

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



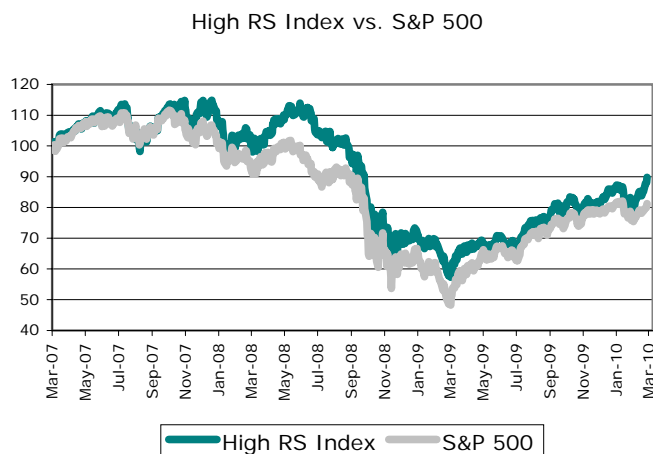
The Leuthold Group's Doug Ramsey recently discussed the psychology that drives bull markets:

Cashing in on bull markets is not a matter of waiting for everything to line up, anyway. There must be a set of intellectually appealing bear arguments keeping some players on the sidelines...it is these same players who will eventually drive prices even higher when "new" and intellectually appealing bull arguments belatedly appear on the scene. I have found that some of the best bull market action occurs when the "bull/bear" arguments superficially appear to be in relative balance, confounding many market players. When the balance tips too heavily to one side or the other, the odds are that most of the related market move is already in the books.

Reliance on relative strength is an effective way of avoiding the trap of overthinking every move. Moreover, it is a process that seeks to capitalize on what the market **is doing** as opposed to what one might think it **should be doing**.

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 3/5/2010:



"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 3/5/2010

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Financials	147%	7%	9%
Consumer Discretionary	95%	21%	10%
Industrials	94%	18%	9%
Materials	84%	11%	9%
Technology	76%	13%	7%
Health Care	47%	12%	4%
Energy	42%	11%	6%
Consumer Staples	41%	11%	6%
Utilities	30%	4%	3%
Telecommunications	12%	-1%	0%

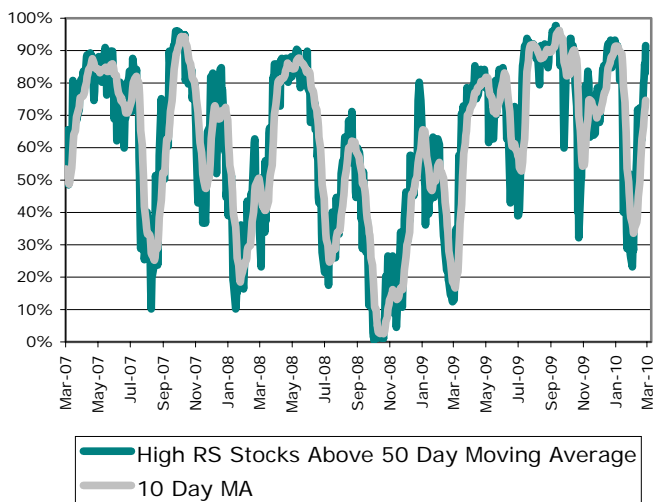
Capitalization Performance

S&P Small-Cap	90%	17%	12%
S&P Mid-Cap	87%	18%	11%
S&P Large-Cap	66%	12%	7%

High RS Diffusion Index

As of 3/5/2010

High RS Diffusion Index

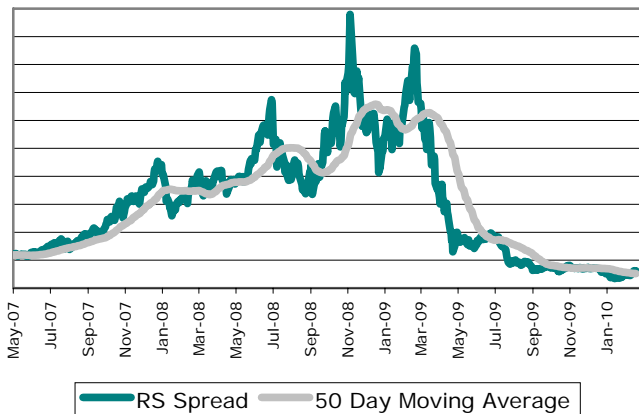


The 10-day moving average of this indicator is 75% and the one-day reading is 92%. After a brief correction, with a single-day low of 23% on 2/8/10, this indicator has snapped back strongly.

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 3/5/2010:

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.

The Land of the Midnight Sun

Norway is now [trying to figure out whether they should continue to use active managers or go to passive management](#). Their crisis came about in the financial meltdown when their previously successful active managers lost a slug of money. Now they are wondering whether they should just save the fees and use a passive approach.

I must confess that I've never completely understood this argument. Sure, an active manager can lose when the market goes down--but a passive manager is guaranteed to lose also. Fees are never pleasant, but as the old saying goes, "the bitterness of poor service lingers long after the sweetness of low cost is gone."

The base question is: are you getting what you pay for? Clearly, it makes no sense to pay a closet indexer the full fee for active management. We've written about this before, and it's true that closet indexers are a large part of the industry. No, you need to find a manager out of the mainstream with a high active share. It means you won't track the benchmark very closely at all, but you've got a very decent shot at beating the market [according to the research](#).

And despite what John Bogle and other EMH apologists say, there are plenty of strategies that do beat the market. Mark Hulbert of [MarketWatch addressed this recently](#):

My three decades of tracking investment advisers has shown that, over long periods of time, about one out of five advisers are able to do better than simply buying and holding an index fund. While that means it isn't impossible to outperform the market over the long term, the odds are stacked against us.

That 20% number sounds about right to me, and obviously Mr. Hulbert has the data to back it up. **The 80/20 rule holds just about everywhere else; I don't know why investment management would be any different.**

If, instead of resorting to passive management, you dedicate yourself to finding that superior 20% of the industry, it could be quite rewarding, not to mention a lot less boring than settling for mediocrity.

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 for the week ending 2/24/2010.

Asset Class	2/24/2010
Taxable Bond	6,815
Foreign Equity	1,817
Hybrid	1,119
Municipal Bond	1,073
Domestic Equity	151

Fixed income continued to attract the biggest portion of new money in the week ending 2/24.

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

Arrow DWA Balanced Fund (DWAFFX)

- [DWAFFX Reaches New Milestone](#), Aug 13, 2009

Arrow DWA Tactical Fund (DWTFX)

- [DWTFX: Good Marks After 3 Months](#), Nov 4, 2009

Dorsey Wright Money Management

- [Bringing Real-World Testing To Relative Strength](#), Jan 2010

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Dorsey, Wright Money Management
595 E. Colorado Blvd, Suite 518
Pasadena, CA 91101
(626) 535-0630