

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.

Feature: Thought Process



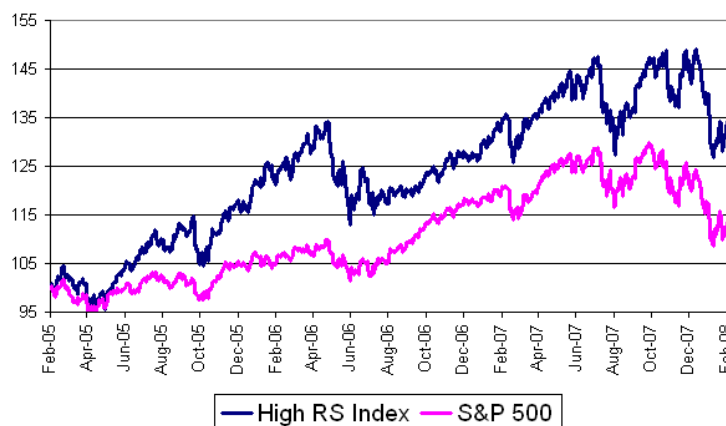
Consider the following results of a recently published study on longevity. It underscores the need to adhere to investing principles that are most likely to lead to exceptional long-term investment returns (at least for your healthy clients!) Long life spans will require large portfolios.

Laurel B. Yates, M.D., M.P.H., of Brigham & Women's Hospital, Boston, and colleagues, recently published the results of a study of a group of 2,357 men who were participants in the Physician's Health Study. At the beginning of the study, in 1981 to 1984, the men (average age 72 at that time) provided information about demographic and health variables, including height, weight, blood pressure and cholesterol levels and how often they exercised. Twice during the first year and then once each following year through 2006, they completed a questionnaire asking about changes in health habits. A total of 970 men (41 percent) lived to age 90 or older. The researchers estimate that a 70-year-old man who did not smoke and had normal blood pressure and weight, no diabetes and exercised two to four times per week had a **54 percent probability of living to age 90.**

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 2/15/08:

High RS Index vs. S&P 500



"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 2/15/08

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Energy	23.01%	8.79%	-2.62%
Materials	6.95%	11.17%	0.28%
Utilities	3.66%	4.64%	-8.03%
Consumer Staples	3.64%	4.66%	-2.20%
Industrials	-0.57%	-2.03%	1.86%
Health Care	-4.20%	-0.84%	-6.83%
Technology	-4.69%	-7.22%	-6.78%
Telecommunications	-7.15%	-9.40%	-4.16%
Consumer Discretionary	-19.59%	-8.50%	7.51%
Financials	-29.11%	-16.44%	-0.41%

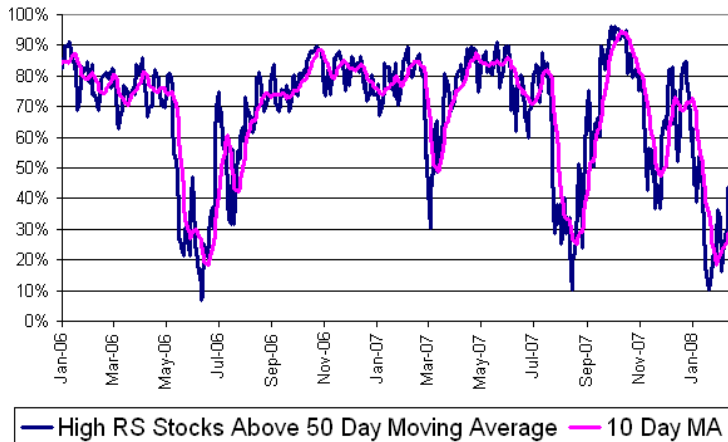
Performance by Capitalization

S&P Large-Cap	-7.31%	-4.18%	-2.19%
S&P Mid-Cap	-7.40%	-3.57%	1.36%
S&P Small-Cap	-11.08%	-6.69%	2.35%

High RS Diffusion Index

As of 2/15/08

Dorsey Wright Diffusion Index

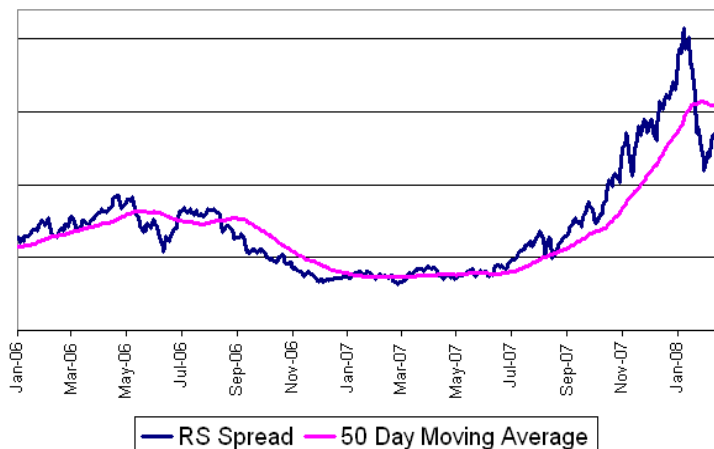


This diffusion index is a means of identifying times when High RS stocks are oversold. A longer look at this index reveals its tendency to spike off the lows. However, it can often remain overbought for extended periods of time. This indicator currently stands at 29 percent. Historically, adding money to RS strategies when oversold, as it is now, has been a good move.

