

# Leveraging Market Dynamics

A small change in a security's price has a big story to tell; it can offer insights into future market trends while also providing a snapshot of the broader economic landscape.

Interpreting these complex patterns and trends can at times be overwhelming; amidst this maze of numbers and figures, the most crucial insights can occasionally get overlooked.

That's where Relative Strength, also known as Momentum, comes into play. Relative Strength is a powerful investment strategy that focuses on identifying securities, sectors, and markets that have consistently shown the ability to outperform others. We believe the fundamental concept of Relative Strength is that entities that have demonstrated their ability to outperform in the past may have the potential to continue to do so.

This strategy encourages investors to develop and follow a rules-based process for spotting leadership trends, adhering to these trends as long as they remain strong, and adapting as new trends emerge. This part of Relative Strength is made possible through a unique technical analysis method known as Point & Figure Charting.

Point & Figure Charting provides a unique perspective on market trends. Unlike other methodologies, it disregards time and focuses solely on changes in price. This approach smartly filters out 'noise' caused by minuscule fluctuations and underscores only those price movements that hold significance.

By focusing on these noteworthy price shifts coupled with persistent momentum, Point & Figure Charting enables a deeper understanding of the securities most likely to shape the market's future trajectory. The method effectively combines historical performance and ongoing market trends to spotlight securities with strong future potential.

When the principles of Relative Strength and Point & Figure Charting are applied, they can help to provide investors with a comprehensive view of the current top-performing securities.

## Point & Figure Charting

Point & Figure methodology has been used for over 100 years and has been endorsed by influential figures like Charles Dow, the first editor of the Wall Street Journal. Its longstanding presence and recognition in the financial industry attest to its credibility and effectiveness in analyzing market trends.

Point & Figure Charting is a well-established and organized approach for recording supply and demand forces in financial markets. Unlike traditional candlestick or line charts, Point & Figure Charts focus solely on changes in price without considering time. This unique approach eliminates noise caused by minor fluctuations and emphasizes significant price movements.

Through the analysis of patterns created by X's and O's, investors gain the ability to recognize trend reversals, pinpoint support and resistance levels, and identify opportune moments for entering or exiting trades. Point & Figure Charting serves as a valuable tool in filtering out market noise, allowing investors to concentrate on the essential factors that influence price movements.

Overall, Point & Figure Charting provides a logical and organized framework for understanding supply and demand dynamics. It answers the crucial question of when to buy and sell based on the balance between buyers and sellers in the market.

## The Benefits of Point & Figure Charting



### Eliminates noise

Unlike traditional candlestick or line charts, Point & Figure charts focus solely on changes in price without considering time. This unique approach eliminates noise caused by minor fluctuations and emphasizes meaningful price movements.



### Clarity in price action

Through the analysis of patterns, investors gain the ability to recognize trend reversals, pinpoint support and resistance levels, and identify opportune moments for entering or exiting trades.



### Identifying trends across asset classes

Can be used across stocks, exchange-traded funds (ETFs), indexes, and even commodities and alternatives like gold and crypto to identify trends – in fact, it can be applied to anything with a market-determined price value.

## Point & Figure Charting

### How It Works:

Point & Figure charting uses end-of-day pricing to capture significant price movements. By focusing on price variances and changes over periods of time, it assists in identifying patterns and trends related to shifts in supply and demand dynamics.

In a Point & Figure Charting:

- X's signify upward price changes
- O's denote downward price changes

These symbols, known as "boxes," represent specific price increments required for each movement; one box is required to create a trend within the chart, highlighting the directional movement of prices. When the price reverses by a predetermined amount, typically three boxes, new X's or O's are added to the chart, indicating a change in price direction.

