

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



The spider monkey lives in the trees of the tropical jungles of South America, have hook-like, narrow and thumbless hands and tiny brains.

In order to catch spider monkeys, hunters in South America simply walk through the jungle and drop heavy containers on

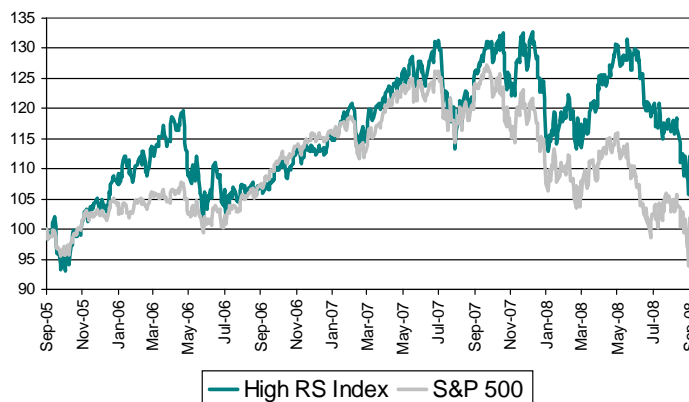
the ground. These containers have very a narrow top and a wider bottom. Inside the containers the hunters drop a special kind of nut which is particularly attractive to the monkeys. Sometime later, the spider monkeys come down from the tops of the trees, smell the nut, but the tops of the containers are so narrow they have a tight squeeze to get their hands inside. Once they grab the nut at the bottom, their fist is too large to remove if through the opening. And the container is too heavy for them to carry. So instead of letting go of the nut, the monkeys just sit there until the hunters come back, pick them up, and throw them in a bag. The spider monkeys are not prepared to let go of a small nut in order to gain their freedom.

Likewise, many investors are holding on to stocks, losers if you will, that prevent their financial liberty. Rather than sell the stock, and admit that it didn't work out, they choose to hold on and hope that it will come back. Running a systematic relative strength strategy relieves us of this problem. Once stocks hit the sell point, we bid farewell for now.

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 9/19/08:

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 9/19/08

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Consumer Staples	1.97%	3.14%	-0.51%
Energy	-7.52%	0.00%	-0.70%
Materials	-8.40%	-1.96%	-0.79%
Health Care	-11.45%	0.84%	-4.96%
Utilities	-14.50%	-7.05%	-5.68%
Technology	-17.38%	-3.29%	-8.69%
Consumer Discretionary	-19.16%	0.53%	1.84%
Industrials	-19.68%	-9.48%	-3.52%
Telecommunications	-29.46%	-8.95%	-3.14%
Financials	-35.62%	-8.94%	13.62%

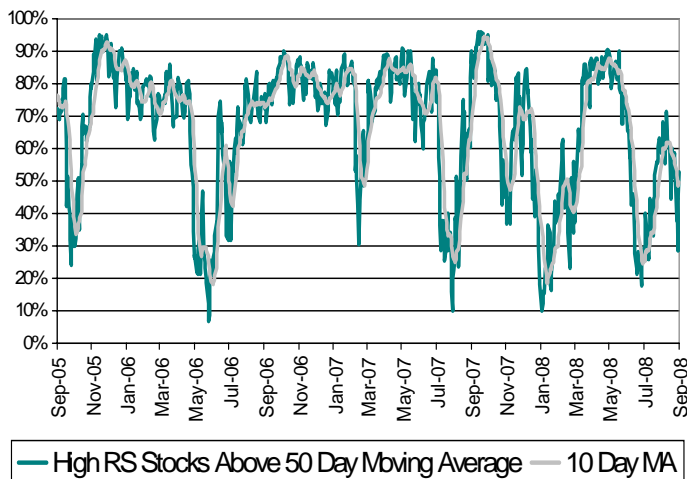
Performance by Capitalization

S&P Small-Cap	-7.79%	12.39%	3.60%
S&P Mid-Cap	-10.06%	5.76%	-0.90%
S&P Large-Cap	-19.07%	-4.76%	-2.26%

