

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.

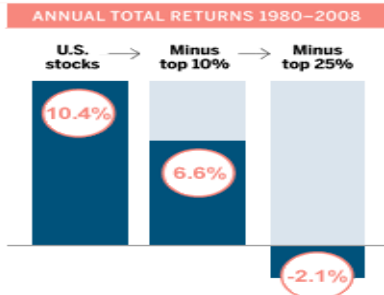
Thought Process

It's a little-known and depressing fact, but the majority of individual securities tend to post negative returns over the long run.

This, I think, is a ringing indictment of buy-and-really-hold investing. Often individuals assume that they can purchase shares of leading companies, shower them with benign neglect, and have the portfolio perform well. But, of course, today's leader always turns into tomorrow's laggard. The majority of stocks, given enough time, collectively lose money. The following chart shows that if you miss the best 25% of stocks, you will end up losing more than 2% per year.

Missing the mark

Trying to pick and choose stocks, rather than owning the broad market, can lead to losses, not gains.



NOTE: FIGURES ARE BASED ON THE UNIVERSITY OF CHICAGO'S CRSP DATABASE OF THE TOTAL U.S. STOCK MARKET. SOURCE: DIMENSIONAL FUND ADVISORS.

(Click to Enlarge)

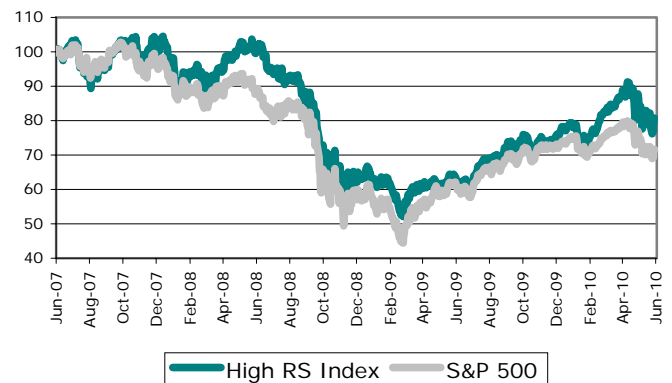
Source: Money Magazine and Dimensional Fund Advisors

With the knowledge that such a large percentage of stocks lose money over time, it becomes apparent that an active approach is necessary. Click [here](#) for our commentary on merits of relative strength investing and a comparison to cap-weighted indexing.

High RS Asset Class

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 6/11/2010:

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 6/11/2010

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Consumer Discretionary	35%	9%	-5%
Industrials	23%	3%	-9%
Technology	21%	-1%	-5%
Financials	17%	1%	-8%
Health Care	14%	-7%	-5%
Consumer Staples	13%	-3%	-4%
Materials	9%	-5%	-5%
Utilities	5%	-8%	-3%
Telecommunications	2%	-8%	1%
Energy	-2%	-4%	-5%

