

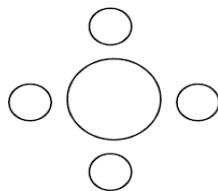
Devoted to information and portfolio strategies for the high relative strength asset class

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

Core-Satellite Investment Strategies



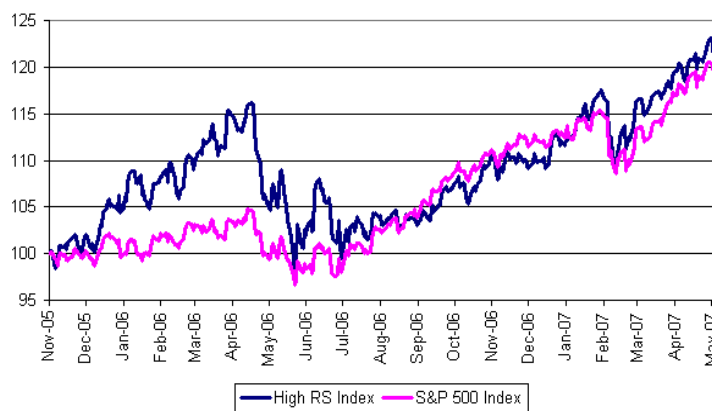
Typically, a Core-Satellite structure consists of an index like a core manager surrounded by satellite managers who are seeking to add value, or alpha. Often the choice for the core is an index fund. **If done properly, the core-satellite approach can improve returns, reduce risk, or both.** The approach of Core-Satellite has been around for decades and has historically been most often employed by institutions. Recently with the wide adaptation of exchange traded funds, growth in the use of Core-Satellite investing for retail clients has occurred. According to a joint On Wall Street-Cerulli Associates survey, nearly 11% of brokers always use core-satellite portfolios, and another 30% do so most of the time.

The satellite portion of an equity portfolio can be made from many sources. Alternative assets, hedge funds, REITs, commodities, options, Micro Caps, foreign currency, Emerging Markets, and International Small Cap are just a few of the frequently used asset classes. 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, making them an ideal candidate for a satellite portfolio.

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 5/25/07:

High RS Index vs. S&P 500 Index



"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 5/25/07

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Telecommunications	42.33%	21.99%	7.21%
Utilities	31.01%	13.42%	-3.75%
Energy	26.73%	17.69%	5.13%
Materials	25.75%	14.94%	1.69%
Health Care	20.73%	11.19%	0.62%
Consumer Discretionary	18.37%	4.74%	-0.19%
Information Technology	18.36%	3.30%	1.58%
Financials	15.03%	4.20%	0.24%
Consumer Staples	14.18%	7.04%	-0.48%
Industrials	12.72%	8.33%	3.44%

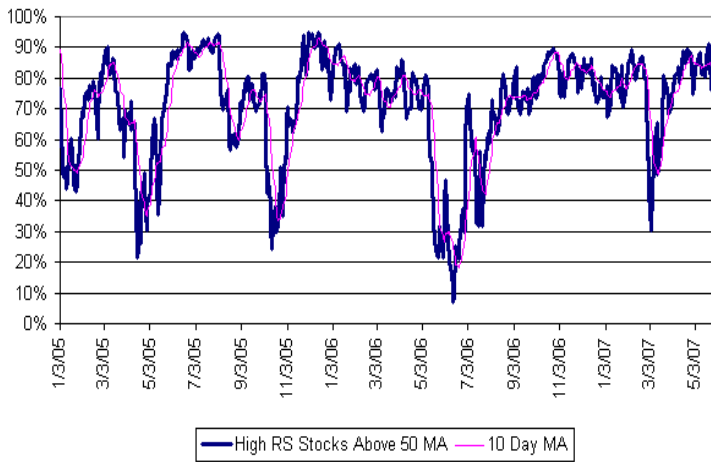
Performance by Capitalization

S&P Large-Cap	18.76%	8.08%	1.48%
S&P Mid-Cap	17.40%	10.46%	1.31%
S&P Small-Cap	13.66%	7.12%	0.60%

High RS Diffusion Index

A large percentage of stocks with high relative strength continue to trade above their 50 Day Moving Average. As of 5/25/07