### Decoding Patterns:

#### The movements in the chart's current column:

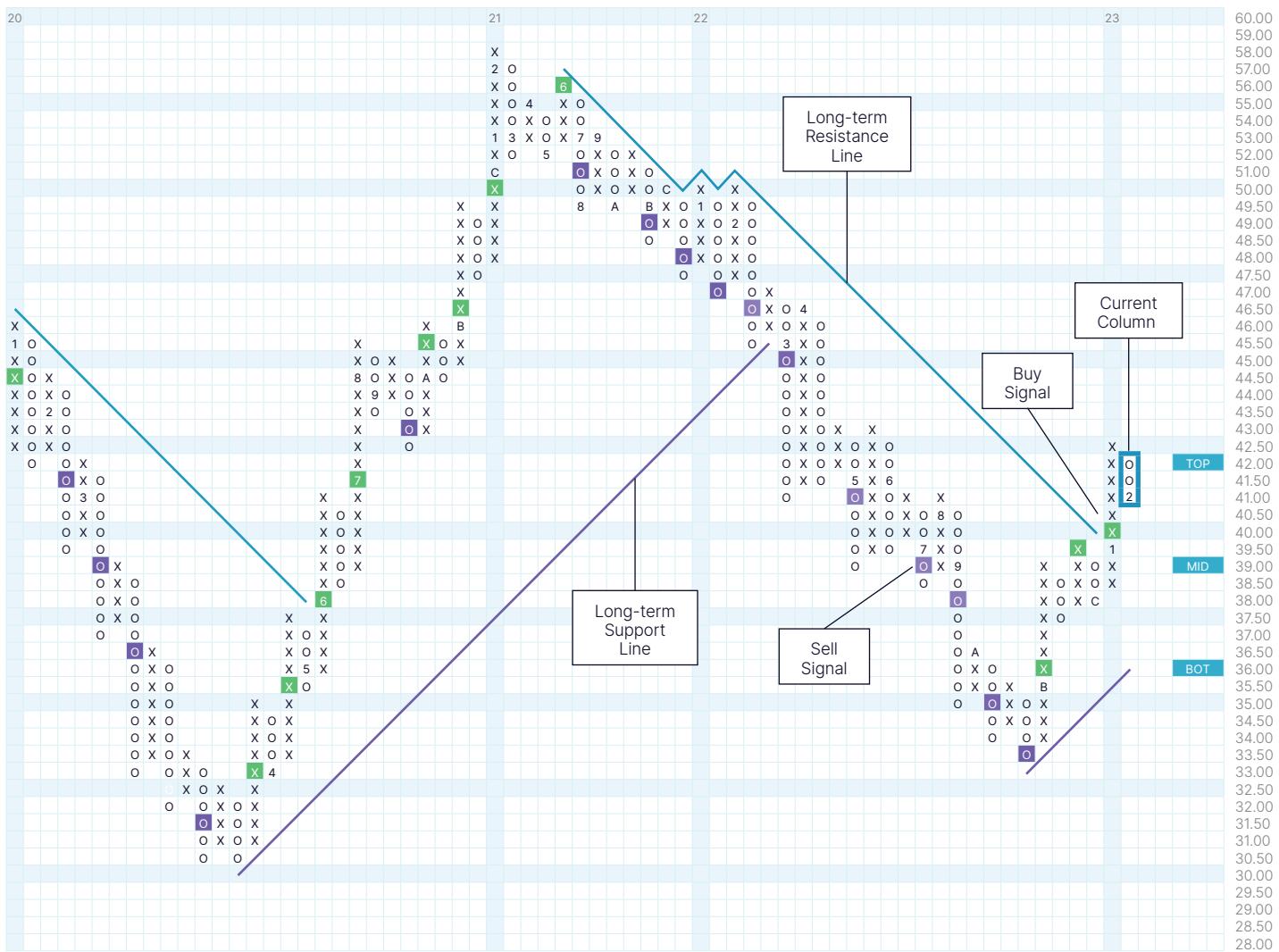
- Column of X's- price is rising, security is showing short-term strength
- Column of O's- price is falling, security is showing short-term weakness
- A reversal from a column of X's to a column of O's and vice versa occurs when the price has reversed direction significantly enough to indicate a change in the short-term strength/weakness of that security.

