

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.

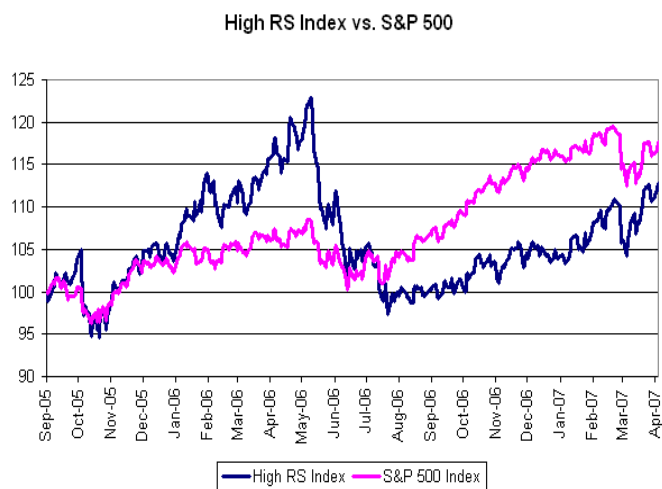
Feature: Thought Process



You should manage the portfolio like a business. Your stocks are your employees—they have a job to do! They work for you and only through them can your business accomplish its goals. You must decide what tasks your workers are to perform and it is also up to you to define what constitutes acceptable job performance. It is your responsibility to periodically review the job performance of your workers against the standards of performance that you have defined. When their performance on the job becomes unacceptable - it is your responsibility to fire that employee and replace him/her with a worker who is judged to be more capable of getting the job done. If you do not upgrade your work force then the goals of the business will not be met and you might even be forced out of business. Firing workers is not pleasant but it has to be done or the business could fail. **This activity does not require predicting the future but only the measurement of actual job performance.** Poor job performance is not to be tolerated and since there is always a reason for poor job performance - the simple fact of unacceptable job performance is grounds for dismissal. (Analogy Source: Clay Allen, *Market Dynamics*)

High RS Asset Class:

High RS stocks, as an asset class, often move independently of broad indexes. Recent performance through 4/3/07:



"High RS Index" is a proprietary Dorsey, Wright Index composed of stocks that meet a high level of relative strength

Sector & Capitalization Snapshot

As of 4/3/07

Sector Performance

S&P 500 GICS Sector	12 Month	6 Month	1 Month
Utilities	31.78%	18.50%	7.33%
Telecommunications	24.75%	15.54%	5.80%
Materials	17.91%	23.13%	5.48%
Energy	15.68%	19.45%	9.68%
Consumer Discretionary	15.12%	9.26%	2.29%
Consumer Staples	13.42%	6.21%	3.84%
Financials	9.90%	2.61%	0.98%
Health Care	7.15%	3.41%	3.05%
Industrials	5.32%	5.66%	2.79%
Technology	3.27%	6.56%	3.87%

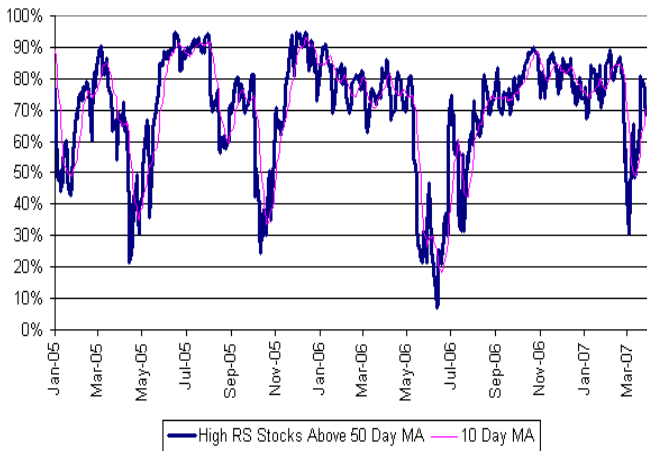
Performance by Capitalization

S&P Large-Cap	10.76%	7.75%	3.62%
S&P Mid-Cap	8.30%	14.37%	4.18%
S&P Small-Cap	6.37%	13.41%	5.11%

High RS Diffusion Index

For high RS strategies, dips are often a good time to add exposure. As of 4/3/07

Dorsey, Wright High RS Diffusion Index



Skew Data

In the stock market, at any given time, there are stocks in strong uptrends, stocks in strong downtrends, and a majority whose trends are currently static. The main objective of high relative strength investing is to find and capitalize on as many strong stocks as possible (and avoid as many weak stocks as possible).

