Dorsey Wright & Associates Money Management

High RS Newsletter

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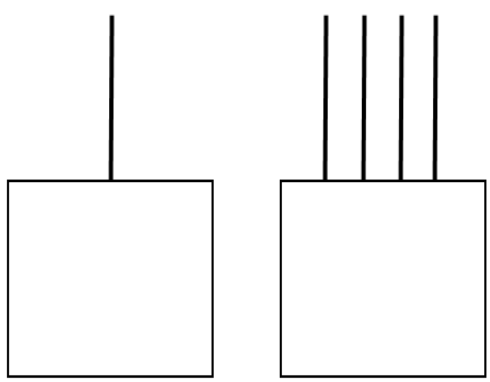
Devoted to information and portfolio strategies for the high relative strength asset class

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



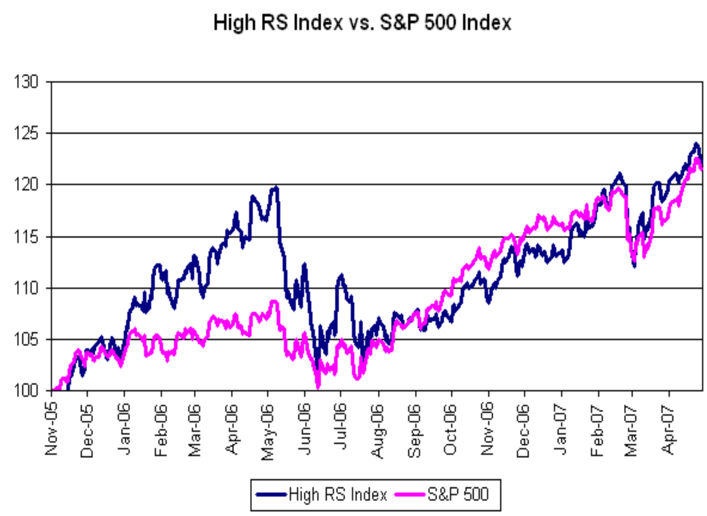
Which elevator would you choose to ride in?

Wouldn't you choose the elevator supported by multiple cables? If one cable were to falter, there are other cables to smooth out the ride. In similar fashion, advisors who provide an allocation for a client that mixes various uncorrelated value-added strategies can help their clients enjoy the benefits of true diversification.

High relative strength stocks have historically provided high returns, but they often do not correlate very well with the broad market. For that reason, high relative strength stocks frequently appear to act like a separate asset class. From an asset allocation perspective, there is significant value in a high-return asset class that is uncorrelated with most other stocks and bonds.

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 4/30/07:



"High RS Index" is a proprietary Dorsey, Wright Index composed of stocks that meet a high level of relative strength

Sector & Capitalization Snapshot

As of 4/30/07

Sector Performance

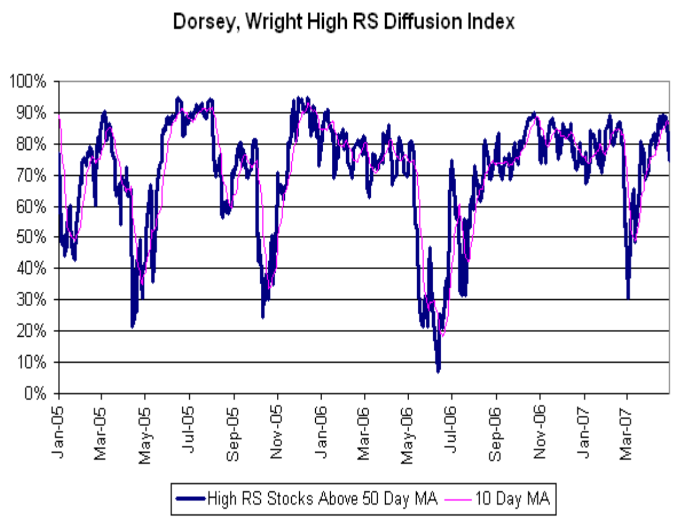
S&P 500 GICS Sector	12 Month	6 Month	1 Month
Utilities	32.84%	16.25%	4.13%
Telecommunications	27.76%	10.58%	0.07%
Health Care	16.78%	7.98%	7.10%
Materials	15.61%	15.72%	1.93%
Consumer Staples	15.29%	5.82%	3.18%
Energy	14.57%	14.55%	5.21%
Consumer Discretionary	14.40%	4.45%	2.50%
Financials	9.24%	4.26%	3.98%
Technology	9.20%	6.45%	5.40%
Industrials	7.63%	8.14%	4.71%

Performance by Capitalization

S&P Large-Cap	12.78%	7.59%	4.42%
S&P Mid-Cap	8.27%	10.47%	2.77%
S&P Small-Cap	6.65%	7.34%	2.16%