#### The chart's most recent buy or sell signal indicates immediate-term strength:

- Buy Signal- column of X's reaches point above previous column of X's
  - Break through near-term level of resistance
  - Sign of increasing demand for security
  - Represented by shaded green box
- Sell Signal- column of O's reaches point below previous column of O's
  - Break through near-term level of support
  - Sign of increasing supply of security
  - Represented by shaded red box

#### The current trend of the security's chart indicates its long-term trend:

- Positive Trend- security is trading above the long-term support line
- Negative Trend- security is trading below the long-term resistance line



## Relative Strength Investing

Relative Strength, also known as Momentum, has been proven to be one of the premier investment factors in use today. Several studies by academics and investment professionals suggest that successful securities tend to perform well, indicating that momentum may have positive effects within and across markets.

This strategy recognizes that assets exhibiting strength have a higher likelihood of continuing their upward trajectory. By focusing on leadership trends and adapting to new market dynamics, Relative Strength becomes a powerful instrument for long-term success.

## The Benefits of Relative Strength



Identify securities that consistently outperform their peers

Relative Strength filters through market noise and highlights areas of strength that may be overlooked by traditional analysis. It assists you in identifying assets with a consistent performance history, potentially aiding in your investment selection process.



Simplify decision-making

The rules-based process of Relative Strength removes subjectivity and emotion from your investment decisions. With a clear methodology guiding your choices, you can better understand and navigate the complexities of the market.



Power in price simplicity

Like Point & Figure trend charting, Point & Figure Relative Strength requires just one simple input – price.

## Step-by-Step Guide On How To Create A Chart:

### 1 Define Your Investment Universe

Start by determining the scope of your analysis. This could be individual stocks, sectors, or even broader market indices. Clarifying your investment universe will provide focus and ensure consistency throughout the analysis.

### 2 Gather Historical Price Data

Collect historical price data for each asset in your investment universe. This information will serve as the foundation for calculating relative performance.

### 3 Calculate Relative Strength Ratios

To calculate Relative Strength ratios, compare the performance of each asset against 'the base', a benchmark or a peer within the same investment universe. The formula for calculating Relative Strength is as follows:

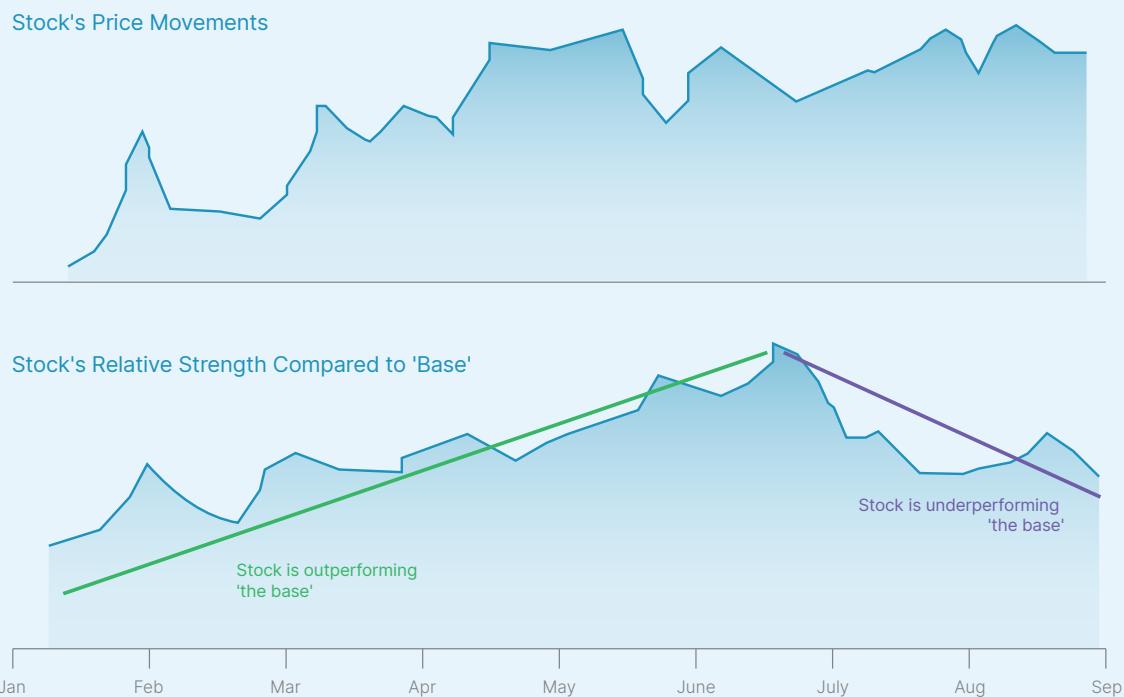
$$\left( \frac{\text{Price Performance of Asset}}{\text{Price Performance of Benchmark}} \right) \times 100$$