Interestingly, high and low relative strength stocks often have a proportion of up days to down days of about 50 percent. One could be fooled into thinking that the price movement is random. However, the trend does not depend on having a lopsided number of days up versus the number of days down. The relative performance achieved by major winners is the result of the days up being persistently larger in percentage terms than the days down. Today we want to look at the worst performing component of the S&P 500 over the past year, AMD. You'll notice the negative skew of the histogram (the left tail is the longest). AMD had positive daily returns 43 percent of the time, but the stock was down 61%. So, whether AMD had an up day or a down day over the past year may have been close to random, but the distribution of percentage return definitely was not.

RS Spread

The chart below is the spread between 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. When investors are risk averse, they tend to sell into strength and buy into weakness. RS strategies tend to perform the best when the RS spread is rising.

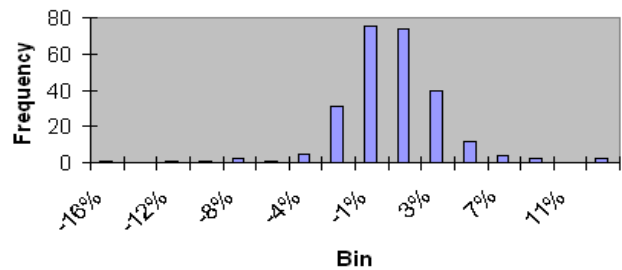
Relative Strength Spread



The RS Spread appears to be gaining some traction and is now above its 50 day moving average—a potential bullish sign for RS strategies.

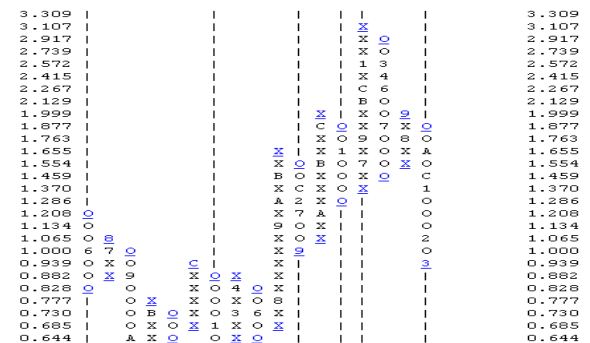
AMD Daily Price Change Histogram

April 3, 06 - April 3, 07



A relative strength chart of AMD, clearly shows the relative weakness of AMD over the past year.

Point & Figure RS Chart AMD vs S&P 500



Sentiment: On the Analyst's Couch

Studies show that investors often undermine their own returns by exiting equities when they feel uncomfortable—often at the lows. Sentiment indicators are often a good guide to how comfortable investors are feeling.

A recent study completed by Dalbar Inc. found that **the average equity investor actually earned just 3.9% annually for the 20-year period between 1986 and 2005**. Meanwhile, an investor who bought and held the components of the Stand & Poor's 500 stock index for that 20-year period would have realized an annual average return of 11.9% (*Investment News, 2006*).

Such sobering studies should make investors think hard before making a knee-jerk investment decision. The better choice is to select good strategies and stick with them.

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, *CBS Marketwatch*, Mar 2, 2007
<http://tinyurl.com/2qt6cd>
- New ETFs start trading on the NYSE, AMEX, *Reuters*, Mar 1, 2007
<http://tinyurl.com/2uw4mu>

Arrow DWA Balanced Fund (DWAFX)

- Fund of ETFs Leads Way for Moderate Allocation, Arrow Funds, Feb 21, 2007
<http://tinyurl.com/2j56ow>

General

- 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
[PDF available upon request](#)

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

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