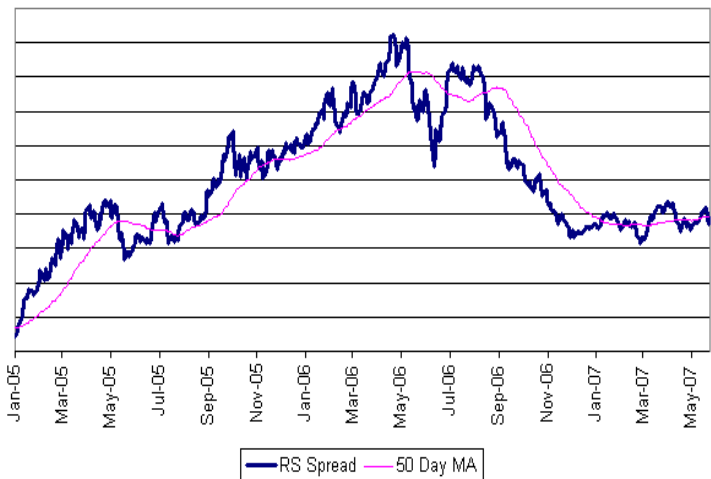
Dorsey Wright High RS Diffusion Index



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 and sell into weakness. When investors are risk averse, they tend to sell into strength and buy into weakness. As of 5/25/07.

Relative Strength Spread



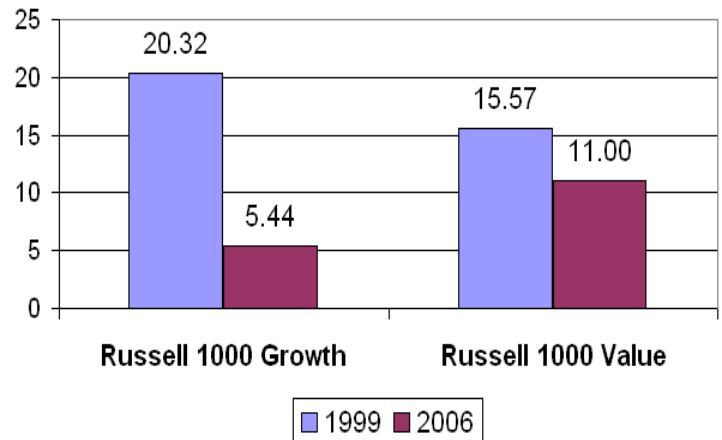
The Spread has shown improvement since late 2006.

Challenge to Strategic Asset Allocation: Over-Optimization

The fundamental goal of Strategic Asset Allocation (SAA) is to optimally allocate between different stocks or different asset classes. The inputs into SAA are expected return, standard deviation of each asset, and the correlation matrix between these assets. The output is the efficient frontier which provides the allocation with the highest return for the least risk. **This process would work fine if those relationships remained constant over time, but they don't.**

For example, expected return is generally estimated by taking the average of historical returns. However, note in the chart below the difference in 10 year annualized returns depending on whether the 10 year return was calculated in 1999 or 2006. A strategic allocation based on preceding 10 year returns, will most likely not be the optimal allocation for the next 10 years—and may not even be close!




10-Year Historical Returns



This is where Tactical Asset Allocation (TAA) can help. TAA, using relative strength, takes a more proactive view on portfolio management. The goal of TAA is to systematically identify and provide exposure to leading strategy components on an ongoing basis. TAA tends to be more flexible to changing trends and will not be stuck in an out of favor allocation for an extended period of time.

Sentiment: On the Analyst's Couch

The American Association of Individual Investors Sentiment Survey measures the percentage of individual investors who are bullish, bearish, and neutral in the stock market short term; individuals are polled from the AAI Web site on a weekly basis. Results as of 5/23/07:

	5/23/2007 Results	Long-Term Average
Bullish 	37.35%	39%
Neutral 	24.10%	32%
Bearish 	38.55%	28%

Negative sentiment persists as indicated by the fact that the bears are considerably above the long term average. Perhaps this is because many individuals have had cash on the sidelines and haven't fully participated. This contrary indicator continues to paint a bullish picture for the market.

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

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- Getting Technical With New ETF, *Investopedia*, April 26, 2007
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Arrow DWA Balanced Fund (DWA FX)

- Fund of ETFs Leads Way for Moderate Allocation, *Arrow Funds*, Feb 21, 2007
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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
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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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