread

The chart below is the spread between the relative strength leaders and relative strength laggards (universe of mid and large cap stocks). When the chart is rising, relative strength leaders are performing better than relative strength laggards. As of 2/3/2011:



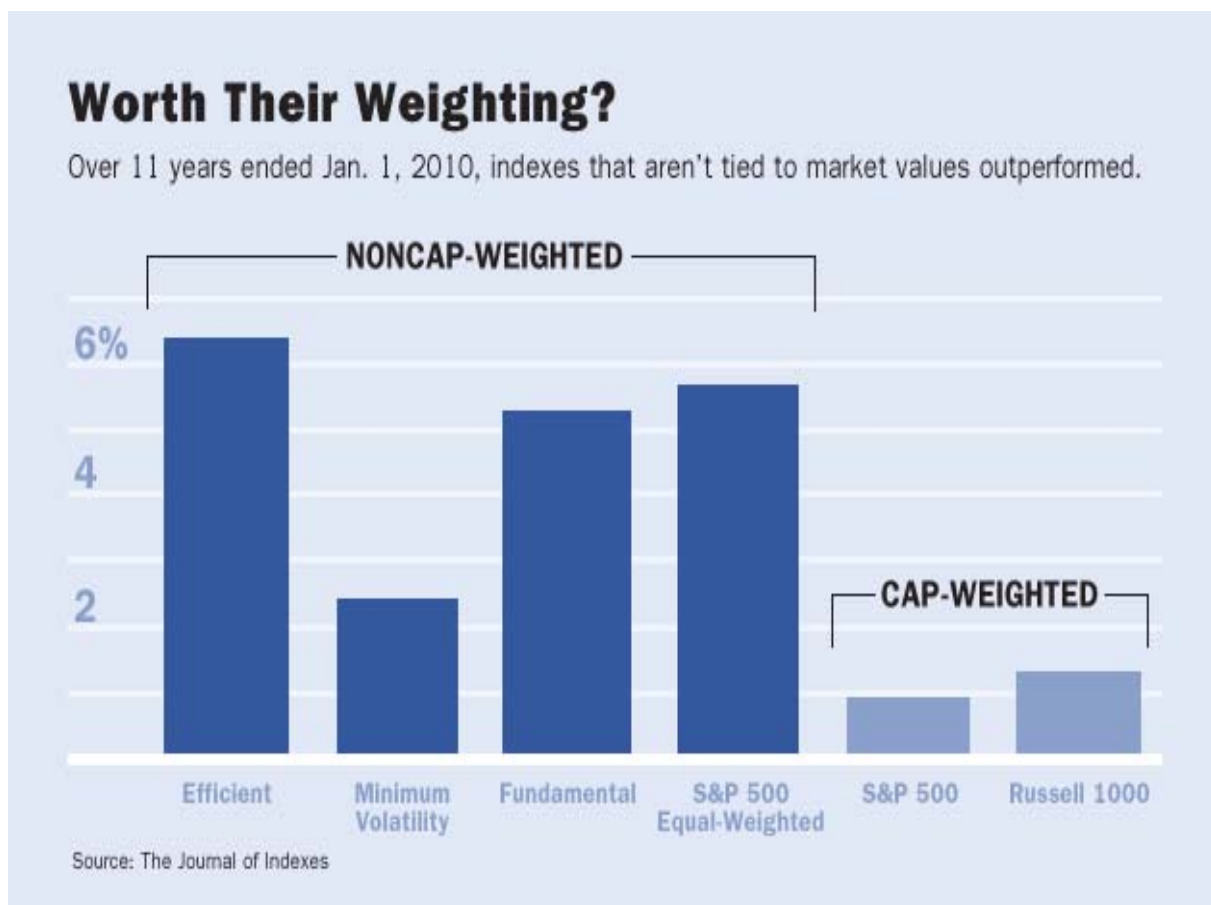
The RS Spread continues to reflect the similar performance between the top quartile and bottom quartile of the RS ranks, as has been seen over the past year and a half.

Is Your Index Fund Broken?

That's the [provocative title of a recent article in *Smart Money*](#). The article makes a controversial claim:

The Journal of Indexes gives academic treatment to bland investments, and so might not seem a likely source of hot controversy. The latest issue, however, is packed with it--and has greatly annoyed mutual fund titan Vanguard. A report therein gives new support for the claim that most index investors are unknowingly missing out on a large portion of the returns that their passive approach ought to provide.

Are investors really missing out on a large part of the passive return? The article implies that a variety of alternative weighting methods like efficiency weighting, volatility weighting, equal weighting, and fundamental weighting provide better returns than traditional capitalization weighting. ETFs are even available for some of these alternative methods, most notably equal weighting (RSP) and fundamental weighting (PRF). Over the eleven-year period cited in the article, all of them have better returns than capitalization weighting.



Source: Smart Money/The Journal of Indexes

Here's what drives me crazy: **when alternative weighting methodologies are discussed, there is always one method omitted. That method is relative strength.** Perhaps it is no surprise that over the eleven-year period cited in the article, relative strength weighting outperformed all of the other methods. (And I didn't get to cherry pick the time period--the article made that choice. If the blowout year of 2010 was included in the results, relative strength would have an even larger advantage over its rivals.)

