

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



Who Moved My Cheese?, a motivational book written by Spencer Johnson in 1998, features four characters; two mice, "Sniff" and "Scurry", and two little people, miniature humans in essence,

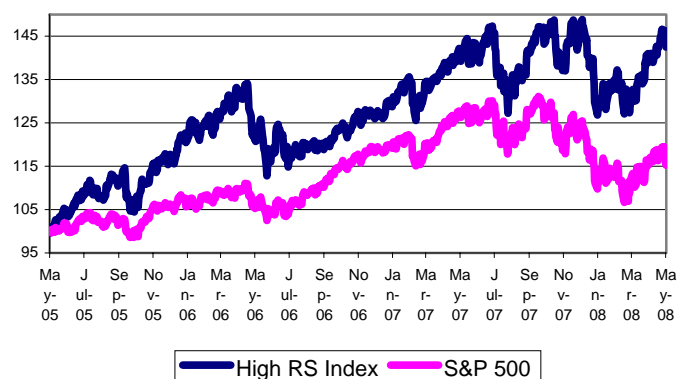
"Hem" and "Haw", who live in a maze, a representation of one's environment, and look for cheese, representative of happiness and success. Initially without cheese, the mice and humans travel the lengthy corridor searching for cheese. One day both groups happen upon a cheese-filled corridor in "Cheese Station C". Content with their find, the humans establish routines around their daily intake of cheese slowly becoming arrogant in the process. One day Sniff and Scurry arrive at Cheese Station C to find no cheese left but they are not surprised. Noticing the cheese supply dwindling, they have mentally prepared for the arduous, but inevitable task of finding more cheese beforehand. Leaving Cheese Station C behind, they begin their hunt for new cheese together. Later that day, Hem and Haw arrive at Cheese Station C only to find the same thing, no cheese. Angered and annoyed, Hem demands "who moved my cheese?" They are then taken to the brink of starvation by their reluctance to change.

Perhaps one of the biggest strengths of a RS strategy is its ability to adapt to change. Those sectors and stocks that are most favored by the market today may not be the most favored in 3 years. By constantly measuring relative performance, RS models gravitate to the new leadership.

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 5/23/08:

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 5/23/08

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Energy	23.41%	14.14%	1.65%
Materials	9.48%	11.04%	0.96%
Consumer Staples	3.09%	-2.11%	-0.39%
Technology	-0.52%	-5.03%	1.07%
Utilities	-3.28%	-2.97%	0.49%
Industrials	-3.63%	-3.25%	-0.70%
Health Care	-14.47%	-11.05%	-0.43%
Telecommunications	-16.15%	-7.58%	1.92%
Consumer Discretionary	-20.72%	-5.51%	0.08%
Financials	-35.03%	-16.28%	-3.92%

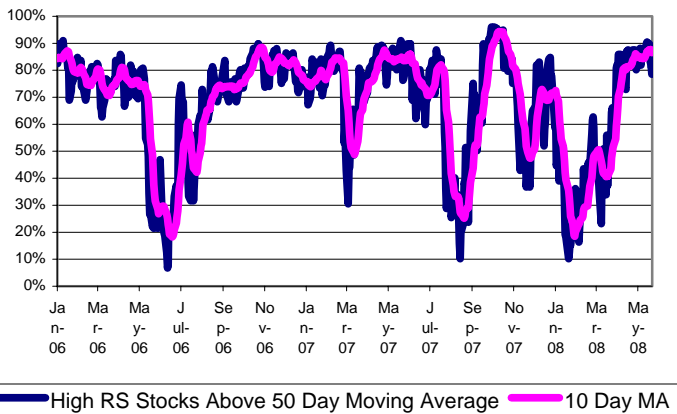
Performance by Capitalization

S&P Mid-Cap	-5.54%	2.66%	4.07%
S&P Large-Cap	-9.71%	-4.50%	-0.06%
S&P Small-Cap	-11.81%	-2.36%	2.82%