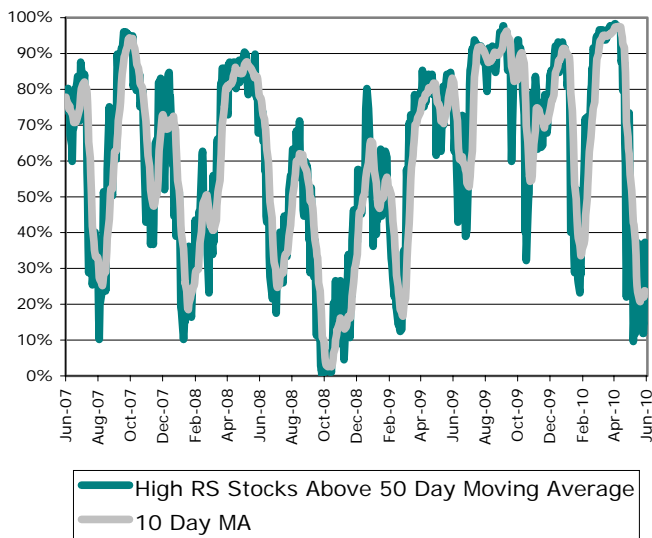
Capitalization Performance

S&P Mid-Cap	27%	7%	-5%
S&P Small-Cap	25%	9%	-7%
S&P Large-Cap	16%	-1%	-5%

High RS Diffusion Index

As of 6/11/2010

High RS Diffusion Index

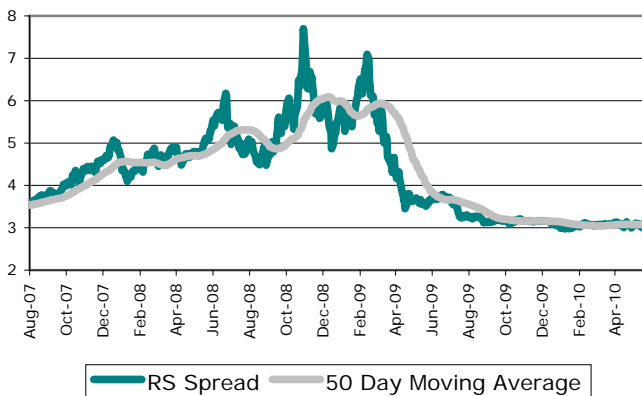


The 10-day moving average of this indicator is 24% and the one-day reading is 37% after reaching a single-day low of 10% on 5/20/10. Dips in this indicator have often provided good opportunities to add to relative strength strategies.

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 6/11/2010:

Relative Strength Spread



What is likely to follow this transitional phase of the Spread over the past year? I suspect that we are setting the stage for a very favorable environment for RS investing in the coming years.

Dealing With Dow Stagnation

The WSJ's Jason Zweig [points out](#) that last week, the Dow Jones Industrial Average rose above 10,000-again. Since March 16, 1999, when it first touched 10,000 in intraday trading, the Dow has bounced over that threshold and back 63 times. Friday, the index closed 219.6 points below where it stood exactly 11 years ago.

This isn't the first time stocks have been stuck on a seemingly endless pogo-stick ride. On Jan. 18, 1966, the Dow hit an intraday high of 1,000.50. It broke through the four-digit barrier three more times that January and February, then faded. The Dow cracked 1,000 again in 1972 and 1976, then fell back both times. Not until December 1982 did the Dow finally hurdle above 1,000 and stay there.

History is under no obligation to repeat itself exactly, but this comparison does beg the question of how long before the Dow Jones Industrial Average will meaningfully rise from the 10,000 level. The fluctuations around Dow 1,000 persisted for 17 years. We have been fluctuating around Dow 10,000 for 11 years. Periods of extended Dow stagnation can test the patience of even the most forbearing equity-only investor.

One way to deal with this U.S. equity stagnation is to employ an investment strategy that has the flexibility to shift into many different asset classes in order to find those asset classes that are currently in secular bull markets. This is exactly the objective of our Global Macro strategy which tactically overweights those asset classes with the best relative strength. Click [here](#) to see a table which shows the average Global Macro allocation to each of the major asset classes since mid 1999.

Every major asset class goes through periods of extended stagnation - it is just part of the cyclical nature of the financial markets. Rather than making permanent commitments to any one asset class, we find it more prudent to employ a flexible global asset allocation strategy that keeps our options open.

Global Macro is available as a separately managed account. To receive a brochure, please click [here](#). Global Macro is also available as the Arrow DWA Tactical Fund (DWTFX). Click [here](#) and [here](#) for disclosures.

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 6/2/2010.

Asset Class	6/2/2010
Taxable Bonds	3,377
Municipal Bonds	869
Foreign Equity	463
Hybrid	-187
Domestic Equities	-1,117

The market correction over the last month and a half has send retail mutual fund investors to seek perceived safety in taxable bond funds.

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 (DWAFFX)

- [The Endowment Portfolio Rides Again](#), Mar 12, 2010

Arrow DWA Tactical Fund (DWTFFX)

- [Core-and-Satellite](#), May 3, 2010

Dorsey Wright Money Management

- [Bringing Real-World Testing To Relative Strength](#), Jan 2010
- [Relative Strength and Asset Class Rotation](#), Mar 2010

Blog

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