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.

ETF Investors Shoot Themselves in the Foot

Proving that retail investor emotionality is consistent regardless of the investment vehicle, it turns out that ETF investors are no better at timing than mutual fund investors. In an Index Universe article entitled ETF Investors Are Horrible Market Timers, Olivier Ludwig reports:

"Just do the opposite of what ETF investors do and you'll do OK," Vincent Deluard, the author of the study, said in a telephone interview. "The ETF is an inexpensive and relatively efficient way to invest passively. But the problem comes from ETF investors who try to time the market."

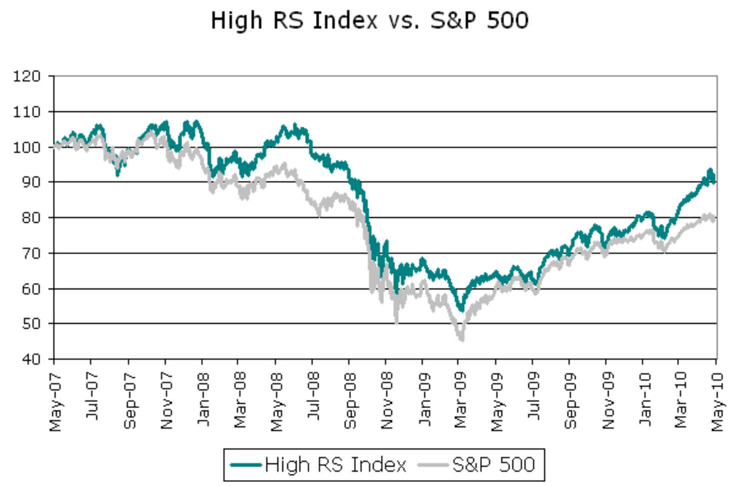
The study found that **literally doing the opposite** of what retail investors were doing (based on the fund flows) was quite profitable, as opposed to what ETF investors actually did. The author of the study at TrimTabs had some advice for investors:

"When you don't know anything about the market, you should buy and hold. But because ETFs are so liquid, they give a false sense of power, especially if you look at the leveraged stuff," Deluard said. "It's spectacular how much money people lose in those things."

Contrast the emotional trading of retail investors with a systematic strategy of asset class rotation. There's no comparison. According to studies, systematic asset class rotation can lead to outperformance over time, while individual investors just tend to shoot themselves in the foot.

High RS Asset Class

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 4/30/2010:



"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 4/30/2010

Sector Performance

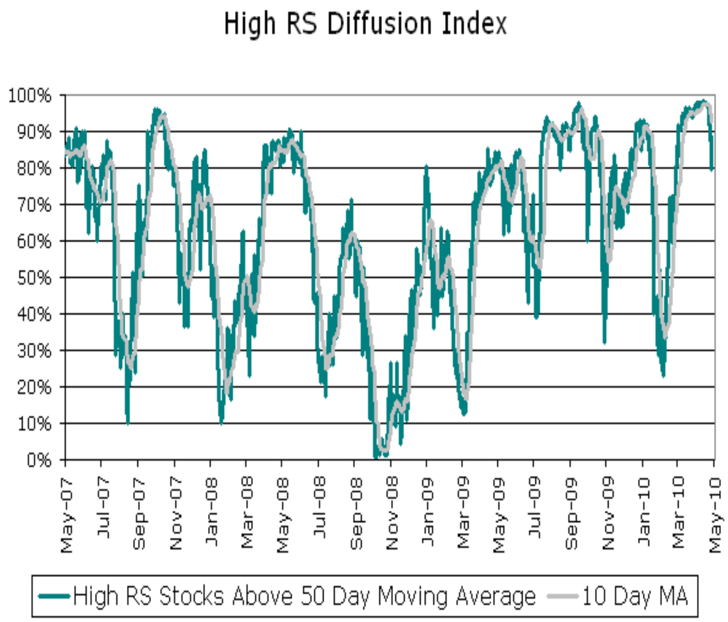
S&P 500 GICS Sector	12 Month	6 Month	1 Month
Financials	50%	15%	1%
Consumer Discretionary	49%	30%	5%
Industrials	49%	29%	3%
Technology	42%	15%	1%
Materials	34%	16%	0%
Health Care	28%	10%	-4%
Energy	26%	6%	5%
Consumer Staples	26%	7%	-2%
Utilities	18%	7%	2%
Telecommunications	2%	3%	-2%

