

*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

2007 NCAA Football Rankings, As of Oct. 28

### Bowl Champ. Series

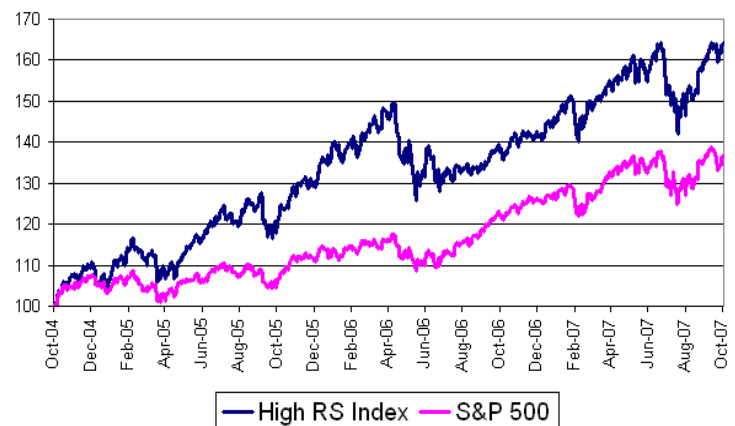
1. Ohio State
2. Boston College
3. LSU
4. Arizona State
5. Oregon
6. Oklahoma
7. West Virginia
8. Kansas
9. Missouri
10. Georgia
11. Virginia Tech
12. Michigan
13. Connecticut
14. Hawaii
15. Texas
16. Auburn
17. Alabama
18. South Florida
19. USC
20. Florida
21. Wisconsin
22. Boise State
23. Virginia
24. Wake Forest
25. Clemson

Those college football teams who rise in the ranks of the top 25 are the best performers (no surprise!) Similarly, those stocks eligible for relative strength (RS) portfolios are, likewise, the best performers. RS adapts as market conditions change, just like the college football rankings change depending on performance. Relative strength does not require forecasting or complex multifactor modeling. It simply requires that we keep the best performing stocks in the portfolio at all times.

## High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 10/29/07:

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 10/29/07

### Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Energy	37.18%	20.09%	2.24%
Materials	31.42%	11.41%	3.73%
Technology	24.64%	15.03%	4.72%
Industrials	17.77%	7.50%	-1.35%
Utilities	17.49%	0.17%	5.16%
Telecommunications	16.66%	7.12%	-1.14%
Consumer Staples	10.88%	4.77%	1.79%
Health Care	6.66%	-1.17%	1.01%
Consumer Discretionary	-1.30%	-7.29%	-0.39%
Financials	-5.13%	-9.88%	-2.23%

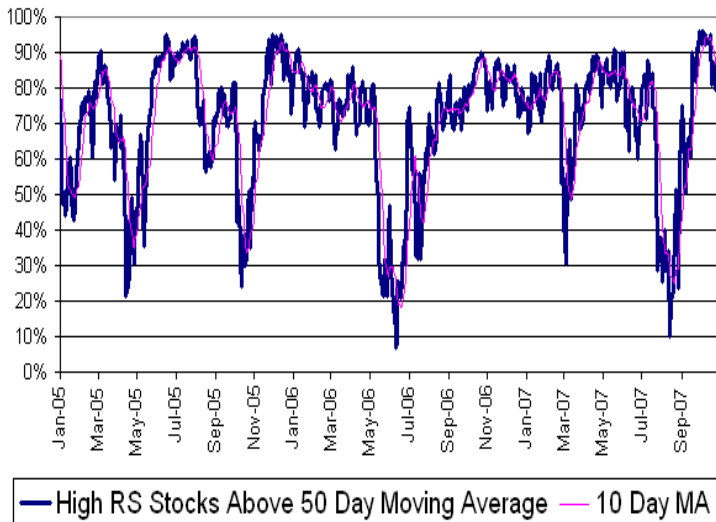
### Performance by Capitalization

S&P Mid-Cap	13.63%	1.38%	1.59%
S&P Large-Cap	11.76%	3.08%	1.02%
S&P Small-Cap	9.55%	8.94%	1.05%

