

*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.

## Thought Process-Buying Losers

I cringe every time I read an article by a value investor that says something like, "You should buy stocks that are on sale, just like you buy [pick your consumer item] on sale." In the financial markets that can be dangerous. In a great essay titled, [I Want to Buy Losers](#), Clay Allen of Market Dynamics explains why this analogy is bunk:

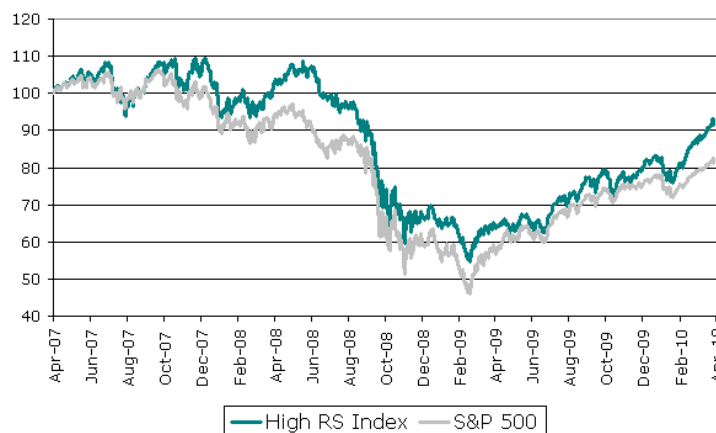
*Many investors buy stocks the way many consumers buy paper towels or any other staple. They are attracted to a sale and loss leaders are a proven method for a retailer to increase the traffic in their store. The value of the item is well known and a sale price gets the attention of potential buyers... But stocks are not like paper towels. Paper towels can be used to satisfy a need and this is what gives the item its value to the consumer. What gives a stock its value? A stock cannot be used to satisfy a need or accomplish a task. The value of a stock is derived from the financial performance of the company, either actual or expected. The fact that the stock is down in price is usually a sure sign that the financial performance of the company is declining...if the value of the stock was constant, then buying bargain stocks would be the correct way to invest in stocks. But stock values are constantly changing as business conditions change for the company and the expectations of investors change.*

In investing, the *expectations* are what counts. Let's face it: strong stocks are usually strong because business conditions or fundamentals are good, and weak stocks are usually weak for a reason.

## High RS Asset Class

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 4/16/2010:

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 4/16/2010

### Sector Performance

	S&P 500	GICS Sector	12 Month	6 Month	1 Month
Consumer Discretionary		54%	21%	6%	
Industrials		51%	18%	5%	
Financials		49%	7%	4%	
Technology		48%	14%	4%	
Materials		41%	7%	2%	
Health Care		29%	8%	-1%	
Consumer Staples		26%	5%	1%	
Energy		25%	-1%	2%	
Utilities		16%	0%	-1%	
Telecommunications		1%	4%	1%	

