

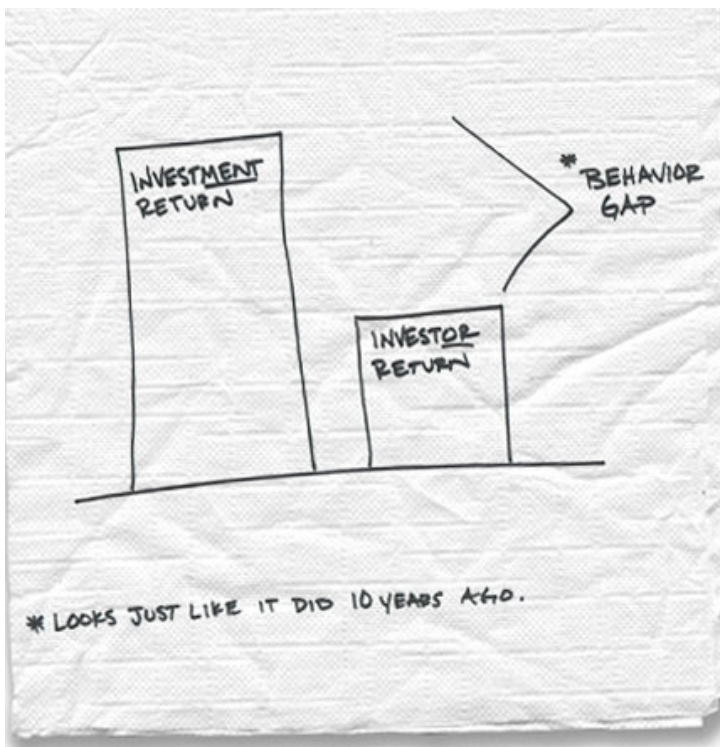
Devoted to information and portfolio strategies for the high relative strength asset class

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.

The Behavior Gap in One Picture

Michael Covell's blog has an [excellent post](#) with some back-of-the-napkin math. It's an elegant way to describe the largest issue facing investors: not the economy, unemployment, or housing, but **their own behavior**.



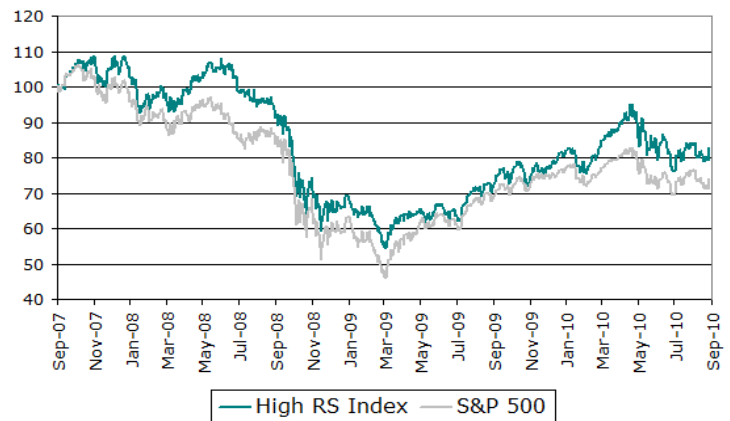
Source: [Michael Covell](#), Carl Richards

Research shows that bad behavior is most likely to manifest itself when the markets are under stress and investors are very bearish, like now. Find a good, adaptive strategy that you are comfortable with (we hope it will be relative strength) and **stick to it**.

High RS Asset Class

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 9/2/2010:

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

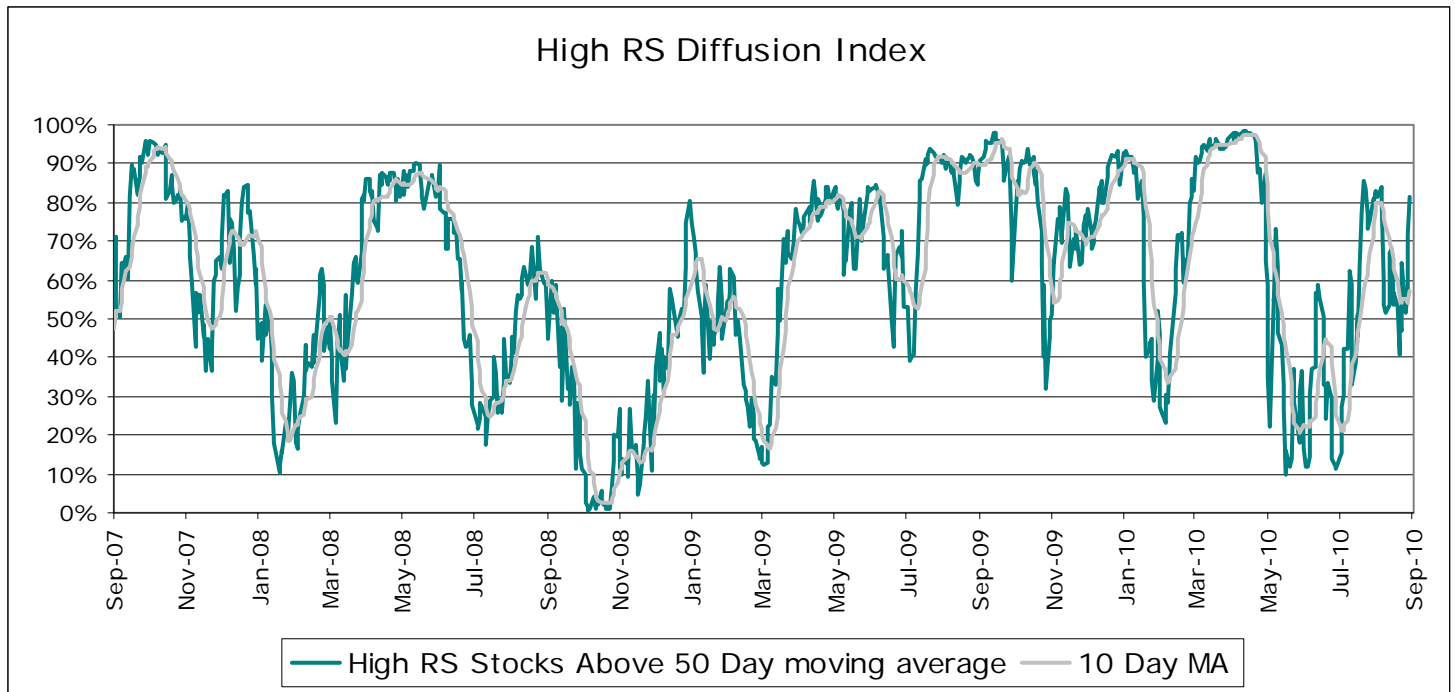
As of 9/2/2010

Sector Performance			
S&P 500 GICS Sector	12 Month	6 Month	1 Month
Consumer Discretionary	24%	3%	-1%
Industrials	21%	1%	-4%
Materials	12%	0%	-2%
Telecommunications	12%	11%	2%
Consumer Staples	11%	-1%	-1%
Utilities	9%	6%	1%
Technology	8%	-5%	-6%
Energy	5%	-6%	-4%
Financials	3%	-4%	-6%
Health Care	3%	-9%	-1%

Performance by Capitalization			
S&P Mid-Cap	19%	0%	-2%
S&P Small-Cap	15%	-2%	-5%
S&P Large-Cap	10%	-2%	-3%