High RS Diffusion Index

As of 5/23/08

High RS Diffusion Index

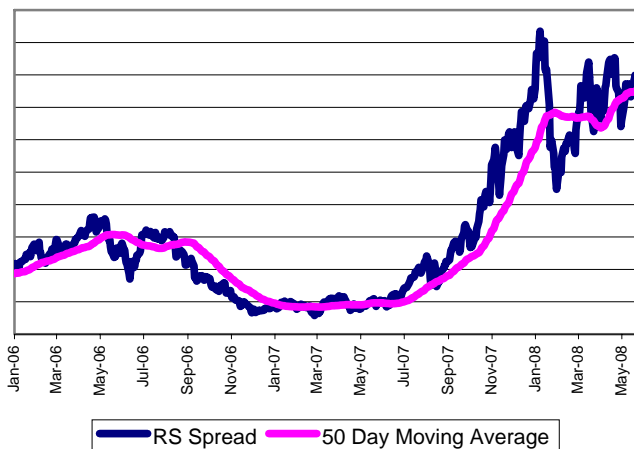


The 10 Day Moving Average of this Diffusion Index is now at 87 percent after seeing a low of 18 percent in late January of this year. It is not uncommon to see this indicator spike off the bottom, rally (as it has) and then remain extended during a sustained move in high relative strength stocks.

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 5/23/08:

Relative Strength Spread



Since February of this year, the RS Spread has been generally rising. It is now rising and is above its 50 day moving average.

Bias Against the "S" Word

Six years ago, big banks paid \$1.4 billion to settle claims that analysts hyped stocks to win lucrative banking deals, but researchers as a group still seem reluctant to advise people to do anything but hold on to stocks or buy more of them. Today, only about 5 percent of all stock recommendations on Wall Street advise investors to sell. That is up from less than 2 percent back in the heady days of the dot-com boom (*New York Times*, May 15, 2008.) As stated by Jenny Anderson of the *New York Times*, "Sometimes Wall Street seems a bit like the make-believe Lake Wobegon: Most stocks are above average, and it is always a good time to buy." Wall Street analysts rarely utter the S word.




Surely, investors would do well to avoid greater than 5 percent of all publicly traded securities! Yet, a stock analyst should know best, right? They spend countless hours analyzing public records of the company and by participating in public conference calls where they can ask direct questions to the management. They read company financial statements and analyze commodity prices, sales, costs, expenses, and tax rates in order to determine a company's value and project future earnings. Usually, financial analysts study an entire industry, assessing current trends in business practices, products, and industry competition. They must keep abreast of new regulations or policies that may affect the industry, as well as monitor the economy to determine its effect on earnings. However, even after doing all of the above, only 5 percent of all securities currently have a sell rating on them. I suspect that a large part of the reason there are so few sell ratings issued by Wall Street analysts is that once an analyst spends so much time researching a company, they tend to buy into the company's success emotionally. They *want* the company to succeed.

Contrast reliance on a Wall Street analyst with a relative strength strategy. In its simplest form, relative strength is the measurement of the performance of one item versus another over a period of time. It is a ranking system which leads to objective scores that are either acceptable or unacceptable. In the context of a relative strength strategy, the sells are no more complicated than the buys. Objective execution of a proven strategy is crucial to superior long-term performance.

Investor Sentiment

The American Association of Individual Investors (AAII) is a non-profit association of more than 150,000 members. AAII produces a weekly sentiment survey of its members that measures the percentage of individual investors who are bullish, bearish and neutral on the stock market in the short term.

Results as of 5/21/08:

	5/21/2008 Results	Long-Term Average
Bullish 	46.30%	39%
Neutral 	19.44%	32%
Bearish 	34.26%	29%

Investor sentiment is a bit of a mixed bag right now. The percentage of bulls are above their long-term average and the percentage of bears are also above their long-term average.

Investor Sentiment is most useful when it reaches extreme levels, which we do not see at this point.

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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<http://tinyurl.com/3wnbxb>
- Concept ETFs provide Portfolio Stability
Seeking Alpha, April 23, 2008
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- Powershares to Expand Family of DWA Technical Leaders Portfolios, *Yahoo! Finance*, Dec 21, 2007
<http://tinyurl.com/37cay2>

Arrow DWA Balanced Fund (DWAFX)

- 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*, Sep 2005
<http://tinyurl.com/38ooq3>
- Systematic Relative Strength Investment, *The Wall Street Transcript*, April 21, 2008
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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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