

*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.

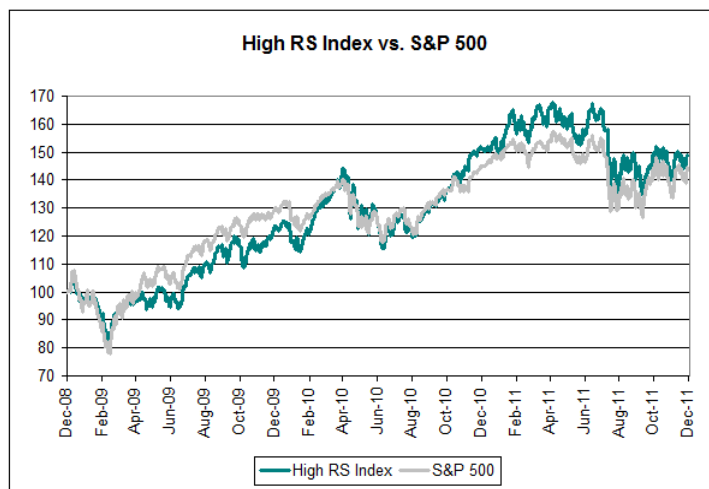
| Asset Class Performance                  |           |          |         |
|--|-----------|----------|---------|
|  | 12 Months | 6 Months | 1 Month |
| Long-term Treasuries <sup>11</sup>       | 34%       | 26%      | -1%     |
| Gold <sup>1</sup>                        | 14%       | 3%       | -6%     |
| U.S. investment-grade bonds <sup>9</sup> | 9%        | 3%       | 1%      |
| Emerging-markets bonds <sup>7</sup>      | 8%        | 3%       | 1%      |
| REIT stocks <sup>3</sup>                 | 7%        | -3%      | 9%      |
| U.S. corporate junk bonds <sup>6</sup>   | 6%        | 1%       | 4%      |
| Dow Jones Industrial Average             | 5%        | 0%       | 6%      |
| Crude oil <sup>10</sup>                  | 3%        | 0%       | 1%      |
| S&P 500-stock index                      | 0%        | -3%      | 6%      |
| Nasdaq Composite Index                   | -3%       | -3%      | 3%      |
| U.S. dollar <sup>8</sup>                 | -4%       | 5%       | 2%      |
| Russell 2000 (small stocks)              | -4%       | -6%      | 7%      |
| Commodities <sup>5</sup>                 | -7%       | -12%     | -4%     |
| European stocks <sup>4</sup>             | -12%      | -18%     | 4%      |
| Emerging-markets stocks <sup>2</sup>     | -16%      | -17%     | 1%      |

<sup>1</sup>PowerShares DB Gold, <sup>2</sup>iShares MSCI Emerging Markets ETF, <sup>3</sup>iShares DJ U.S. Real Estate Index, <sup>4</sup>iShares S&P Europe 350 Index, <sup>5</sup>Green Haven Continuous Commodity Index, <sup>6</sup>iBoxx High Yield Corporate Bond Fund, <sup>7</sup>JP Morgan Emerging Markets Bond Fund, <sup>8</sup>PowerShares DB US Dollar Index, <sup>9</sup>iBoxx Investment Grade Corporate Bond Fund, <sup>10</sup>PowerShares DB Oil, <sup>11</sup>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 12/22/2011:



