

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.

China Tightens Australia's Monetary Policy

In case you are not convinced that we have a new world order, here is [an interesting tidbit](#) from the Wall Street Journal. On Tuesday, the Reserve Bank of Australia was expected to raise interest rates. They did not. The Australian dollar had been expecting the rate increase and took a hit when it didn't happen. The most interesting reason is why Australia didn't make a rate change.

...[the Reserve Bank of Australia] surprised the market by holding steady at 3.75%, noting among other factors China's efforts "to reduce the degree of stimulus to their economy."

You may ask what China's slowdown has to do with Australia's monetary policy. It's pretty straightforward.

Because a reduction of credit in China will ripple through to demand for Australia's raw materials, China essentially did Australia's tightening for it.

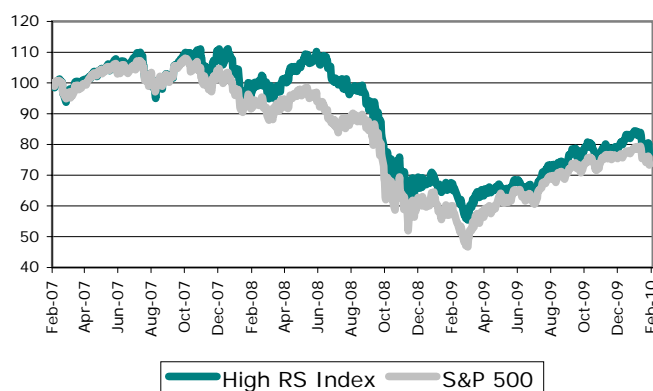
So there you have it. China is such a large trading partner for Australia that the assumption is that there will be a trickle-down effect. It used to be said that when America got the sniffles, the rest of the world caught a cold. Now, at least in Asia, that role is being played by China.

It's not clear what the investment implications of the new world order will be, but it's pretty clear that some traditional relationships are going to change dramatically. Your investment portfolio needs to be broad enough to have the ability to adapt.

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 2/5/2010:

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 2/5/2010

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Financials	55%	-1%	-7%
Consumer Discretionary	47%	12%	-5%
Technology	43%	8%	-9%
Materials	38%	1%	-11%
Industrials	32%	12%	-4%
Consumer Staples	17%	7%	-3%
Health Care	13%	11%	-2%
Energy	5%	4%	-8%
Telecommunications	1%	-3%	-12%
Utilities	-3%	1%	-6%

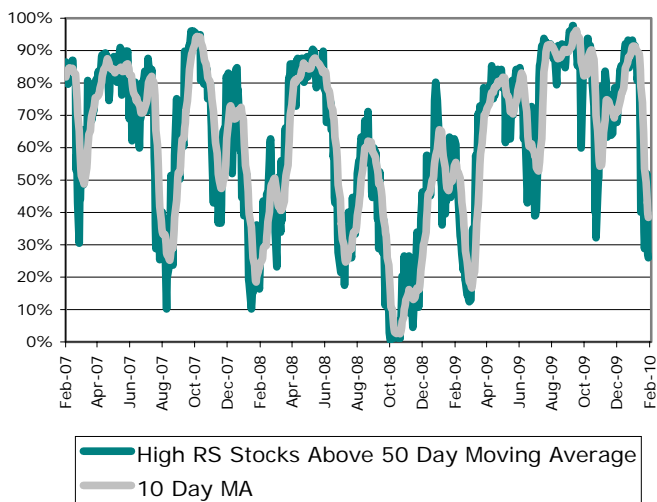
Capitalization Performance

S&P Mid-Cap	36%	8%	-6%
S&P Small-Cap	32%	5%	-7%
S&P Large-Cap	26%	6%	-6%

High RS Diffusion Index

As of 2/5/2010

High RS Diffusion Index

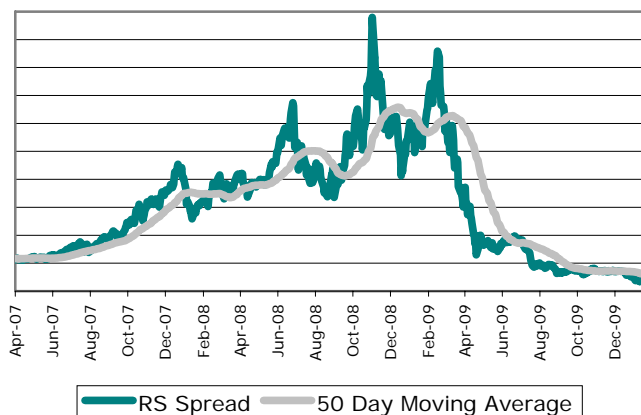


The 10-day moving average of this indicator is 38% and the one-day reading is 26%. Declines in this indicator have often provided good opportunities to added to RS strategies.

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. As of 2/5/2010:

Relative Strength Spread



The sharp decline in the RS Spread for much of the last 12 months has moderated considerably in recent months, and may well be setting the stage for a more favorable RS environment.

How to Find the Winners

Martjin Cremers, a professor at Yale, and his colleague, Antti Petajisto, authored a paper on the concept of active share. [Advisor Perspectives recently interviewed Mr. Cremers](#) to ask about his research.

Active share is a holdings-based measure of how different the holdings in an active portfolio are from the benchmark portfolio. As an example, an S&P 500 index fund would have an active share of 0%, since the holdings would be identical to the benchmark. Portfolios with low active shares around 30% are still so close to the benchmark that they are considered closet indexers.

Where Cremers and Petajisto differ from the establishment is that by segmenting managers in this way, they believe they are able to identify a subset of managers--those with high active share--who can outperform the benchmark over time.

That result is probably the most controversial. We find significant evidence, in our view, that a lot of managers actually do have some skill.

What I find refreshing about their approach is their willingness to examine aggregate data more thoroughly. In aggregate, their data also shows that fund managers do not outperform the benchmark. Most studies stop there, **pretend not to notice that numerous tested factors show evidence of long-term outperformance**, and then advise investors to buy index funds and to forget about active management.

Cremers and Petajisto were not content to take the lazy road. And, in fact, when looked at in more granular fashion, the data tells a different story. Closet indexers do worse than the market, but many managers with high active share show evidence of skill. This is much more in accord with other academic research that shows that broad, robust factors like relative strength and deep value can outperform over time. A manager that pursued such a strategy would have high active share and would have a good chance of long-term outperformance. That's exactly what our systematic relative strength strategies are designed to do.

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). Flow estimates are derived from data collected covering more than 95 percent of industry assets and are adjusted to represent industry totals. The table below is ranked in descending order based on flows through 1/27/2010.

	1/27/2010	1/31/2009
Taxable Bond	6,053	12,673
Municipal Bond	1,429	3,861
Foreign Equity	1,180	2,270
Hybrid	570	-340
Domestic Equity	-370	6,931

Investors continue to flock to bonds.

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)

- Ten Myths About ETF Investing, *ETFdb*, Nov 25, 2009
<http://tinyurl.com/yaxnklh>

Arrow DWA Balanced Fund (DWA FX)

- DWA FX Reaches New Milestone, Aug 13, 2009
<http://tinyurl.com/qursom>

Arrow DWA Tactical Fund (DWT FX)

- DWT FX: Good Marks After 3 Months, Nov 4, 2009
<http://tinyurl.com/yI5kbdd>

Dorsey Wright Money Management

- *Bringing Real-World Testing To Relative Strength*, Jan 2010
<http://tinyurl.com/yb37bfh>

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