

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

Michael Marchese of Marchese Capital Management, LLC recently wrote the following (which we think is right on the money.)

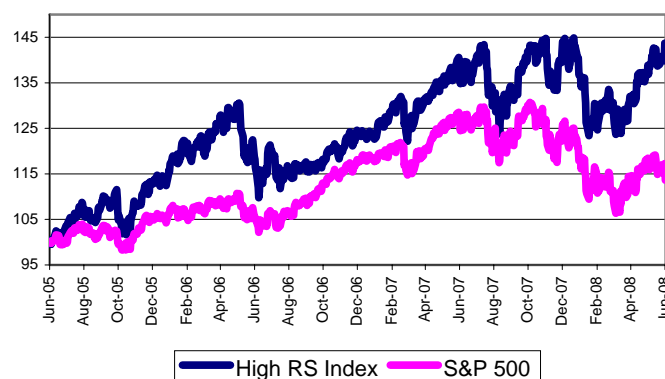
"This past week there was an article in the Financial Times denouncing price as a proper indicator for determining entry and exit triggers in trading, touting "value" as a true measure of when trading should begin and end. There are many perspectives on the street and just as many ways to make and lose money...Price happens to be my choice for exit and entry indication. I am partial to price because there is no truer value of a liquid security than price itself. My faith is also in the theory of "now." For me there is no future, it simply doesn't exist, there is only now, and the current price represents the only value that anyone can know with any true sense of reality. "Future value" is a phrase used throughout history by charlatans. Whether they are dressed in turban and cape, gazing into a crystal ball or wearing gray pinstripes, looking you straight in the eye and working on Wall Street, they are no more than soothsayers trying to sell you on their ability to predict the future, a future which frankly does not exist... Value means different things to different people. In the market there is a number in front of you, one party just bought there and another sold, it represents the current market value, and traders call it "price."

Predictions are great for your ego when you are "right," great for cocktail party conversation, but when you are trading with real money and trying to turn a profit; ...cut your losses, let your winners run, leave your ego at the door."

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 6/6/08:

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 6/6/08

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Energy	21.05%	9.04%	0.73%
Materials	10.20%	4.16%	1.11%
Consumer Staples	1.56%	-5.76%	-1.29%
Utilities	0.72%	-8.08%	0.09%
Technology	0.32%	-7.79%	-0.23%
Industrials	-5.89%	-8.72%	-5.44%
Health Care	-13.27%	-14.66%	-2.06%
Telecommunications	-16.04%	-9.90%	-2.50%
Consumer Discretionary	-21.42%	-9.90%	-5.18%
Financials	-37.58%	-25.94%	-15.18%

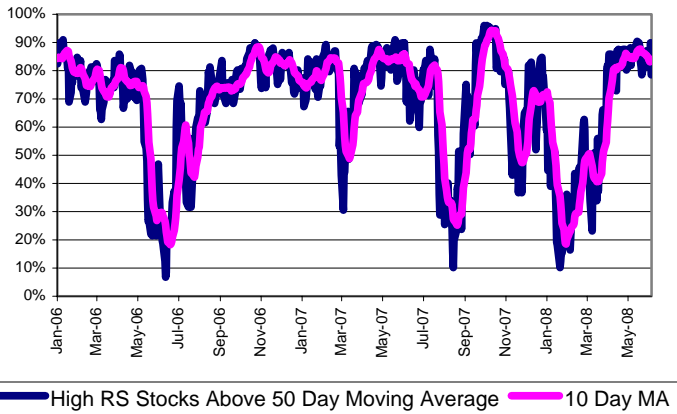
Performance by Capitalization

S&P Mid-Cap	-3.99%	-1.23%	1.78%
S&P Large-Cap	-10.24%	-9.71%	-4.05%
S&P Small-Cap	-10.50%	-4.52%	1.55%

High RS Diffusion Index

As of 6/6/08

High RS Diffusion Index

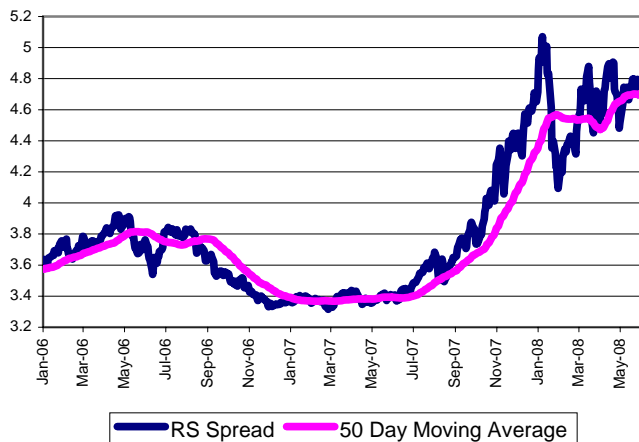


The 10 Day Moving Average of this Diffusion Index is now at 84 percent after seeing a low of 18 percent in late January of this year. It is not uncommon to see this indicator spike off the bottom, rally (as it has) and then remain extended during a sustained move in high relative strength stocks.

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 6/6/08:

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.

The Influence of the Crowd



In team sports, it has often been observed that the home team tends to win more often than the visiting team. As an example, of the 82 games played so far in this year's NBA playoffs, 59, or 72 percent, of them have been won by the home team. The two most likely explanations for this phenomenon are the effect that the roaring crowd has on each of the teams, and the effect that the crowd has on the referees. For some analysis to back up the second explanation, consider the following experiment:




In what has become a famous experiment in sports-science circles, a sample of 40 referees were exposed to a recording of Liverpool's match with Leicester at Anfield during the 1998-99 season (soccer), with half watching the match with all crowd effects included and half watching a silent version. The researchers found that the referees who heard the sound of the crowd were less likely to call fouls against the home team than the ones who saw the game in silence (though, interestingly, the baying of the crowd did not make them more likely to penalize the away team). This preference for the home team coincided with the actual decisions of the match official on the day. The researchers concluded that referees tend to avoid making calls against the home team as a way of shielding themselves from the extra stress levels that come with antagonizing the crowd. It's not that the officials do what the crowd wants; they just try not to do whatever would direct the crowd's fury straight at them.

External influences (CNBC, your brother-in-law, etc.) also cause investors to alter their investment decisions in ways that often prove to inhibit investment returns. These external influences often start to applaud a given investment theme often at exactly the wrong time. Given the need for ratings, the media would have you believe that in order to keep an investment edge, you must be constantly checking "the news" for new tips. Our advice is seek to minimize the external noise. Do your homework up front, choose an adaptive strategy (like relative strength!) and read the sports pages.

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 6/4/08:

	6/4/2008 Results	Long-Term Average
Bullish 	43.48%	39%
Neutral 	18.48%	32%
Bearish 	38.04%	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

Powershares DWA Technical Leaders ETFs (PDP, PIE, and PIZ)

- PowerShares Technical Fund Delivers on Promise, *TheStreet.com*, April, 24 2008
<http://tinyurl.com/3wnbxb>
- Concept ETFs provide Portfolio Stability
Seeking Alpha, April 23, 2008
<http://tinyurl.com/52qdt5>

Arrow DWA Balanced Fund (DWAFFX)

- 2007 Lipper Performance Achievement
www.arrowfunds.com

Arrow DWA Tactical Fund (DWTFX)

- Arrow Fund Launches DWA Tactical Fund,
CNNMoney.com, June 2, 2008
<http://tinyurl.com/3grnp6>

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
<http://tinyurl.com/2m7cls>

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