High RS Diffusion Index

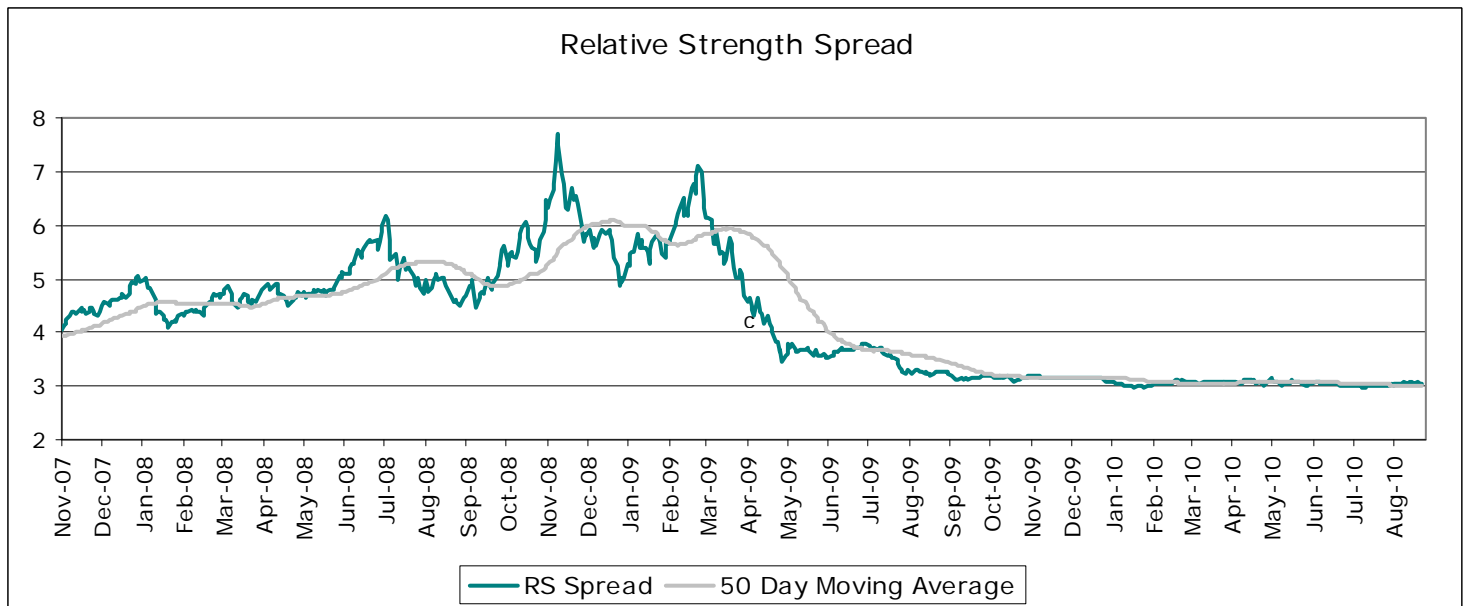
As of 9/2/2010



The 10-day moving average of this indicator is 57% and the one-day reading is 81%. After pulling back to the middle of the distribution in August, this index has risen sharply over the past week.

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 9/2/2010:



Over the past 12 months the relative strength spread has been pretty dull as both the relative strength leaders and laggards have generated similar performance. It is quite possible that the transition that we are seeing now could lead to an excellent environment for relative strength strategies.

Shift Your Paradigm!

Sometimes in order to see something differently, you just have to look at it from a different vantage point. Jonathan Hoenig, writing in *Smart Money*, makes [a very valid point about how investors tend to look at the market](#).

First, we're conditioned to want a bargain. If we're bullish on [NTT DoCoMo](#) (DCM: 17.04, +0.34, +2.03%) trading at \$16.75, for some reason we refuse to pay anything more than \$16.40, and when it rallies further, we stubbornly sit on our hands and promise to add shares only if the price corrects back to where we originally spotted it. We're a nation of hagglers: No body wants to pay full price.*

In other words, investors tend to look at things in terms of high or low. The desire for a bargain has led to various flawed analogies that investors should be delighted to buy stocks "on sale," as if they were buying toilet paper or vegetables. That may not be the correct frame to use. Toilet paper and vegetables are consumables that fulfill a specific need. Vegetables and toilet paper are not performance-based. **A financial asset cannot be consumed to fulfill a specific need--its only value lies in its eventual performance.**

Hoenig goes on to say:

Regular readers know we never characterize markets as "high" or "low," but as "strong" or "weak." And in trending markets, strong securities like the [yen](#) or [bonds](#) tend to stay strong, or at least stronger than alternatives. On a price basis alone, an all-time-high is a reason to follow a market, not flee it.

Although this is a simple statement, the implications are profound. As soon as markets are framed as strong or weak (rather than high or low), your perspective changes. It is a crucial paradigm shift. As Hoenig points out (and lots of research has confirmed), strong markets tend to stay strong. I think **strong and weak is the correct mindset when dealing with financial markets from a performance perspective.** Relative strength approaches financial markets from this perspective--measuring strength or weakness objectively and always pushing the portfolio toward strength.

In every other endeavor where performance is important, we gravitate to strength. When a baseball manager fills in a lineup card, he tries to put the best players on the field to win the game. When a corporation needs to win over a big account, they send their best salesperson, not their worst. When we send a relay team to the Olympics, we send the four fastest runners--not slow runners that we hope will improve. As Damon Runyan wrote, "The race is not always to the swift, but if you have to bet, that's the way to play it."

Markets are no different. The paradigm shift in thinking about strong and weak assets seems simple but may be a tipping point in terms of finding profitable investment strategies.

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 8/25/2010. *Millions of dollars*

	8/25/10	YTD
Taxable Bonds	4,836	183,816
Municipal Bonds	1,120	27,585
Hybrid	382	13,674
Foreign Equity	-292	27,655
Domestic Equity	-4,313	-42,995

The story of the year, in terms of asset flows, has been \$183 billion into taxable bond funds and \$42 billion out of domestic equity 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 Arrow DWA Balanced Fund](#), Jun 17, 2010

Arrow DWA Tactical Fund (DWTAFX)

- [The "All-in-One Fund" With a Twist](#), Jun 16, 2010

Dorsey Wright Money Management

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

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