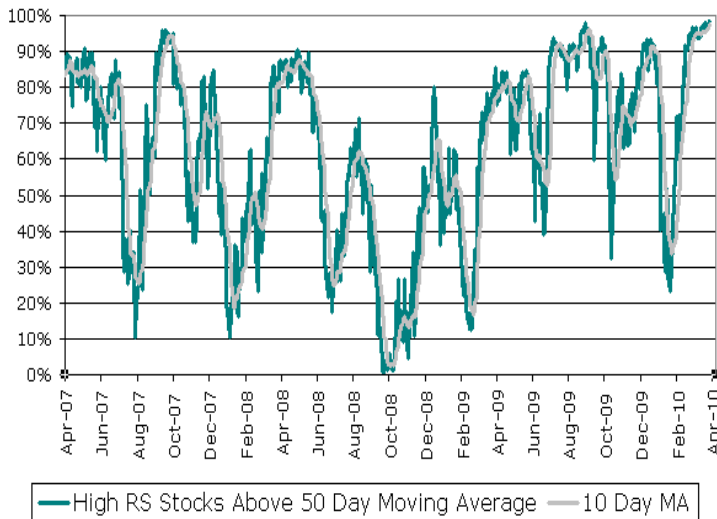
### Capitalization Performance

S&P Mid-Cap	51%	16%	4%
S&P Small-Cap	51%	16%	5%
S&P Large-Cap	38%	10%	3%

## High RS Diffusion Index

As of 4/16/2010

High RS Diffusion Index

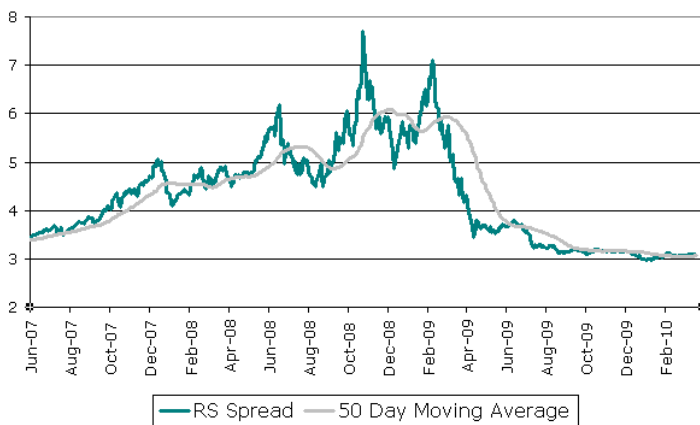


The 10-day moving average of this indicator is 97% and the one-day reading is 98%. This oscillator has shown the tendency to remain overbought for extended periods of time, while over-sold measures tend to be much more abrupt.

## 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 4/16/2010:

Relative Strength Spread



The sharp decline in the RS Spread during much of 2009 has transitioned to a flat relative strength spread that may very well be setting the stage for a favorable environment for RS.

## The Taxman Cometh

*The difference between death and taxes is death doesn't get worse every time Congress meets. — Will Rogers*

I suspect that if the wealthiest 10 percent of Americans were surveyed to find out if they believed that the best stock market returns came when tax rates were relatively high or if they came when tax rates were relatively low (compared to tax rates over the past century) that the results would fall on the side of believing that low tax rates and high stock market returns go together. That is certainly what I would have guessed...until I read John Buckingham's [recent blog post](#) analyzing the data over the past 84 years.

Using data from *The Tax Foundation* and *Ibbotson*, Buckingham pointed out that the average tax rate from 1926-2009 was 46% with a median of 50%. Using that median as the dividing line, here are the non-annualized equity performance figures:

	Large Company	Small Company
Average Return, When Tax Rate $\geq$ 50%	10.95%	16.07%
Average Return, When Tax Rate $<$ 50%	11.87%	17.19%
Median Return, When Tax Rate $\geq$ 50%	14.30%	18.39%
Median Return, When Tax Rate $<$ 50%	12.25%	12.11%

I certainly wouldn't use this data to suggest that high tax rates and big government are the way to go, because I don't. However, I think it is a safe assumption that taxes are going up in the next decade. After all, the new healthcare legislation will bring a number of new taxes starting in 2013 and the tax on long-term capital gains rises from 15% to 20% starting in 2011.

Surely, there are more taxes to follow. However, this does not mean that the stock market has to tank. We have to remember that the stock market even generated excellent returns in the 1950s when the top tax rate ranged from 59-75%! As wealthy investors consider whether or not to commit capital to the stock market in the coming decade, rising taxes shouldn't necessarily be a factor that deters them.

## 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). Flow estimates are derived from data collected covering more than 95 percent of industry assets and are adjusted to represent industry totals. The table below is ranked in descending order based on flows for the week ending 4/7/2010.

Asset Class	4/7/2010
Taxable Bond	6,134
Foreign Equity	2,905
Domestic Equity	1,939
Hybrid	1,241
Municipal Bond	352

The affinity for taxable bonds among retail mutual fund investors continued in the week ending 4/7.

## 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)

- [Under the Microscope: Powershares DWA Technical Leaders ETF](#), *Seeking Alpha*, Mar 31, 2010

Arrow DWA Balanced Fund (DWAFF)

- [DWAFF Reaches New Milestone](#), Aug 13, 2009

Arrow DWA Tactical Fund (DWTFF)

- [DWTFF: Good Marks After 3 Months](#), Nov 4, 2009

Dorsey Wright Money Management

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

## Blog

Visit (and bookmark!) our blog at [www.systematicrelativestrength.com](http://www.systematicrelativestrength.com)

## To Request Info

To request information about our Systematic Relative Strength accounts, please call us at 626-535-0630, or e-mail us at [moneymangement@dorseywright.com](mailto:moneymangement@dorseywright.com) or click [here](#).

Dorsey, Wright Money Management  
595 E. Colorado Blvd, Suite 518  
Pasadena, CA 91101  
(626) 535-0630