

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



Abalone are medium-sized to very large edible sea snails that have long been a valuable food source for humans in every area of the world where the species is abundant. One of the major challenges faced by hunters of Abalone is prying them off the rocks because when Abalone are disturbed they adhere themselves to the rocks. A pry bar must be inserted under the abalone's foot and the suction holding it to the rock must be released before it can be removed.

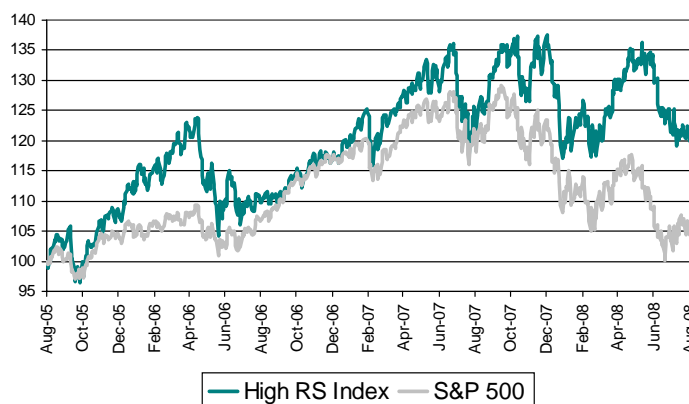
Many investors can also relate to the reaction of Abalone when disturbed. How often do investors purchase a stock without much thought given to what their action will be if that stock performs poorly? Inevitably, some stocks do not perform well after being purchased and many investors, like the Abalone, adhere themselves to the stocks all the way down.

Relative Strength takes a different approach. Holdings are only kept until the stock loses its intermediate to longer-term relative strength. Once that point is reached, we dispassionately say good-bye to the stock for now.

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 8/25/08:

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 8/25/08

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Consumer Staples	4.17%	1.31%	3.95%
Energy	3.41%	-4.77%	-1.01%
Materials	-1.88%	-9.37%	-1.80%
Health Care	-5.15%	-2.62%	2.08%
Utilities	-5.93%	-5.29%	-1.27%
Technology	-7.17%	3.88%	3.16%
Industrials	-13.98%	-8.78%	-0.11%
Consumer Discretionary	-18.99%	-8.26%	5.16%
Telecommunications	-26.11%	-9.69%	-1.24%
Financials	-42.13%	-26.87%	-4.15%

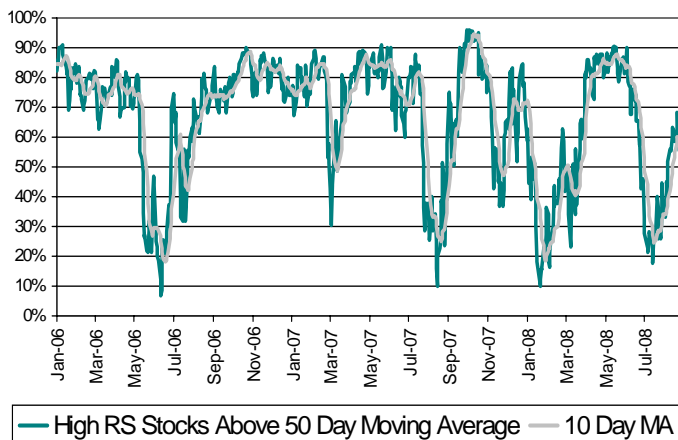
Performance by Capitalization

S&P Mid-Cap	-7.68%	-2.35%	0.78%
S&P Small-Cap	-9.88%	0.64%	2.40%
S&P Large-Cap	-14.37%	-7.51%	1.23%

High RS Diffusion Index

As of 8/25/08

High RS Diffusion Index

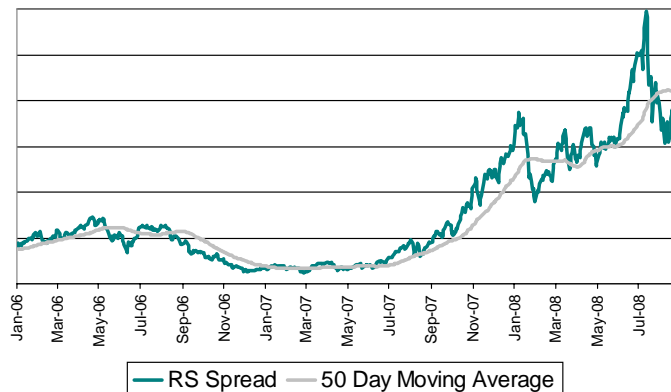


The 10 Day Moving Average of this Diffusion Index is now at 59% after reaching a low of 25% on the 17th of July.

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 8/25/08:

Relative Strength Spread



Since the beginning of July, relative strength leaders have underperformed the relative strength laggards. However, as can be seen in the chart above, the Spread is showing some signs of stabilization.

Wall of Worry

The media excels at pointing out all the things that are wrong (with the economy, politics, health care...). However, they often fail to consider how or why the stock market can often perform well when the news is bleak. Consider the following explanation by Jeremy Siegel, author of *Stocks for the Long Run*.

"It is a well-known (and true) Wall Street aphorism that markets hate uncertainty. Investors do not like to make commitments when there are major risks ahead. Anxious investors claim they will put money in the stock market only when major sources of uncertainty are resolved. But there has always been uncertainty in our economy. If investors waited until all uncertainties worked themselves out, they will never have bought stocks.

Professionals call the ever present risk facing investors the 'Wall of Worry.' History shows that stocks have often climbed this 'wall of worry,' amply rewarding investors who stay with equities. Uncertainty is one of the reasons why the stock market has over the long run been such a good investment and why stock returns have sported such a hefty premium return over fixed income assets.

No one knows what the future will bring. There will always be risks in buying stocks and if worst-case scenarios materialize, stock will no doubt fall. But I think the odds favor continued economic expansion and if this turns out to be the case, stocks will no doubt by your best investment." — Jeremy Siegel

Given how poorly the stock market has performed over the past year, I thought it worthwhile to again point out the long-term returns of stocks, Treasury Bonds, and Treasury Bills.




1951-2006 (Source: Ibbotson Associates):

Large-Cap Stocks:	11.7%
Treasury Bonds:	6.0%
Treasury Bills:	5.0%

Stocks are one of the highest performing asset classes over time. Pessimists persist in focusing on the worst-case scenarios. History strongly suggests that it is much more profitable to be an optimist, assuming you adhere to a prudent approach and have the proper time horizon.

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 8/20/08:

	8/20/2008 Results	Long-Term Average
Bullish 	38.10%	39%
Neutral 	24.60%	32%
Bearish 	37.30%	29%

Bullish sentiment among individual investors is about in line with the long-term average, but bearish sentiment remains above its long-term average. The relatively high bearish sentiment is not surprising given the poor performance of the stock market over the past year. This group of investors is generally 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.

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Media Center

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<http://tinyurl.com/3wnbxb>
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<http://tinyurl.com/58aq9o>

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<http://tinyurl.com/38ooq3>
- Systematic Relative Strength Investment, *The Wall Street Transcript*, April 21, 2008
<http://tinyurl.com/2m7cls>

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