"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

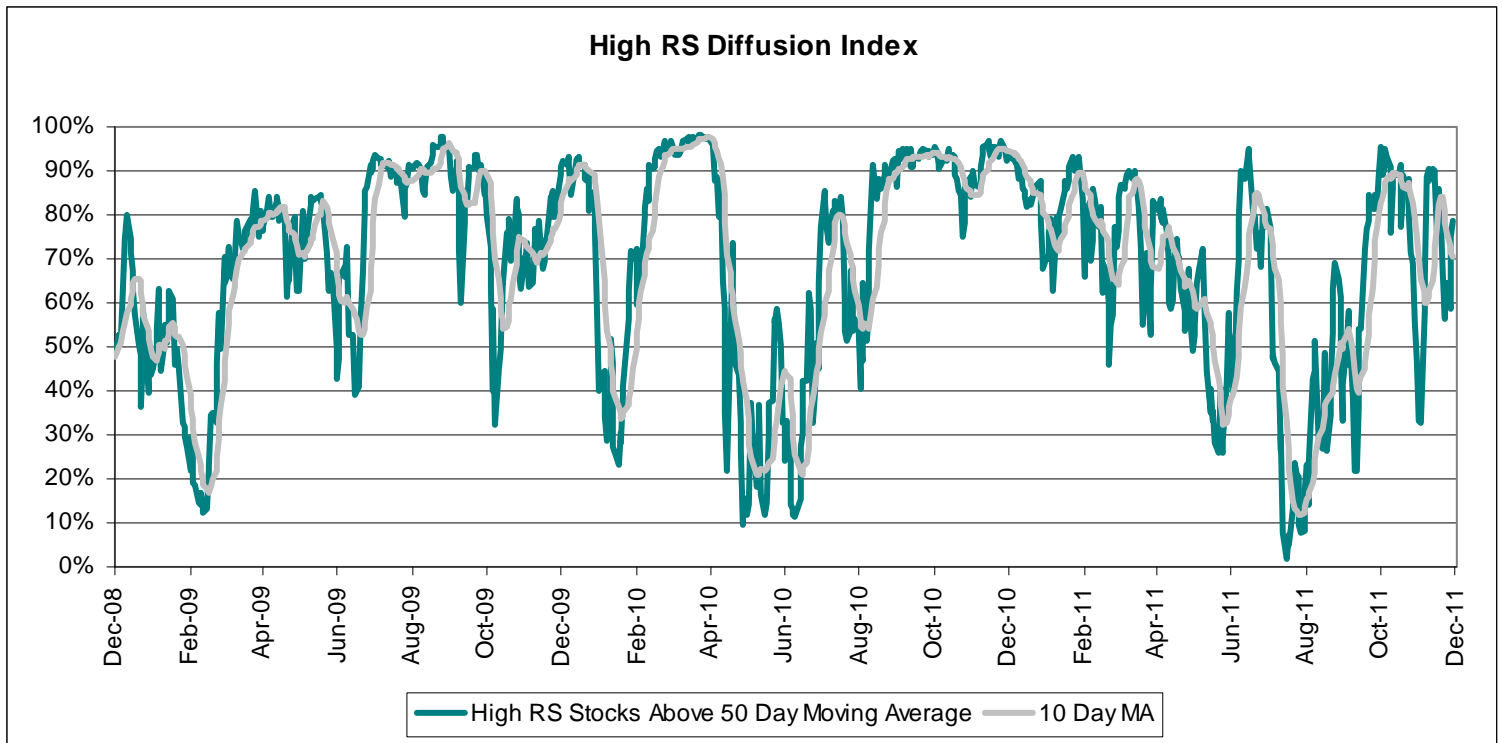
As of 12/22/2011

| Sector Performance     |          |         |         |
|------------------------|----------|---------|---------|
| S&P 500 GICS Sector    | 12 Month | 6 Month | 1 Month |
| Utilities              | 13%      | 8%      | 6%      |
| Consumer Staples       | 10%      | 4%      | 6%      |
| Health Care            | 9%       | -1%     | 7%      |
| Energy                 | 4%       | -4%     | 6%      |
| Consumer Discretionary | 3%       | 0%      | 4%      |
| Technology             | 0%       | 3%      | 2%      |
| Telecommunications     | 0%       | -3%     | 6%      |
| Industrials            | -3%      | -6%     | 7%      |
| Materials              | -10%     | -10%    | 4%      |
| Financials             | -18%     | -13%    | 9%      |

| Capitalization Performance |          |         |         |
|----------------------------|----------|---------|---------|
| S&P Large-Cap              | 12 Month | 6 Month | 1 Month |
| S&P Large-Cap              | 0%       | -3%     | 6%      |
| S&P Small-Cap              | 0%       | -3%     | 8%      |
| S&P Mid-Cap                | -4%      | -8%     | 5%      |

## High RS Diffusion Index

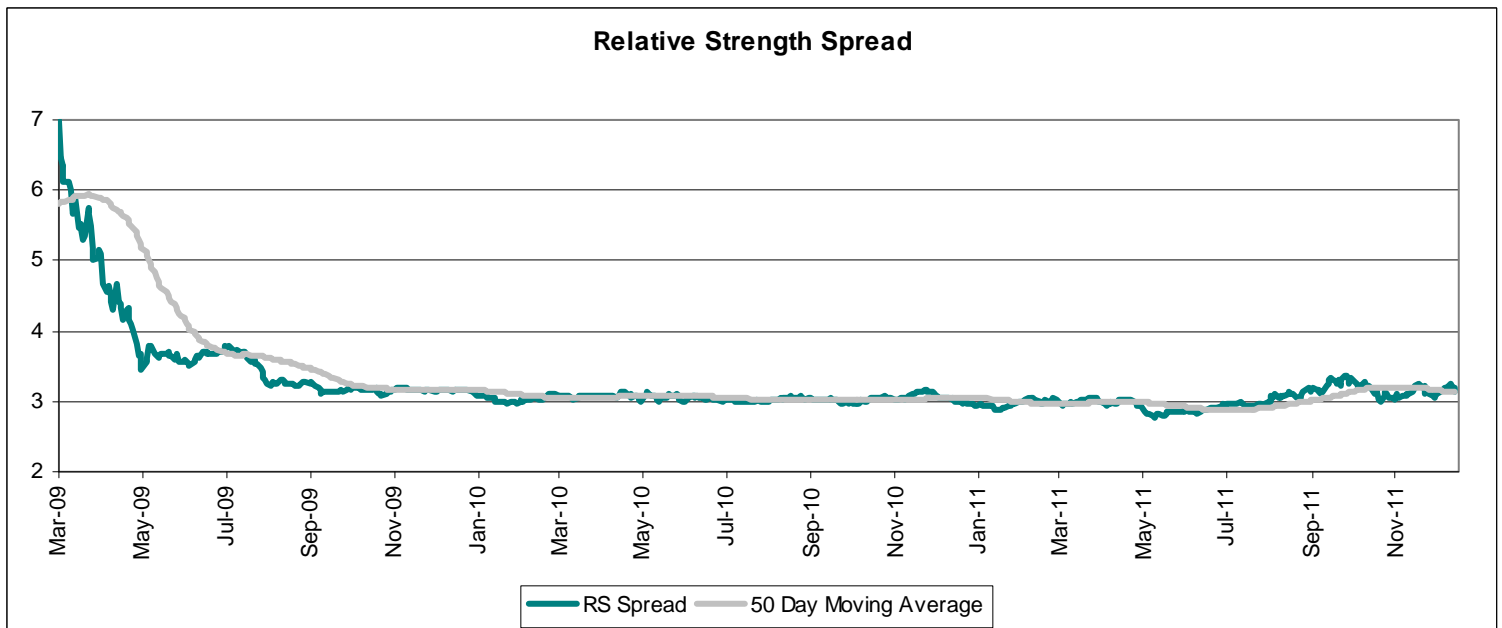
As of 12/22/2011:



The 10-day moving average is 71% and the one-day reading is 79%.

## 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 12/22/2011:



Over the past two 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.

## Don't Eat the Marshmallow!

It turns out that one of the best predictors of future success is the ability to manage "hot" emotional states and to learn self-control. Stanford psychologist Walter Mischel concocted an experiment involving 4-year olds and marshmallows to test self-control back in the 1960s, and only understood its significance much later. (The experiment has been repeated more recently by others. Here, for example, is [a video of Columbian psychologist Joachim de Posada replicating the results](#). Watch only if your tolerance for adorable 4-year olds trying to resist a marshmallow is extremely high!) [As Jonah Lehrer writes in \*The New Yorker\*](#):

*For decades, psychologists have focused on raw intelligence as the most important variable when it comes to predicting success in life. Mischel argues that intelligence is largely at the mercy of self-control: even the smartest kids still need to do their homework.*

This is very true in financial markets. Temperament trumps brains when it comes to making money over the long run. You can have a great plan, but if you do not have the discipline to execute it, the plan is useless.

News flow in financial markets---much of it alarming, since scary new always gets better ratings--gives investors a multitude of opportunities to behave badly. The best strategy? Distract yourself.

*At the time, psychologists assumed that children's ability to wait depended on how badly they wanted the marshmallow. But it soon became obvious that every child craved the extra treat. What, then, determined self-control? Mischel's conclusion, based on hundreds of hours of observation, was that the crucial skill was the "strategic allocation of attention." Instead of getting obsessed with the marshmallow—the "hot stimulus"—the patient children distracted themselves by covering their eyes, pretending to play hide-and-seek underneath the desk, or singing songs from "Sesame Street." Their desire wasn't defeated—it was merely forgotten. "If you're thinking about the marshmallow and how delicious it is, then you're going to eat it," Mischel says. "The key is to avoid thinking about it in the first place."*

*According to Mischel, this view of will power also helps explain why the marshmallow task is such a powerfully predictive test. "If you can deal with hot emotions, then you can study for the S.A.T. instead of watching television," Mischel says. "And you can save more money for retirement. It's not just about marshmallows."*

As Mr. Mischel points out, it's not just about marshmallows. When clients ask me what to do in volatile markets, I only half-jokingly suggest that they read the sports pages. Focusing on the business news is just going to make you more likely to react. The more impulsive you are, the more likely you are to make a poor decision.

*Continued on next page*

## **Don't Eat the Marshmallow!**

Self-control is very important when using return factors, none of which offer smooth sailing. Whether you are implementing relative strength or deep value or whatever, the market is going to gyrate and test you---basically do everything possible to get you to abandon your plan. A systematic, rules-based approach can be very helpful in this regard. If you have chosen a successful long-term strategy, more than anything else, your results are going to be dictated by how well you can follow it over the long run.



Source: [www.instructables.com](http://www.instructables.com)

## 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 12/14/2011.

(Dollar Figures in Millions)  
Net New Cash Flow

|                 | 12/14/11 | YTD      |
|-----------------|----------|----------|
| Taxable Bond    | 4,705    | 141,516  |
| Municipal Bonds | 868      | -15,515  |
| Hybrid          | 745      | 31,487   |
| Foreign Equity  | -1,515   | 8,752    |
| Domestic Equity | -3,979   | -133,964 |

In terms of fund flows, the story of the year (which is actually a continuation from 2010) is the exodus from domestic equity funds and the flood 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 (DWAFFX)

- [High Marks For DWAFFX After 5 Years](#), Aug 9, 2011
- [What is a Balanced Fund, and Why Should You Care?](#), Nov 15, 2010

Arrow DWA Tactical Fund (DWTFFX)

- [Escaping Failed Asset Allocation](#), Sep 3, 2011
- [Funds With Maximum Flexibility](#), Jun 3, 2011

Dorsey Wright Money Management

- [Bringing Real-World Testing To Relative Strength](#), Jan 2011
- [Relative Strength and Asset Class Rotation](#), Feb 2011

## Blog

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