## High RS Diffusion Index

As of 10/29/07

### Dorsey Wright Diffusion Index

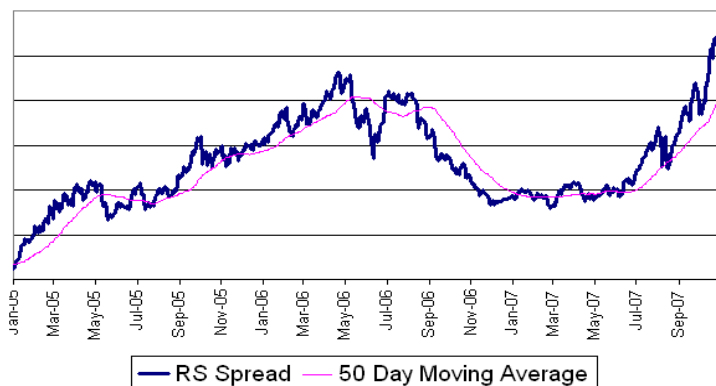


High RS stocks powered higher following the short correction in August of this year. A high percentage of high RS stocks continue to trade above their 50 day moving average.

## 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. When investors are confident in market leadership, they continue to buy into strength and sell into weakness. When investors are risk averse, they tend to sell into strength and buy into weakness. As of 10/29/07

### Relative Strength Spread



The current environment is very favorable for relative strength strategies as RS leaders are outperforming RS laggards.

## Social Proof And Trends




There are two major reasons that trends tend to persist in the stock market (which enables relative strength strategies to earn excess returns over time).

- 1– The Market Persistently Under Reacts to Fundamental Trends
- 2– Investors Tend to Exhibit “Herd Behavior”

The psychological principle of social proof is closely tied to number 2—the herd behavior exhibited over and over again by investors. In *Influence* by Robert B. Cialdini, Ph.D., social proof is described as a means people use to decide what constitutes correct behavior. We view a behavior as more correct in a given situation to the degree that we see others performing it. Whether the question is what to do with an empty popcorn box in a movie theater, how fast to drive on a certain stretch of highway, or how to eat the chicken at a dinner party, the actions of those around us will be important in defining the answer.

Cialdini points out that “when we are unsure of ourselves, when the situation is unclear or ambiguous, when uncertainty reigns, we are most likely to look to and accept the actions of others as correct.” That is a pretty good description of the stock market. Uncertainty always abounds. So, how do many portfolio managers and investors determine what to do? They look to their peers for guidance. In the case of an individual investor, perhaps they listen to their brother-in-law’s tales of making a fortune in this stock or that. They in turn follow suit. And professional portfolio managers are certainly not above such behavior. Searching the SEC quarterly 13F filings provides an easy way to view the holdings of each of their competitors. The media loves to cover the top holdings of various top performing money managers. For example, you can most likely name a couple of Bill Miller’s (Legg Mason) or Warren Buffet’s (Berkshire Hathaway) top holdings. All of these influences add to buying and selling pressure that leads to trends. The strongest of the trends tend to go for much longer than many guess. Relative strength is simply a disciplined method of capitalizing on those trends. It is never the first on a trend, nor the first off, but it does allow the investor to participate in the major moves of stocks, sectors, and asset classes.

## Investor Sentiment

	10/24/2007 Results	Long-Term Average
<b>Bullish</b> 	31.25%	39%
<b>Neutral</b> 	20.54%	32%
<b>Bearish</b> 	48.21%	28%

The AAI Sentiment Survey measures the percentage of individual investors who are bullish, bearish, and neutral on the stock market short term; individuals are polled from the AAI web site on a weekly basis. Results as of 10/25/07.

The current bullish reading of 31.25% is the second lowest of the year (lowest came on May 3). The current bearish reading of 48.21% is also the second highest of the year (highest bearish reading also came on May 3).

It is generally a healthy sign for the broad market when there is some skepticism among individual investors. As a result, we view the current sentiment as favorable for continuation of the rising trend.

## 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 ETF (PDP)

- New ETF follows trends based on technical factors, *MarketWatch*, Mar 2, 2007  
<http://tinyurl.com/2qt6cd>

### Arrow DWA Balanced Fund (DWAFX)

- Arrow DWA Balanced Fund Hits \$100 Million in Assets, *Marketwire*, September 11, 2007  
<http://tinyurl.com/336e6u>

### Dorsey Wright Money Management

- Is a bottom in place?, *MarketWatch*, Aug 8, 2007  
<http://tinyurl.com/3c6yoo>
- Can Relative Strength Be Used in Portfolio Management?, *Technical Analysis of Stock & Commodities*, Aug 2005  
<http://tinyurl.com/38ooq3>
- Systematic Relative Strength Investment, *The Wall Street Transcript*, Jan 29, 2007  
<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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