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 2/15/08:

Relative Strength Spread



The first couple weeks of the year were a bit rough for RS Strategies as RS laggards performed relatively better than RS leaders. However, in the last week or two RS leaders have seen notable improvement.

RS and the Tax Bite

Those of you following the US Presidential race know that there has been much debate about whether or not to make the Bush tax cuts of 2003 permanent. All of the those tax cuts will expire by 2011 unless made permanent. A look at the Historical Federal Tax Rates since 1980 reveals that taxes on capital gains and dividends have varied dramatically:

Historical Federal Tax Rates Favor Long-Term Capital Gains

Year	Long-Term Gains Rate	Short-Term Gains Rate	Dividends
1980	28.0	70.0	70.0
1985	20.0	50.0	50.0
1990	28.0	31.0	31.0
1995	28.0	39.6	39.6
2000	20.0	39.6	39.6
2003	15.0	35.0	15.0

Source: Congressional Budget Office

While tax rates have varied, one constant has been the favored tax status of long-term capital gains versus short-term capital gains. Taxes clearly impair wealth accumulation and that is why it is so important to consider both an investment strategy's pre-tax and after-tax returns. Those strategies that generate a high percentage of short-term gains must be extremely good in order to overcome the effects of taxation.

The way that relative strength strategies adapt to new trends in the market is to sell the losers, while holding on to the winners. Not only is this good for pre-tax returns, but it is also a very tax efficient way to earn money. In the research on relative strength that Dorsey Wright published in 2005 (<http://tinyurl.com/38ooq3>) we tested two publicly known relative strength models; one of which had very high turnover and the other had more moderate turnover. As we point out in the article, the relative strength model that had more moderate turnover had superior pre-tax returns over time. That being the case, there is no good reason to adhere to a short-term relative strength strategy (high turnover) when you have the choice of also adhering to a one in which the turnover is more moderate. Even the Aggressive model of the Systematic Relative Strength accounts managed by Dorsey Wright has relatively moderate turnover.

When pre-tax and after-tax returns are considered, RS strategies stack up very favorably.

Investor Sentiment

The AAI Sentiment Survey measures the percentage of individual investors who are bullish, bearish, and neutral on the stock market short-term. Individuals are polled from the AAI web site on a weekly basis. Results as of 2/13/08:

	2/13/2008 Results	Long-Term Average
Bullish	33.33%	39%
Neutral	24.81%	32%
Bearish	41.86%	29%

Individual investor sentiment has improved some in recent weeks. After reaching extreme bearishness in January (59% bearish on 1/24/08), bearishness has receded to 41%. While improved, it is still above the long-term average. The stock market has essentially moved sideways since the extreme bearish readings seen in late January. Using extreme bearish sentiment measures as an opportunity to add money to accounts has historically proven fruitful for investors.

Other RS Sources

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

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

Earnings Growth, P/Es and Relative Price Strength, Robert A. Levy and Speros L. Kripotos, Financial Analysts Journal, 1967

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

Momentum Strategies, Louis K.C. Chan, Narasimhan Jegadeesh, and Josef Lakonishok, Journal of Finance, 1996.

Media Center

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

- Powershares to Expand Family of DWA Technical Leaders Portfolios, *Yahoo! Finance*, Dec 21, 2007
<http://tinyurl.com/37cay2>
- New ETF follows trends based on technical factors, *MarketWatch*, Mar 2, 2007
<http://tinyurl.com/2qt6cd>

Arrow DWA Balanced Fund (DWAFFX)

- Arrow DWA Balanced Fund Hits \$100 Million in Assets, *Marketwire*, September 11, 2007
<http://tinyurl.com/336e6u>

Dorsey Wright Money Management

- Can Relative Strength Be Used in Portfolio Management?, *Technical Analysis of Stock & Commodities*, Aug 2005
<http://tinyurl.com/38ooq3>
- Systematic Relative Strength Investment, *The Wall Street Transcript*, Jan 29, 2007
<http://tinyurl.com/2m7cls>

To Request Info

To request information about our Systematic Relative Strength accounts, please call us at 626-535-0630, or e-mail us at moneymanagement@dorseywright.com

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