Capitalization Performance

S&P Mid-Cap	47%	25%	3%
S&P Small-Cap	46%	27%	5%
S&P Large-Cap	36%	15%	1%

High RS Diffusion Index

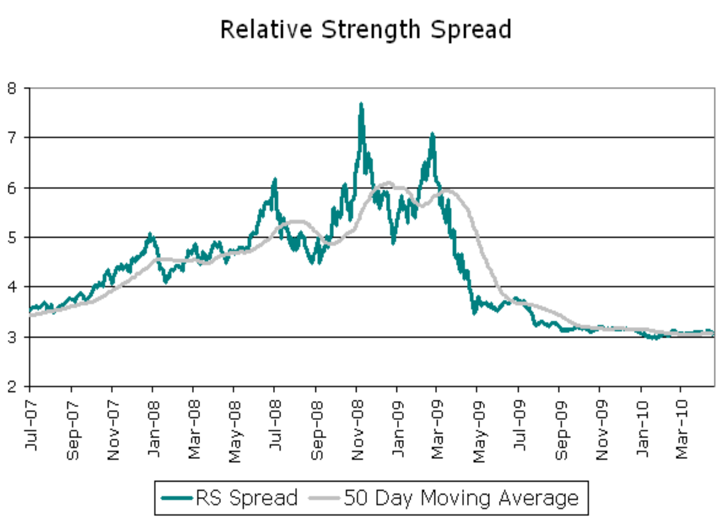
As of 4/30/2010



The 10-day moving average of this indicator is 93% and the one-day reading is 80%. This oscillator has shown the tendency to remain overbought for extended periods of time, while oversold 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 4/30/2010:



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.

Managing Future Inflation Risk

One of the many risks investors have to deal with, especially bond investors, is inflation risk. PIMCO has a paper out entitled "A Diversified Real Asset Approach for Managing Future Inflation Risk" that is worth reading. They discuss one way of dealing with inflation through using real assets, the most liquid of which are:

... inflation-linked bonds (including Treasury Inflation-Protected Securities, or TIPS), commodities, real estate investment trusts (REITs) and commodity-related equities.

The authors also endorse tactical asset allocation:

This "one-third, one-third, one third" benchmark is also a good starting point for actively managing the mix of asset classes, which can be an important tool for enhancing the overall effectiveness of the diversified real asset strategy. As the drivers of future inflation risk naturally evolve, relative attractiveness across these three real asset classes will change, since they each respond differently to different inflation drivers. A rigorous asset allocation methodology that can identify macroeconomic and sector-specific risks and opportunities may add value for investors by tilting the real asset mix around the static benchmark weights.

Systematic relative strength provides just such a rigorous approach. It should be a comfort to know that all of these asset classes used to manage inflation risk are included in the investment universe of our global tactical allocation products, such as the Global Macro separate account, the Arrow DWA Balanced Fund, and the Arrow DWA Tactical Fund. The investment universe of those products, however, does not stop at inflation hedges. They are also fully capable of adapting to environments with a strong equity focus, whether domestic or international, or a strong defensive focus, where cash, short-term bonds, or inverse positions (Global Macro and Arrow DWA Tactical Fund) might be in vogue. Whether the world economy faces deflation or inflation in the future, flexible allocation across a broad universe should allow a rigorous tactical process to adapt.

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 4/21/2010.

Asset Class	**4/7/2010**
Taxable Bond	5,945
Domestic Equity	2,864
Foreign Equity	1,893
Hybrid	1,169
Municipal Bond	710

Taxable bonds were still on top for the week ending 4/21/10, but equities also saw some decent inflows.

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)

- Four Alpha-Seeking ETFs Crushing SPY, *ETFdb*, Apr 30, 2010
- Under the Microscope: Powershares DWA Technical Leaders ETF, *Seeking Alpha*, Mar 31, 2010

Arrow DWA Balanced Fund (DWAFX)

- DWAFX Reaches New Milestone, Aug 13, 2009

Arrow DWA Tactical Fund (DWTFX)

- DWTFX: Good Marks After 3 Months, Nov 4, 2009

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- *Bringing Real-World Testing To Relative Strength*, Jan 2010
- *Relative Strength and Asset Class Rotation*, Mar 2010

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