HIGH RS NEWSLETTER

JANUARY 30, 2012 ISSUE 116

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.

What's Hot...And Not

How different investments have done over the past 12 months, 6 months, and month.

Asset Class Performance

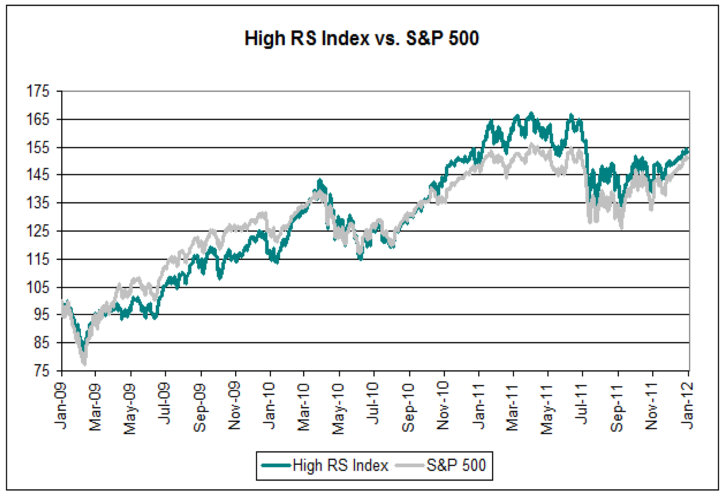
	12 Months	6 Months	1 Month
Long-term Treasurys[11]	35%	25%	-1%
Gold[1]	26%	5%	8%
U.S. investment-grade bonds[9]	11%	6%	3%
REIT stocks[3]	10%	0%	6%
Emerging-markets bonds[7]	9%	3%	2%
U.S. corporate junk bonds[6]	7%	2%	3%
Dow Jones Industrial Average	6%	2%	4%
Crude oil[10]	4%	-2%	0%
Nasdaq Composite Index	2%	-1%	7%
S&P 500-stock index	2%	-1%	4%
Russell 2000 (small stocks)	1%	-3%	6%
U.S. dollar[8]	-1%	6%	-1%
Commodities[5]	-6%	-9%	5%
Emerging-markets stocks[2]	-9%	-11%	10%
European stocks[4]	-9%	-12%	7%

[1]PowerShares DB Gold, [2]iShares MSCI Emerging Markets ETF, [3]iShares DJ U.S. Real Estate Index, [4]iShares S&P Europe 350 Index, [5]Green Haven Continuous Commodity Index, [6]iBoxx High Yield Corporate Bond Fund, [7]JP Morgan Emerging Markets Bond Fund, [8]PowerShares DB US Dollar Index, [9]iBoxx Investment Grade Corporate Bond Fund, [10]PowerShares DB Oil, [11]iShares Barclays 20+ Year Treasury Bond

Never before has it been easier for investors to invest in the strongest trends wherever they might be found in the world. Relative strength offers an ideal framework for allocating among those trends. **Markets are global and your portfolio should be too.**

High RS Asset Class

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 1/26/2012:



"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 1/26/2012:

Sector Performance

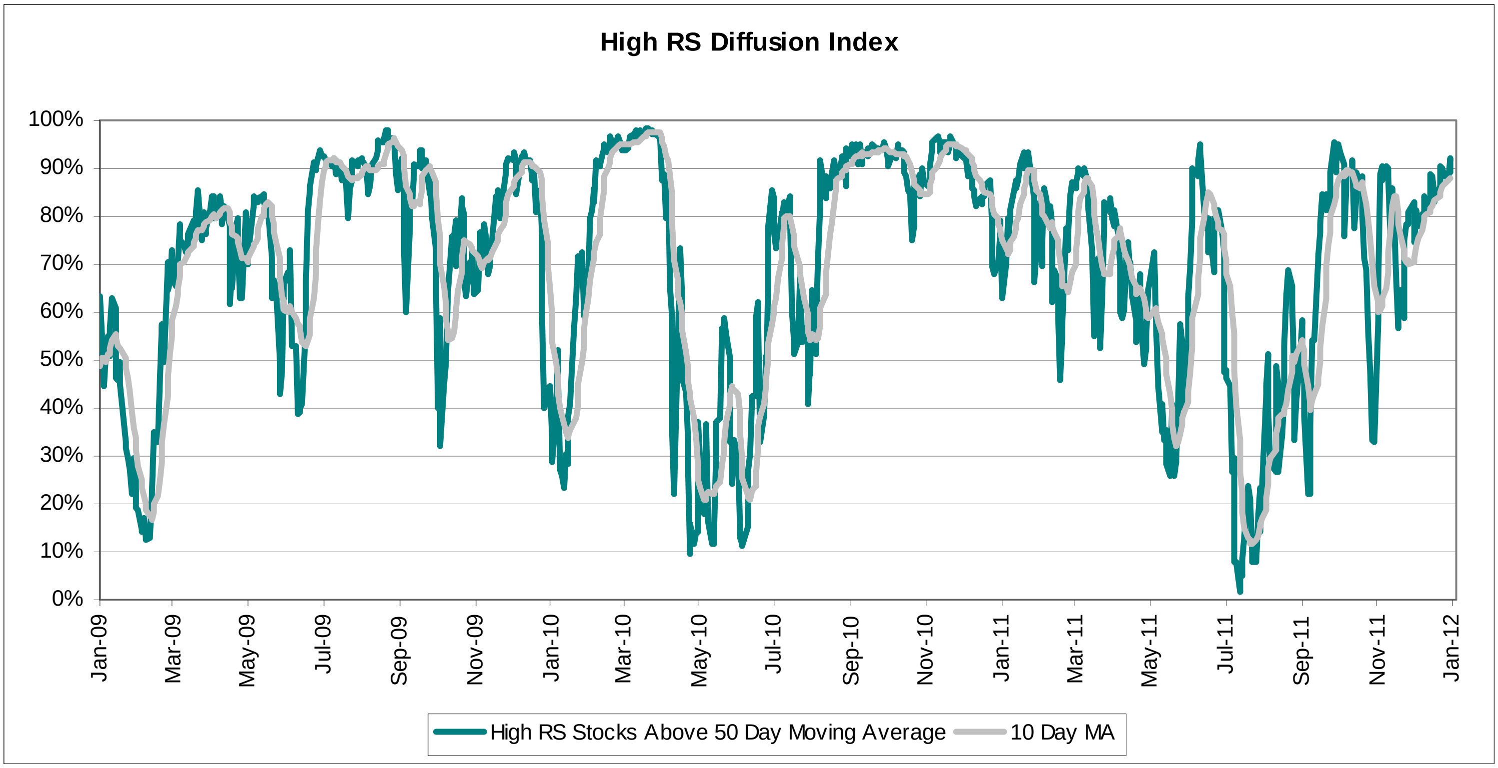
S&P 500 GICS Sector	12 Month	6 Month	1 Month
Health Care	12%	3%	3%
Utilities	10%	4%	-3%
Consumer Staples	10%	4%	-1%
Consumer Discretionary	9%	2%	6%
Technology	3%	1%	6%
Energy	0%	-8%	2%
Industrials	0%	1%	7%
Telecommunications	-2%	-4%	-4%
Materials	-2%	-5%	10%
Financials	-14%	-7%	8%

Capitalization Performance

S&P Small-Cap	5%	0%	5%
S&P Large-Cap	2%	-1%	4%
S&P Mid-Cap	1%	-4%	6%

High RS Diffusion Index

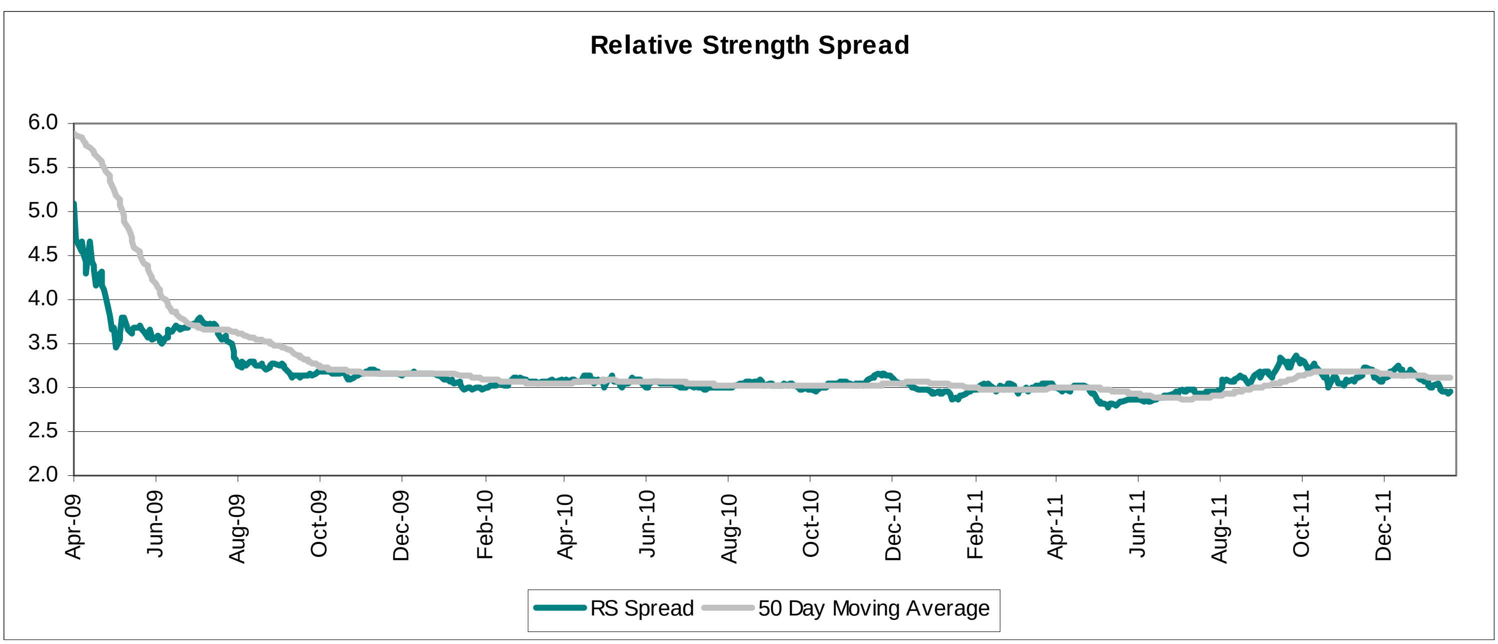
As of 1/26/2012:



The 10-day moving average is 88% and the one-day reading is 89%.

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 1/26/2012:



Over the past two and a half years, relative strength leaders have had similar performance to the relative strength laggards. Using history as a guide, we expect this spread to eventually resume its upward trend.

Harnessing the Power of Momentum

That's the title of [a recent article in *Advisor Perspectives* about relative strength investing](). (Academics call it momentum.) The article was written by a principal at a Canadian money management firm, Michael Nairne, so it's nice to see a little cross-border validation. From the article:

> *Numerous academic studies have confirmed that, when measured in periods of approximately three to 12 months, past investment winners tend to keep on outperforming while past losers tend to keep underperforming.*
>
> *Momentum is not simply a US phenomenon. A recent study[2] covering equities in 23 countries from November 1989 to September 2010 found evidence of strong momentum returns in North America, Europe and Asia Pacific; only Japan was an exception. Another study tracking the largest 100 stocks in the British market from 1900 to 2009 found that a portfolio comprised of the 20 best performers over the prior 12 months outperformed the worst performers by 10.3% annually[3]. The same authors found momentum in 18 out of 19 markets, dating back to 1975 in larger European markets and 1926 in the US.*
>
> *Momentum is not confined to portfolios of individual stocks – it exists in a variety of asset classes. A recent study[4] has found that momentum exists in government bonds, commodities and currencies as well as country equity indexes. Momentum has also been found in corporate bonds[5] as well as the financial futures market[6].*

The article is well-footnoted. I recommend you read the original, which I linked to above. The article does a good job discussing both the pros and cons of relative strength. For example, the author points out that:

> *...there are prolonged periods where stocks with positive momentum underperform the market. Despite an overall annualized premium of 3.9%, there have 22 periods where stocks with positive momentum have underperformed the market by greater than 5%, with durations as long as several years.*

Although investors have a marked tendency to abandon strategies when they underperform for a period of time, that might not be a good idea with relative strength. Despite periods of underperformance, long-term results have been remarkable:

> ***The $1.00 investment in momentum stocks grew to $67,309, nearly 30-times larger than the $2,321 earned in the S&P 500****. [August 1927 to July 2011] For long-term investors, this outperformance has been remarkably enduring. In 99.6% of the 10-year rolling periods since July 1937, momentum stocks have outperformed the S&P 500. [my emphasis]*

Investors have a lot of choices when it comes to selecting an investment strategy, but not many have been as well validated over as long a period of time in multiple markets as relative strength.

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). The table below is ranked in descending order based on flows for the week ending 1/18/2012.

(Dollar Figures in Millions)
Net New Cash Flow

	1/18/12	YTD
Taxable Bond	3,813	12,071
Municipal Bonds	1,743	4,665
Hybrid	1,265	3,673
Foreign Equity	320	-1,293
Domestic Equity	-804	-7,111

Domestic equity funds were the only category with negative flows last week; the bulk of the money continues to flow into taxable bond 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)

- Combining Relative Strength and Low Volatility, Oct 12, 2011
- The #1 Investment Return Factor No One Wants to Talk About, Jun 29, 2011

Arrow DWA Balanced Fund (DWAFX)

- High Marks For DWAFX After 5 Years, Aug 9, 2011
- What is a Balanced Fund, and Why Should You Care?, Nov 15, 2010

Arrow DWA Tactical Fund (DWTFX)

- Anything Can Happen—and Probably Will, Jan 17, 2012
- Combining Global Macro & MDLOX, Jan 12, 2012

Dorsey Wright Money Management

- *Bringing Real-World Testing To Relative Strength*, Jan 2011
- *Relative Strength and Asset Class Rotation*, Feb 2011

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