

*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



Lou Piniella, legendary baseball manager: "He will never be a tough competitor. He doesn't know how to be comfortable with being uncomfortable."

How can someone be comfortable with being uncomfortable? I suspect that Piniella means

that a tough competitor realizes that their actions during the uncomfortable times will largely determine their ultimate success or failure. For athletes, weight training can often be uncomfortable. Trailing an opponent during competition can be uncomfortable. Taking criticism from a coach can be uncomfortable. Yet those athletes that don't "lose their head" during those moments are the ones that put themselves in a position to ultimately win the competition.

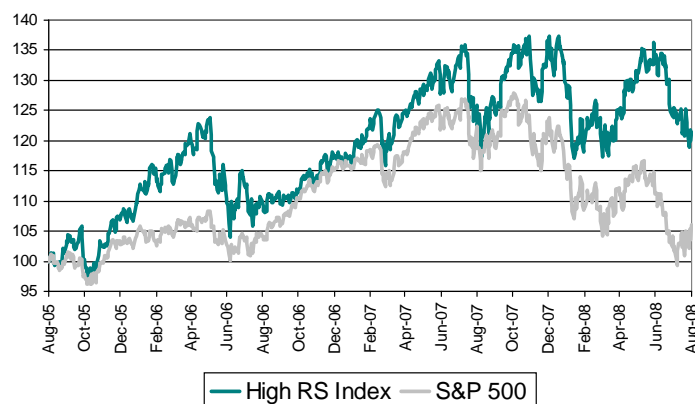
Many aspects of relative strength investing are also uncomfortable. It can be uncomfortable to buy stocks that are already strong because of the desire to try to pick tomorrow's winners from yesterday's losers. It can be uncomfortable during a change in leadership when relative strength strategies go through temporary periods of underperformance. It can be uncomfortable to constantly adhere to the discipline.

On the other hand, there is great comfort in using a discipline that adapts to changing market conditions. There is great comfort in knowing that periods of underperformance tend to be relatively short. Finally, there is great comfort in observing the long-term results of relative strength strategies.

## High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 8/8/08:

**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 8/8/08

### Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Consumer Staples	3.34%	5.22%	4.72%
Energy	-0.14%	2.08%	-11.77%
Materials	-3.79%	-3.46%	-2.37%
Health Care	-4.34%	0.98%	6.40%
Technology	-6.72%	7.33%	3.53%
Utilities	-7.56%	-4.29%	-7.37%
Industrials	-12.20%	-2.74%	5.01%
Consumer Discretionary	-18.75%	-3.12%	7.57%
Telecommunications	-25.57%	-9.71%	-3.56%
Financials	-36.96%	-19.00%	6.83%

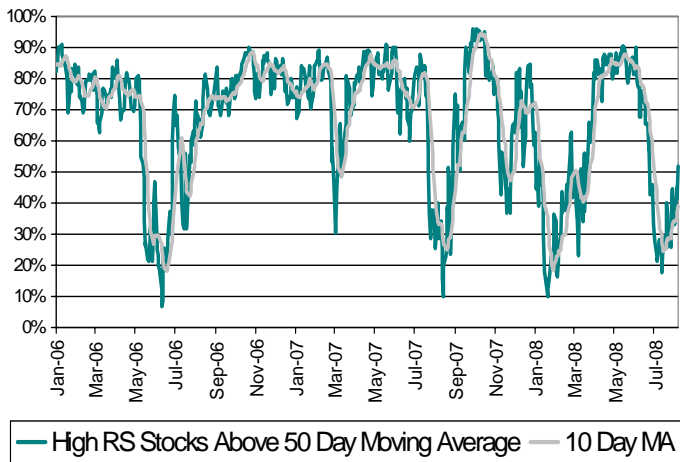
### Performance by Capitalization

S&P Small-Cap	-6.28%	4.66%	7.55%
S&P Mid-Cap	-6.71%	2.50%	1.90%
S&P Large-Cap	-13.66%	-2.78%	1.67%

## High RS Diffusion Index

As of 8/8/08

### High RS Diffusion Index

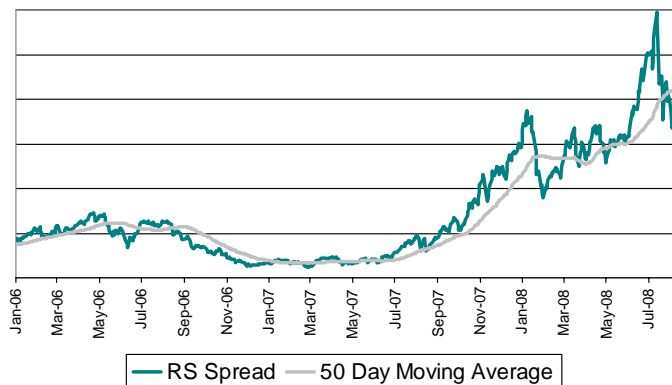


The 10 Day Moving Average of this Diffusion Index is now at 39% after reaching a low of 25% on the 17th of July. Historically, dips in this indicator have provided good opportunities to add to RS strategies.

## 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 8/8/08:

### Relative Strength Spread



RS strategies have proven the ability to provide superior returns over time, but the returns are often lumpy. This has certainly been the case this year as can be seen by the above chart.

## Expert Opinion



Just over a month ago, many experts were predicting that crude oil would reach \$200 by year-end. That didn't seem like such a stretch given that oil went from \$100 in April to \$150 at the beginning of July. Rather than adhere to those expert's forecasts, oil has gone the other direction in rather dramatic fashion. As of Friday, oil is now \$115, or 20% lower than it was just over a month ago.

On Friday, Lehman Brothers said in a report that the bubble is "almost certainly" over (*Houston Chronicle, 8/8/08.*) Why couldn't Lehman have issued that report a month ago! Now, a quick Google search reveals that there are a host of experts forecasting \$100 oil, and lower, by year-end.




There are several major problems with expert opinions. First, how do you identify an expert? Education? Position? Accuracy of previous forecasts? Second, one can always find an expert to support your personal bias. Finally, experts are great at telling you what just happened, but not so good at telling you what will happen.

This leads me to relative strength, an un-biased method of sorting the winners from the losers. Admittedly, relative strength analysis does not tell you what will be strong over the next year. It can be startling to some that accurate forecasting is not necessary in order to build an investment strategy that has a very high probability of beating the market over time. Research shows that building portfolios that are largely exposed to those areas of the market that have been strong over an intermediate time from (roughly the last six to twelve months) is an effective method of beating the market over time. Rather simplistic, yet effective.

Is it a good idea to seek out expert forecasts when making portfolio changes? Only if you like to invest with roughly the same odds as playing the slots in Vegas. For better odds, stick with relative strength.

## 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 8/6/08:

	8/6/2008 Results	Long-Term Average
<b>Bullish</b> 	35.61%	39%
<b>Neutral</b> 	21.97%	32%
<b>Bearish</b> 	42.42%	29%

Continuing a familiar theme this year, the bulls are below their long-term average and the bears are above their long-term average. Individual investor sentiment is often a useful contrarian indicator because of their tendency to be wrong at the extremes.

## 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](http://www.arrowfunds.com)

Arrow DWA Tactical Fund (DWTFX)

- New Fund Targets Aggressive Investors, *Investment News*, July 14, 2008  
<http://tinyurl.com/58aq9o>

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>

## 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](mailto:moneymanagement@dorseywright.com)

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