### 4 Rank Assets Based on Relative Strength

Rank the assets in your investment universe based on their Relative Strength values. This ranking can assist in pinpointing the assets that have generally performed better compared to others.

### 5 Identify Leadership Trends

Analyze the ranked list to identify assets that consistently exhibit high Relative Strength values. These are the securities, sectors, or markets that have proven their ability to outperform their peers and may continue to do so in the future.



## Utilizing Point & Figure Charting to Determine Relative Strength

Point & Figure Charting and Relative Strength work hand in hand to provide insightful analysis in investment decisions.

Using the Point & Figure charting method, investors can effectively track the supply and demand dynamics of various securities over time. This helps investors to understand the price movements and identify potential trends.

Relative Strength, on the other hand, is a comparative analysis tool. Using basic division to calculate the relative price

movement ratio between a security (stock, ETF index) versus another security, it can be used to compare the performance of multiple securities against each other.

This value is calculated daily and when plotted over time using the Point & Figure methodology, Relative Strength signals begin to develop among the X's and O's.

By combining the two, investors can determine which security is showing stronger performance over time (Relative Strength), based on the trends observed in supply and demand (Point & Figure Charting).

### Relative Strength Signals



Because there are only four types of potential Relative Strength (RS) signals – RS Buy in X's, RS Buy in O's, RS Sell in X's, RS Sell in O's, this methodology provides an objective, clear-cut way to measure a security's momentum and Relative Strength. RS Buy in X's is the most bullish signal for the security in question, while RS Sell in O's is the most bearish.

## The Case For Relative Strength Point & Figure Charting in Identifying High Performing Securities

Relative Strength is a powerful investment factor that can help investors identify securities with the potential for strong performance.

To put this theory to the test, we created a test universe using the performance of real-life securities from December 1989 to December 2023. The goal was to see how well Relative Strength can accurately pinpoint future high performing stocks using the insights provided during this specific timeframe.

The calculation of Relative Strength is graphically represented on a Point & Figure Chart. Every individual stock possesses a relative strength chart that tracks its long-term and short-term relative strength performance respectively. The most favorable relative strength indicator is observed when the chart demonstrates a buy signal and is situated in a column of X's.

### Methodology:

This study focused on examining the performance of real-life top-performing securities from the U.S. stock market spanning from December 1989 to December 2023. The selection process

involved choosing the top 1000 U.S. stocks annually based on their market capitalization as eligible securities for analysis.

The test universe encompassed both currently active stocks and those that had been delisted due to factors like buyouts or bankruptcies. To ensure liquidity and maintain an unbiased sample, securities that fell out of the top 1000 in market capitalization were removed from the universe, while new securities were regularly added.

The analysis of each stock's performance was conducted by categorizing them based on their Point & Figure Relative Strength pattern. Consistent parameters, including a box size of 6.5% and a minimum reversal of three boxes, were employed for all securities. The benchmark used for comparison throughout the study was the S&P 500.

### Actions

On a monthly basis, each stock was assigned to one of four baskets according to its Point & Figure Chart pattern: Best (BX), Good (BO), Improving (SX), or Very Weak (SO). Equal-weighted returns for each basket were calculated to evaluate their respective performance. At the end of every month, the baskets were reconstituted and equal weighted again. To provide a clearer understanding of the performance exhibited by these categorized groups, the S&P 500 Total Return Index (SPXTR) was utilized as a comparative reference.

