High RS Newsletter

Dorsey Wright & Associates Money Management

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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.

Thought Process: Role of Volatility

Consider two different opinions on volatility:

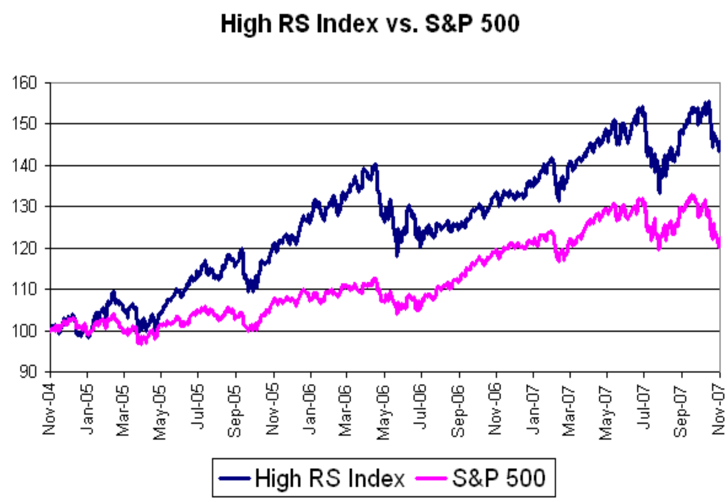
- Money is made in common stocks <u>despite</u> the volatility.
- Money is made in common stocks <u>because</u> of the volatility.

If there were an easy way to time the stock market (get all of the up and none of the down), investors would buy stocks in advance of a market rise and sell them in advance of a foreseen decline. This buying and selling activity, however, would change the pattern of future stock price behavior by smoothing out the market's ups and downs. There is only one problem: When common stock volatility disappears, so does the reward for bearing it! For the long-term investor, volatility is not the major risk; inflation is.

Sometimes investors forget that volatility is the very reason that common stocks have higher returns than other investments over time. Investors with the proper time horizon **prefer** their short-run, unpredictable volatility because they understand that it is part of the foundation on which their long-term higher returns are built. Given the proper time horizon, even a passive investment in common stocks has outperformed all other investments. In our experience, a relative strength strategy improves the risk/return profile of investing in common stocks. It is simply a way of allowing the volatility associated with common stocks to work in the investor's favor over time. This is accomplished by systematically holding the winners and cutting out the losers.

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 11/23/07:



"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 11/23/07

Sector Performance

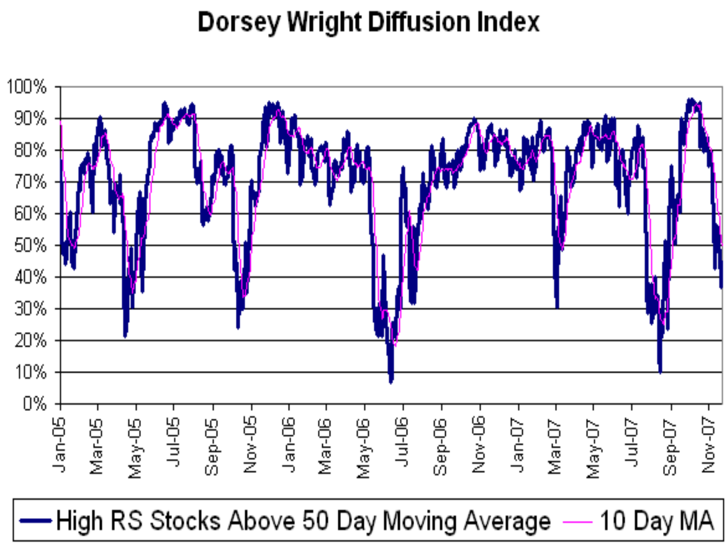
S&P 500 GICS Sector	12 Month	6 Month	1 Month
Energy	26.93%	8.12%	-1.96%
Utilities	16.57%	-0.32%	4.59%
Materials	13.40%	-1.41%	-6.04%
Consumber Staples	12.09%	5.31%	2.30%
Telecommunications	10.19%	-9.27%	-9.05%
Technology	8.68%	4.75%	-6.14%
Industrials	7.35%	-0.40%	-5.27%
Health Care	6.55%	-3.85%	-0.91%
Consumer Discretionary	-12.15%	-16.10%	-8.35%
Financials	-18.82%	-22.40%	-11.83%

Performance by Capitalization

S&P Mid-Cap	2.37%	-7.98%	-6.06%
S&P Large-Cap	2.28%	-5.45%	-5.03%
S&P Small-Cap	-2.60%	-9.67%	-7.83%