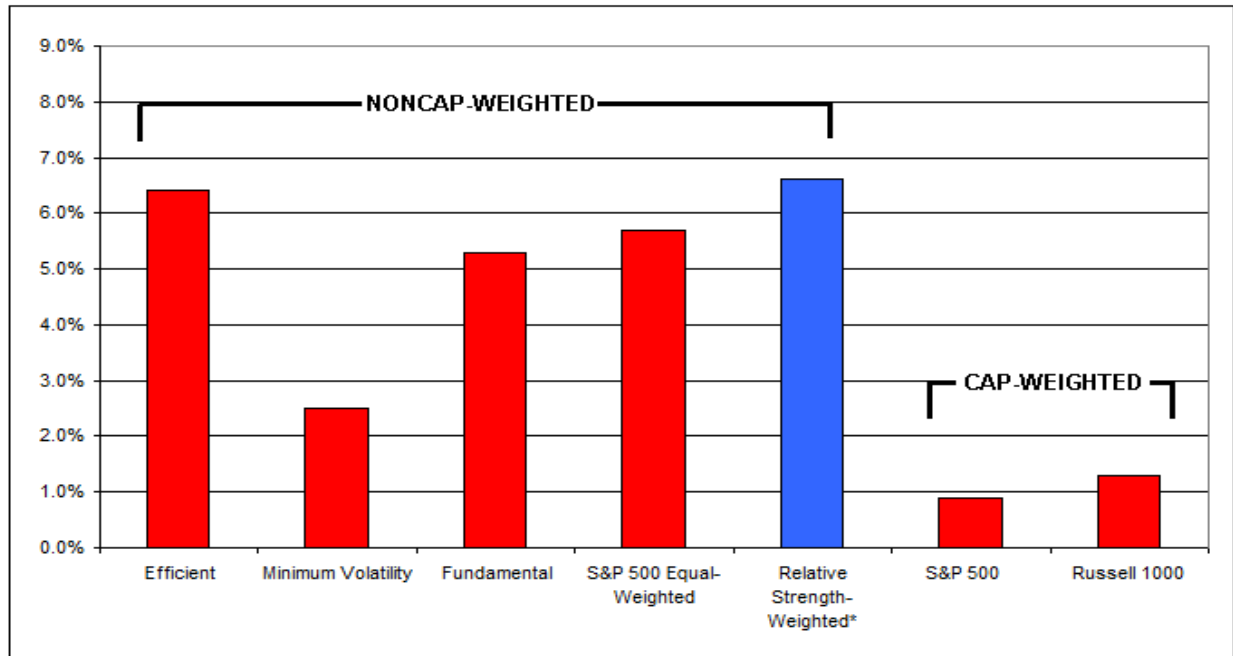
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Is Your Index Fund Broken?

It's also nice to note that there is a relative strength weighted index available, the Technical Leaders Index (PDP). Here's what the same chart looks like if relative strength weighting is included.

Worth Their Weighting?

Over 11 years ended January 1, 2010, indexes that aren't tied to market values outperformed.



*PDP

Source: The Journal of Indexes

Source: Journal of Indexes, Dorsey Wright

Why is relative strength weighting always left out? If I were cynical, I might say that relative strength is intentionally disregarded so that alternative methodologies do not have to show their comparative performance. But since I am in a charitable mood, I think the reason it is often ignored is because it is *too simple*. **Yes, too simple.**

It does not require manipulation of a massive fundamental database. It does not require equations and a mainframe computer to calculate a covariance matrix. It does not require a CFA, MBA, or PhD. (Think how much money you could save on grad school!) Instead, it requires a pocket calculator or spreadsheet and one of the many methods for measuring relative strength. We are partial to our proprietary measurements, but lots of methods work just fine. What does it say about your complicated alternative indexing method when it can be outperformed by something a middle-school student could learn to calculate?

There is one big advantage to capitalization weighting: it can be implemented in nearly infinite size. Along with theoretical reasons ("owning the market portfolio" in Modern Portfolio Theory), that may well be one reason why institutions, and Vanguard, believe it is the way to go. On the other hand, it is not really a stretch to believe that there are alternative indexing methodologies that could be designed for better performance. We think that relative strength has been demonstrated to be the simplest and most robust way to build the better mousetrap.

Fund Flows

The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). The table below is ranked in descending order based on flows for the week ending 1/26/11.

(Dollar Figures in Millions)
Net New Cash Flow

	1/26/11	YTD
Taxable Bond	3,509	11,174
Domestic Equity	3,248	5,755
Hybrid	1,941	6,186
Foreign Equity	1,875	8,717
Municipal Bonds	-2,678	-12,940

The attraction to taxable bond funds continues as they pulled in another \$3.5 billion last week, bringing the year-to-date total to \$11.2 billion. Domestic equity, hybrid, and foreign equity funds also had positive flows for the week.

Other RS Sources

Relative Strength investing has a long history of well-documented testing. Some of the best known resources in the area are:

Brush, John S. "Eight Relative Strength Models Compared." Journal of Portfolio Management (1986).

Berger, Israel, Moskowitz. "The Case for Momentum Investing." AQR Capital Management. 2009.

Jegadeesh and Titman. "Returns to Buying Winners and Selling Losers." Journal of Finance (1993).

O'Shaughnessy, James P. What Works on Wall Street. McGraw Hill, 1997.

Media Center

Powershares DWA Technical Leaders ETFs (PDP, PIE, and PIZ)

- [Is Your Index Fund Broken?](#), Jan 31, 2011
- [Thanks a Trillion!](#), Dec. 21, 2010

Arrow DWA Balanced Fund (DWAFX)

- [Banner Year For DWAFX](#), Dec 30, 2010
- [What is a Balanced Fund, and Why Should You Care?](#), Nov 15, 2010

Arrow DWA Tactical Fund (DWTFX)

- [But If Not](#), Nov 30, 2010
- [The "All-in-One Fund" With a Twist](#), Jun 16, 2010

Dorsey Wright Money Management

- [Bringing Real-World Testing To Relative Strength](#), Jan 2011
- [Relative Strength and Asset Class Rotation](#), Mar 2010

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