### Annual Returns by Point & Figure Relative Strength Group

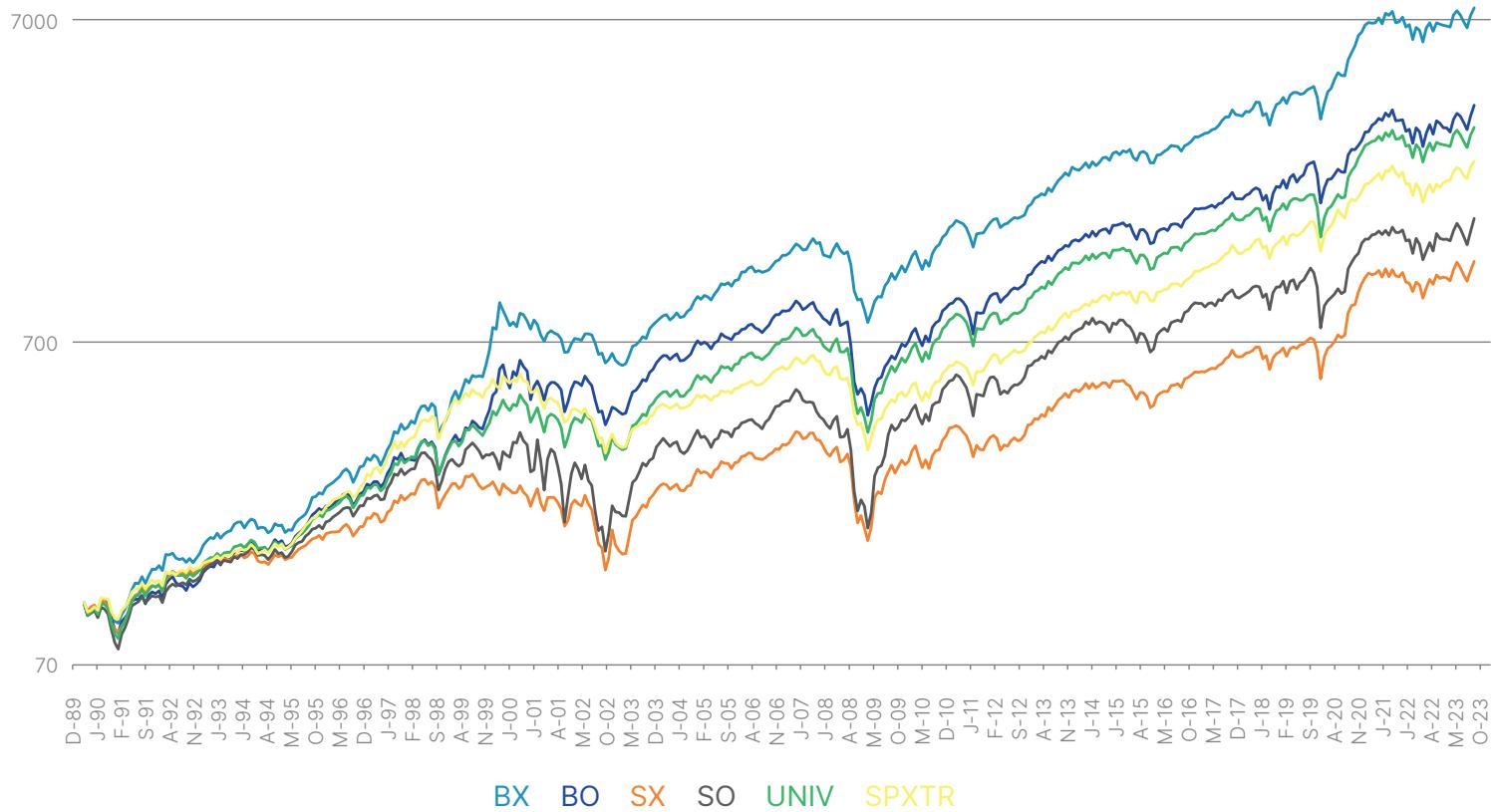
Date	BXw	BO	SX	SO	Univ	SPXTR
31/12/1990	-4.63%	-10.02%	-12.24%	-16.05%	-12.38%	-3.10%
31/12/1991	49.68%	28.06%	36.89%	31.18%	38.63%	30.47%
31/12/1992	10.65%	12.36%	12.00%	20.41%	13.88%	7.62%
31/12/1993	14.32%	18.19%	6.66%	11.82%	12.82%	10.08%
30/12/1994	-4.99%	0.36%	-1.50%	-3.19%	-2.72%	1.32%
29/12/1995	38.92%	32.17%	21.28%	30.65%	32.06%	37.58%
31/12/1996	19.81%	17.89%	11.33%	17.96%	17.31%	22.96%
31/12/1997	34.08%	21.52%	20.85%	24.83%	26.60%	33.36%
31/12/1998	18.20%	15.00%	7.58%	7.55%	11.68%	28.58%
31/12/1999	68.41%	40.41%	1.66%	5.24%	25.63%	21.04%
29/12/2000	5.66%	6.51%	-10.79%	-12.07%	-2.49%	-9.10%
31/12/2001	-12.70%	3.78%	-2.53%	5.31%	-2.30%	-11.89%