High RS Diffusion Index

As of 9/19/08

High RS Diffusion Index

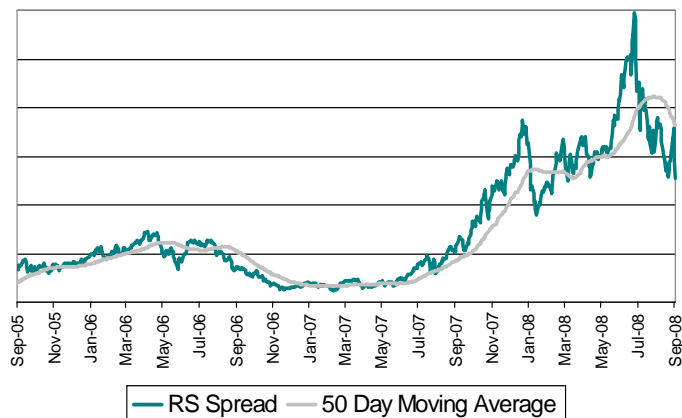


The 10 Day Moving Average of this Diffusion Index is now at 49%, while the one day reading is at 53%. We tend to take notice of this indicator when it reaches extreme oversold levels, as it does periodically.

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 9/19/08:

Relative Strength Spread



As often noted, the performance of RS strategies tends to be lumpy. While the long-term performance tends to be exceptional, it does experience short-term periods of underperformance, as seen for the last couple of months.

The Power of One

In a recent commentary about the fact that AIG (now public property) has been removed as a component of the Dow Jones Industrial Average, Eddy Elfenbein of *Crossing Wall Street*, also commented on another change to the index which took place many years ago—IBM. As he pointed out, little changes in the Dow can have major impacts. The editors of the *Wall Street Journal* changed the index in 1939 by tossing out IBM. They added it back in 1979. In those 40 years, IBM gained 22,000%. If the editors had left it in, the Dow would now be about 35% higher than where it is now. All the historical benchmarks would be different. The Dow would have cracked 1,000 in 1961 instead of twelve years later.

Behold the power of one really good stock.

The powerful impact that one or a handful of very strong stocks can have on overall portfolio performance has not been lost on relative strength managers. Our mantra is “cut your losses short, and let your winners run.” One challenge of holding on to those extremely strong stocks is the fact that they periodically sell off and go through periods of underperformance before going on to new highs. If your stops are set too closely, you’ll get stopped out, and miss out on the long-term trend. By giving the stocks some room to underperform before selling them, the probability of round-tripping (seeing gains evaporate) for some of your holdings increases. It also takes a little longer to adapt to major theme changes in the market by focusing on the longer-term relative strength. Those are some of the challenges, but the rewards are plentiful by focusing on longer-term relative strength. Another interesting lesson from the IBM example is that a strong stock may deteriorate enough to be sold out of a relative strength strategy, but if it recovers and again becomes a leader, it will dispassionately be purchased again in the portfolio. In other words, just because we owned it once doesn’t mean that we’ll wait 40 years to buy it again if that is what our models want.

A rules-based relative strength strategy is the best approach that we know of to identify and lock on to those dynamic moves in the strongest stocks. As can be seen with the IBM example, one big winner can have an enormous impact on overall portfolio performance.

Investor Sentiment

Since volatility often signifies financial turmoil, the VIX is often referred to as the 'investor fear gauge.' On Thursday, September 18, the VIX reached an intra-day high of 42.16, which is the 14th highest reading since 1990 (out of 4716 readings). Previous peaks have been followed by very strong performance of the S&P 500. All intra-day values of the VIX that are higher than Thursday's value are listed below:

Date	Intra-Day VIX High	Return of S&P 500 100 Days later
8-Oct-98	45.74	29.58%
10-Sep-98	45.29	21.20%
5-Aug-02	45.08	5.74%
23-Jul-02	44.92	11.04%
31-Aug-98	44.28	23.63%
20-Sep-01	43.74	17.93%
11-Sep-98	43.74	17.74%
7-Oct-98	43.51	28.08%
1-Oct-98	43.48	29.27%
4-Sep-98	43.31	19.77%
5-Oct-98	42.81	24.87%
21-Sep-01	42.66	20.21%
7-Oct-02	42.64	16.93%
18-Sep-08	42.16	?

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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<http://tinyurl.com/3wnbxb>
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Seeking Alpha, April 23, 2008
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Arrow DWA Balanced Fund (DWAFFX)

- 2007 Lipper Performance Achievement
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
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