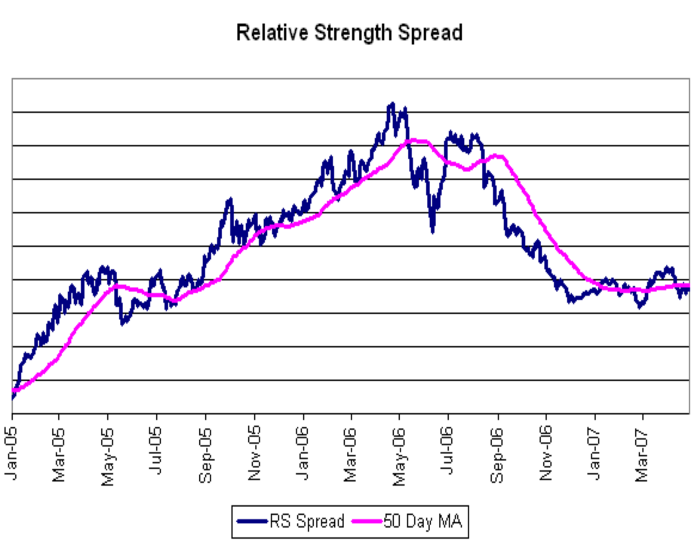
High RS Diffusion Index

For high RS strategies, dips are often a good time to add exposure. As of 4/30/07



RS Spread

The chart below is the spread between 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. When investors are confident in market leadership, they continue to buy into strength. When investors are risk averse, they tend to sell into strength and buy into weakness. RS strategies tend to perform the best when the RS spread is rising. As of 4/30/07

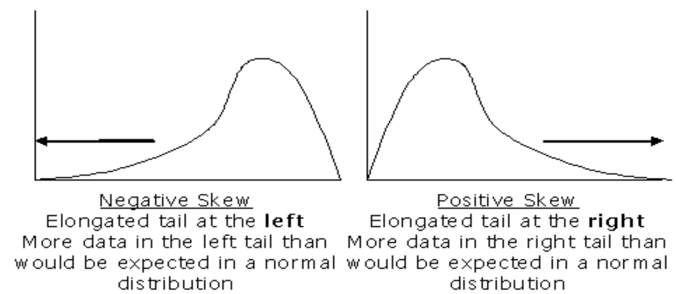


The RS Spread is showing signs of improvement after declining for much of the past year.

Skew Data

In the stock market, at any given time there are stocks in a strong positive trend, stocks in a strong negative trend, and a majority whose trend is currently static. Relative Strength strategies make their money on the edges of the bell curve—from those stocks which are large positive outliers.

Relative strength strategies exhibit a positive skew return profile because the trading methodology eliminates losing positions and holds profitable positions.



Strategies that have frequent small winners (such as selling puts for example) and infrequent large losses are often very appealing to investors because of the allure of the small steady returns. Such negative skew strategies cater to investors' biases. The problem is that these strategies are the ones most likely to blow up. It has been demonstrated that the stock market is not normally distributed (*The MisBehavior of Markets, Madelbrot, 2004).* Extreme values of a distribution are frequently underestimated. There is a clear difference between strategies with positive skew and those with negative skew. **One gambles dollars to win a succession of pennies. The other risks a succession of pennies to win dollars.** While the former (negative skew) is more appealing to the masses, we believe the more financially rewarding strategy is the latter (positive skew). There is also a significant difference in risk management. While a strategy with negative skew may be right 95% of the time, that 5% of the time when it is wrong doesn't just lead to a bad quarter, it leads to the end of business. A relative strength strategy, on the other hand, often has many small losses, and a few large winners. Investors sometimes get caught up on the fact that that there are many small losses. They shouldn't. What is important is the effect that the strategy has on the overall risk management and on the overall returns.

Sentiment: On the Analyst's Couch

Cavemen and Investors:

Investors generally don't act like rational Wharton MBAs. Rather, investors most often act as would a caveman. Consider the caveman who is minding his own business in his cave when all of the sudden he hears a growl behind him. He has two options—he can immediately turn around and find out if this is a herbivore or a carnivore. If a herbivore, no problem. If a carnivore, the caveman must then ascertain if it is a well-fed carnivore or a hungry carnivore. If it is the latter…he is in trouble. Otherwise, he is in good shape. Or, the caveman can simply run like hell once he hears the growl. **We are all descendents of the latter type of caveman!** Such behavior led to survival as a caveman, but unfortunately leads to very poor results as an investor. (Analogy by Jonathan Golub, *JPMorgan Chase*)

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 ETF (PDP)

- New ETF follows trends based on technical factors, *CBS Marketwatch,* Mar 2, 2007
  http://tinyurl.com/2qt6cd

- New ETFs start trading on the NYSE, AMEX, *Reuters*, Mar 1, 2007
  http://tinyurl.com/2uw4mu

Arrow DWA Balanced Fund (DWAFX)

- Fund of ETFs Leads Way for Moderate Allocation, Arrow Funds, Feb 21, 2007
  http://tinyurl.com/2j56ow

General

- 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
  PDF available upon request

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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