High RS Diffusion Index

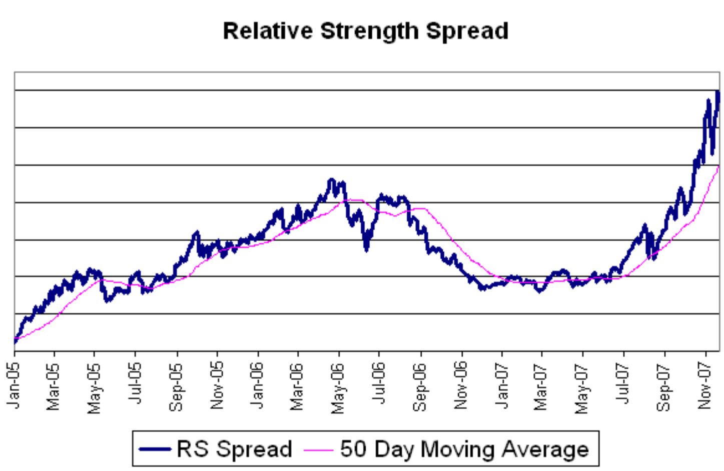
As of 11/23/07



Currently, 45% of high relative strength stocks are trading above their 50 day moving average (up from 36% reached in the middle of last week). Dips in this indicator have historically been good opportunities to add to relative strength strategies.

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 11/23/07

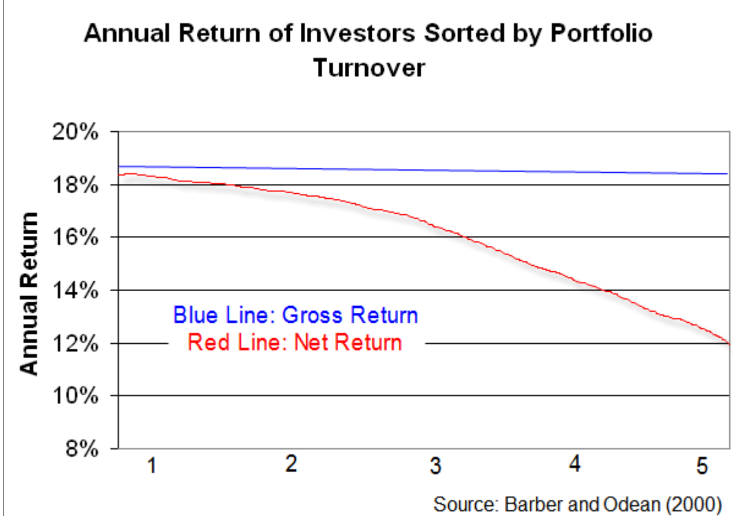


Location, location, location. RS leaders remain strong and RS laggards remain weak. We see no change in market leadership at this point.

Overtrading

One of the most frequent questions that we receive about relative strength strategies is, "Why don't you trade more?" Such a question often gives us the opportunity to explain that the nature of relative strength investing is to capture longer term-trends rather than to get every little market wiggle correct.

The question of how portfolio turnover affects performance has been researched by many. In 2000, Barber and Odean published a study on the effect of portfolio turnover in The *Journal of Finance.* In a sample of 78,000 household accounts over the period 1991 to 1996, they examined the relationship between turnover and portfolio returns. First, Barber and Odean determined the level of trading for the investors in their sample and categorized them into five groups. The highest turnover group experienced an average annual turnover rate of more than 250 percent per year.



Note that the average annual return for each of the five groups was about the same in gross returns. Therefore, high-turnover investors did not realize higher return for the additional efforts. However, commissions significantly reduced the performance for the more frequent turnover. While this is not a conclusive analysis of the effects of portfolio turnover, it does point to something that we have also found to be true—higher turnover doesn't always lead to better results. Even if no commissions were being paid, tax efficiency is a factor for taxable accounts. Even in qualified accounts, trading slippage is a factor. With RS strategies, we have found a certain amount of turnover to be helpful. After all, how else would you adapt to new trends? Yet, higher turnover does not always equal better results.

Investor Sentiment

		11/21/2007 Results	Long-Term Average
Bullish		25.58%	39%
Neutral		21.71%	32%
Bearish		52.71%	28%

The AAII 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 AAII web site on a weekly basis.

Since the survey's inception in 1987, there have only been 30 bearish readings above 50% (less than 3% of total readings). It is interesting to look at the previous times that individuals were so bearish (fall of 1990, Spring of 2003 to name a few). While not a perfect gauge, there have been quite a few times when individuals reached high levels of bearishness just before a broad market rally. At a minimum, it suggests pausing before succumbing to the bearishness.

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

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