Date	BXw	BO	SX	SO	Univ	SPXTR
31/12/2002	-15.09%	-18.38%	-28.97%	-30.92%	-17.81%	-22.10%
31/12/2003	33.29%	40.62%	51.68%	62.85%	40.74%	28.68%
31/12/2004	20.49%	18.16%	17.33%	13.67%	18.59%	10.88%
30/12/2005	13.11%	5.46%	5.64%	1.66%	9.20%	4.91%
29/12/2006	15.66%	14.98%	9.89%	18.01%	16.03%	15.79%
31/12/2007	13.79%	0.72%	7.08%	-7.85%	4.05%	5.49%
31/12/2008	-34.00%	-42.62%	-43.52%	-46.44%	-40.14%	-37.00%
31/12/2009	27.60%	39.20%	52.45%	82.43%	44.15%	26.46%
31/12/2010	23.71%	27.87%	16.33%	25.57%	24.45%	15.06%
30/12/2011	3.12%	-1.43%	-7.18%	-4.82%	-0.15%	2.11%
31/12/2012	13.87%	23.88%	12.00%	15.42%	16.54%	16.00%
31/12/2013	36.70%	33.19%	37.28%	35.38%	35.79%	32.39%
31/12/2014	12.31%	13.22%	8.05%	9.19%	10.95%	13.69%
31/12/2015	2.51%	-3.43%	-9.71%	-11.19%	-4.31%	1.38%
30/12/2016	7.40%	12.82%	15.42%	25.19%	14.14%	11.96%
29/12/2017	22.17%	16.02%	17.26%	14.70%	18.26%	21.83%
31/12/2018	-5.75%	-8.67%	-9.26%	-12.07%	-8.58%	-4.38%
31/12/2019	31.29%	41.09%	26.90%	36.63%	31.29%	31.49%
31/12/2020	30.04%	10.69%	27.86%	4.41%	19.17%	18.40%
31/12/2021	35.54%	34.02%	31.20%	30.27%	35.07%	28.71%
30/12/2022	-13.59%	-16.48%	-10.49%	-16.36%	-14.02%	-18.11%
29/12/2023	18.82%	23.90%	18.92%	27.65%	18.82%	26.29%
<hr/>						
Cum	7,972.94%	3,942.29%	1,237.59%	1,713.99%	3,354.17%	2,622.08%
Annual	13.78%	11.49%	7.92%	8.89%	10.97%	10.20%
St Dev	20.33%	19.06%	20.42%	24.87%	18.79%	17.66%

## Results

Examining these returns, it becomes evident how crucial it is to remain invested in stocks that exhibit robust intermediate and long-term relative strength characteristics. The “Buy in X” basket has shown positive performance compared to both the S&P 500

and the equal weighted index of the eligible universe in certain periods. Although this basket displays slightly higher volatility compared to the broad market, it still manages to generate the best Sharpe ratio among all the baskets considered.



