

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

When choosing an investment strategy, expected long-term performance is only one of the factors that should be considered. The volatility and correlation of the return stream should also be considered. Another factor to be considered is an investment strategy's failure rate. Failure rate was the focus of a study completed by Columbine Capital in 2003. Each of the factors listed below were tested. For example, months in which stocks with the lowest dividend yield outperformed stocks with the highest dividend yield resulted in a failure of the Dividend Yield factor for that month. Months in which relative strength laggards outperformed relative strength leaders likewise resulted in a "failure" for that month. Notice that price momentum (or relative strength) had the lowest failure rate. **In other words, relative strength was the most consistent winner.**

Monthly Failure Rate by Factor 1971-2003

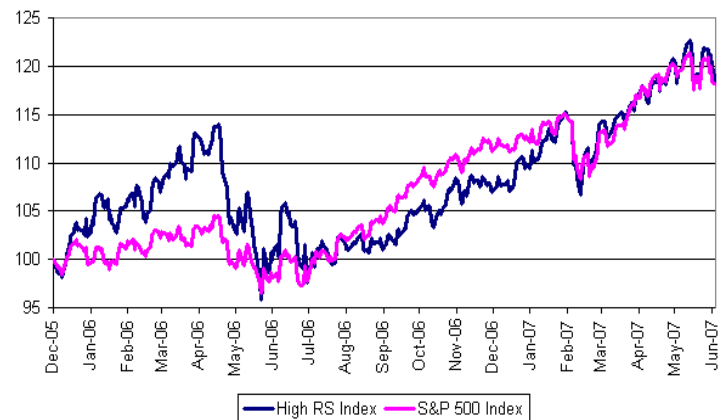
EPS Change	28.4%
EPS Growth	38.4%
Price Momentum	27.3%
Book Value	43.8%
Cash Flow	38.4%
Dividend Yield	49.7%
Reported EPS Yield	37.4%
EPS Surprise	36.9%
Estimate Revision	31.9%
Estimated EPS Yield	42.5%

Source: Columbine Capital

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 6/25/07:

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 6/25/07

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Telecommunications	34.30%	34.30%	-3.00%
Energy	33.56%	33.56%	1.90%
Materials	30.92%	30.92%	0.73%
Technology	25.69%	25.69%	1.80%
Utilities	23.18%	23.18%	-4.55%
Consumer Discretionary	19.37%	19.37%	-1.13%
Industrials	16.76%	16.76%	1.34%
Health Care	16.74%	16.74%	-4.38%
Financials	14.34%	14.34%	-3.39%
Consumer Staples	13.26%	13.26%	-1.96%

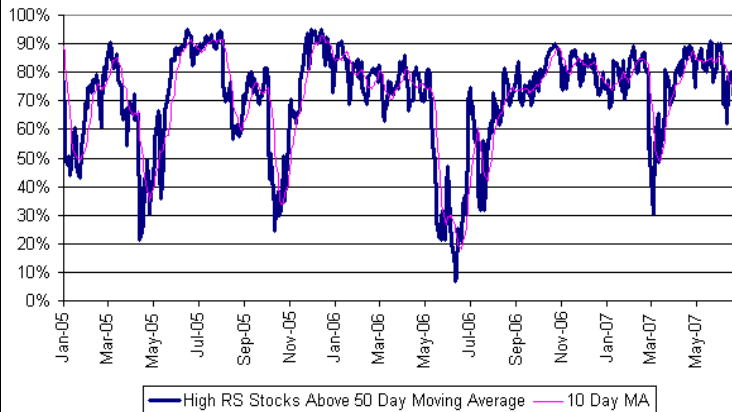
Performance by Capitalization

S&P Large-Cap	20.40%	5.83%	-1.23%
S&P Mid-Cap	19.68%	10.23%	-0.91%
S&P Small-Cap	18.82%	7.35%	-0.31%

High RS Diffusion Index

On May 22 of this year, 90 percent of high relative strength stocks were trading above their 50 day moving average. That number is now 64 percent. Dips are often a good time to add exposure. As of 6/25/07

Dorsey Wright 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 6/25/07.

Relative Strength Spread



Relative strength leaders continue to show improvement as indicated by this chart.

Behavioral Boxes

Proponents of the efficient market hypothesis believe that investors are fully informed utility maximizers with homogenous behaviors. However, experimental research reveals that there is no reason to assume that attitudes towards observed price trends should be the same for every individual, nor that they should be stable over time.




Consider an investor's reaction to a price change. Each holds a collection of common stocks. Whatever criteria used to select the stocks or contemplated holding period, the objective is likely gain. Suppose that stock E increases by a considerable amount over some time period. Reactions to this increase vary from person to person and over time. Optimistic Monty might sell other stocks to buy more of E, expecting continuation of the observed positive trend. His philosophy: if E goes up; get more of it! Over time he rotates his portfolio to get past winners. Now consider Roberta Reversal, who will take a profit in E, thinking that the gain is likely to be retraced. She may buy another stock. She thinks of her portfolio as a collection of lottery tickets. She doesn't play the same number twice. Roberta represents the quick profit takers. In between those two extremes are Ralph Rationalizer who will do some more research before buying more of E. Fred Fixed will simply not react to the price change. Emma Equal-weighted is a risk minimizer. She will sell some of E and spread it out across other holdings.

Monty, Ralph, Fred, Emma and Roberta are arranged in order from optimistic to pessimistic, based on their apparent belief that observed price changes will persist or reverse. These behavior classes interact to determine the price of stock E and all other stocks. To the extent that active investor behavior is closer to that of Monty or Roberta, price trends will persist or reverse. *Analogy by John Brush of Columbine Capital.*

The market goes through periods of time when "Monty" is the dominant force (and relative strength strategies perform extremely well) and periods of time when "Roberta" is the dominant force (and relative strength strategies lag). While Roberta has her day in the sun from time to time, our research concludes that "Monty" reaps the greatest rewards over time.

Sentiment: On the Analyst's Couch

The American Association of Individual Investors (AAII) Sentiment Survey measures the percentage of individual investors who are bullish, bearish, and neutral on the stock market short term. Extreme bullish or bearish reading often serve as a good contrary indicator. Sentiment Survey Results as of 6/20/2007:

	6/20/2007 Results	Long-Term Average
Bullish 	43.16%	39%
Neutral 	23.16%	32%
Bearish 	33.68%	28%

The current measure shows the bulls to be slightly greater than the long term average, and the bears to also be slightly above the long term average. Currently, there doesn't seem to be extreme bullish sentiment that could potentially derail the current bull 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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- Technical Leaders ETF Buys Strongest Charts, *Investors Business Daily*, June 15, 2007
<http://tinyurl.com/yrho94>
- Getting Technical With New ETF, *Investopedia*, April 26, 2007
<http://tinyurl.com/35f8ch>
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<http://tinyurl.com/2qt6cd>

Arrow DWA Balanced Fund (DWAFFX)

- Fund of ETFs Leads Way for Moderate Allocation, *Arrow Funds*, Feb 21, 2007
<http://tinyurl.com/2j56ow>

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

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

Dorsey, Wright Money Management
595 E. Colorado Blvd, Suite 518
Pasadena, CA 91101
(626) 535-0630