Source Dorsey Wright

All Performance numbers are based on the back-tested performance of non-investable indexes. Investors cannot invest directly in an index. Indexes have no fees. Please see the final page for important disclosures regarding back-tested performance. Examples presented herein are for illustrative purposes only and do not represent past or present recommendations. Past performance not indicative of future results. Potential for profits accompanied by possibility of loss.

## Comparative Insights

Stocks on a buy signal and in a column of X's performed the best over time, outperforming other baskets and benchmarks. Stocks on sell signals underperformed, and those in a column of O's performed slightly better but still not as well as the buy signal and X's basket. Momentum has historically shown potential for long-term growth, and focusing on stocks with strong rankings may contribute to improved performance.

**To put this into context; Stocks with strong Point & Figure Relative Strength consistently outperformed both the S&P 500 Total Return Index and the equal-weighted return of the 1000 U.S. stocks. Over a rolling 3-year period, the buy signal in X's basket outperformed the S&P 500 in 71% of months and the equal weighted universe in 78% of months.**

Relative Strength is an investment factor that often performs well compared to broad market benchmarks. The key to success lies in staying invested in stocks that demonstrate strong intermediate and long-term relative strength characteristics. Despite exhibiting slightly higher volatility compared to the broader market, this strategy managed to deliver the highest returns.

**Want to unlock more valuable insights like these?**

Nasdaq Dorsey Wright's advanced research platform is designed to provide investors with a variety of research tools and resources to aid in their investment decision-making process.

Utilizing the power of Point & Figure charts, the platform objectively categorizes securities based on their intermediate and long-term Relative Strength attributes. Users have access to insights on asset performance, which can aid them in identifying potential investment opportunities.

**Gain access to valuable insights right at your fingertips with a free trial of the Nasdaq Dorsey Wright Research Platform**

Nasdaq Dorsey Wright (NDW) is a registered investment advisory firm specializing in Relative Strength-based tactical solutions. Our mission is to empower financial advisors with the tools and insights needed to enhance their client service. With over 30 years of experience, we offer a comprehensive suite of resources, including our Research Platform, managed account strategies, and ETFs, all grounded in NDW's unbiased and objective data. This data has guided our clients successfully through various market cycles.

Our Research Platform equips advisors to optimize portfolio allocations based on Relative Strength and effortlessly monitor their watchlists. With access to over 100 systematic strategies and custom alerts covering more than 50,000 individual stocks, ETFs, and mutual funds, NDW streamlines portfolio construction and elevates risk management. This enables advisors to prioritize client relationships and business growth while staying attuned to market dynamics.

We believe NDW's pioneering use of Relative Strength Technical Analysis & Trading Strategies has made us early adopters of smart beta strategies, enhancing performance through alternative weightings and proprietary tactical asset allocation

models. Since introducing our first ETF-linked index in 2007, we've expanded our index offerings into new markets and transformed our portfolio and tactical asset allocation models into innovative global solutions for investment professionals.

In the ever-evolving advisory landscape, the choice between in-house portfolio management and third-party outsourcing is pivotal. Nasdaq Dorsey Wright offers a versatile solution through our Systematic Relative Strength investment strategies, accessible as separately managed accounts (SMAs) and/or unified managed accounts (UMAs) on more than 15 platforms. Our commitment to disciplined, rules-based methodologies helps us utilize the Relative Strength model across various investment universes and model constraints, aiming to deliver varied risk and return profiles that may benefit from ongoing leadership trends.

For over three decades, our research platform, strategies, indexes, and analysts have been instrumental in helping advisors safeguard and grow portfolios. With NDW's suite of tools, products, and strategies, you can engage in more informed client conversations, assist them in achieving their financial goals, and simultaneously expand your business.

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## Dorsey Wright Money Management

Registered Investment Advisor

790 E Colorado Blvd., Suite 550  
Pasadena, CA 91101

**Email:** [moneymanagement@dorseywright.com](mailto:moneymanagement@dorseywright.com)

**Phone:** +1 626 535 0630

[nasdaq.com/solutions/nasdaq-dorsey-wright](http://nasdaq.com/solutions/nasdaq-dorsey-wright)

