

# Capturing Momentum through Sector Rotation: Dorsey Wright® Focus Five™ Index (DWANQFF™)

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## **Introduction**

The Dorsey Wright® Focus Five™ Index (DWANQFF™) was launched in February 2014 and is designed to measure the performance of five funds from a universe of First Trust sector-focused exchange-traded funds (ETFs) that demonstrate high Relative Strength. The Dorsey Wright Focus Five Index follows an objective, rules-based methodology, removing emotion and “gut feel” from the process entirely. Because Relative Strength is a dynamic measure by nature, the Dorsey Wright Focus Five is evaluated every two weeks to ensure the index is consistently positioned towards five sector-based ETFs with the highest Relative Strength based on the index methodology.

Between November 2017 and January 2021, the Dorsey Wright Focus Five Index maintained a steady overweight to the broader Technology sector due to its superior Relative Strength versus other sectors represented in the index universe. In January 2021, however, the First Trust Dow Jones Internet Index Fund (FDN) found itself below the index’s sell threshold when it fell significantly out of favor on a relative basis, triggering its removal from the Dorsey Wright Focus Five Index. This marked the start of what was to be the Dorsey Wright Focus Five’s gradual rotation out of the broader Technology sector. In March 2022, the Index’s Technology exposure hit 0% for the first time in its eight-year history when the First Trust Nasdaq-100 Technology Sector ETF (QTEC) was removed. In place of its Technology exposure, the Dorsey Wright Focus Five rotated into higher Relative Strength sector representatives, including Consumer Staples, Energy, and Materials. Technology remained on the sidelines for the remainder of 2022 due to its weak Relative Strength. Throughout the first quarter of 2023, however, the broader US market began to rebound, mainly driven by the Technology sector. Financials began to weaken following the collapse of Silicon Valley Bank (SVB) and the ensuing banking crisis. Other previously leading (or outperforming) sectors in 2022, including Energy, Health Care, and Utilities, also flipped to lagging (or underperforming) positions. As a result, the Dorsey Wright Focus Five Index removed its exposure to Financials and Oil & Gas in March 2023. It rotated into the First Trust Nasdaq Semiconductor ETF (FTXL) as well as the Consumer Discretionary sector via the First Trust Consumer Discretionary AlphaDEX ETF (FXD), speaking to the adaptive nature of the Relative Strength methodology that drives the Dorsey Wright Focus Five Index.

**Figure 1: Dorsey Wright Focus Five Index Sector Inventory**

Sector	Symbol	ETF Name	Sector	Symbol	ETF Name
Healthcare	FBT	First Trust NYSE Arca Biotechnology Index Fund	Non-Cyclical	FXG	First Trust Consumer Staples AlphaDEX® Fund
Technology	FDN	First Trust Dow Jones Internet Index Fund	Healthcare	FXH	First Trust Health Care AlphaDEX® Fund
Real Estate	FRI	First Trust S&P REIT Index Fund	Technology	FXL	First Trust Technology AlphaDEX® Fund
Non-Cyclical	FTXG	First Trust Nasdaq Food & Beverage ETF	Energy	FXN	First Trust Energy AlphaDEX® Fund
Healthcare	FTXH	First Trust Nasdaq Pharmaceuticals ETF	Financial	FXO	First Trust Financial AlphaDEX® Fund
Technology	FTXL	First Trust Nasdaq Semiconductor ETF	Industrial	FXR	First Trust Industrials/Producer Durables AlphaDEX® Fund
Energy	FTXN	First Trust Nasdaq Oil & Gas ETF	Utilities	FXU	First Trust Utilities AlphaDEX® Fund
Financial	FTXO	First Trust Nasdaq Bank ETF	Materials	FXZ	First Trust Materials AlphaDEX® Fund
Industrial	FTXR	First Trust Nasdaq Transportation ETF	Cyclicals	QQXT	First Trust NASDAQ-100 Ex-Technology Sector Index Fund
Cyclicals	FXD	First Trust Consumer Discretionary AlphaDEX® Fund	Technology	QTEC	First Trust NASDAQ-100 Technology Index Fund

### ***Dorsey Wright Focus Five Index Methodology***

Instead of holding individual stocks, the Dorsey Wright Focus Five takes an “index of funds” approach. At all times, the Dorsey Wright Focus Five Index is comprised of five ETFs representing at least three broad sectors. Post-reconstitution, the five funds that make up the Index are considered to be the strongest on a Relative Strength basis out of a universe of 20 sector-based ETFs from First Trust. To construct the index, a Relative Strength Matrix (RS Matrix) first compares and aggregates the daily relative price relationships of each sector fund in the inventory versus one another, ranking all 20 ETFs from strongest to weakest, as shown in Figure 2. The sector ETFs with the strongest Relative Strength rank near the top of the RS Matrix, while relatively weaker funds fall to the bottom. Once ranked, any ETF whose RS Matrix Rank falls outside the top three within its designated sector is ineligible for inclusion, as well as any security that ranks below the RS Matrix’s designated sell threshold (approximately bottom 1/2 or 50% of the RS Matrix) to ensure that the strongest funds are considered from at least three broad sectors. Finally, any ETF not currently held in the Index as of the Reconstitution Reference Date is removed from consideration if its RS Matrix Rank falls outside of the buy threshold (approximately the top 1/3 or 33% of the RS Matrix). Securities still eligible are ordered along two dimensions: first, by inclusion in the Index as of the Reconstitution Reference Date (yes to no) and second, by Matrix Rank (highest to lowest). The five first-ordered securities are selected for inclusion in the Index. When a change is made, the Index is rebalanced so that each position is equally weighted at 20%.

**Figure 2: Dorsey Wright Focus Five Index RS Matrix Ranking**

Rank	Symbol	ETF Name	Buys	X's	Total
1	FXR	First Trust Industrials/Producer Durables AlphaDEX® Fund	15	14	29
2	FXZ	First Trust Materials AlphaDEX® Fund	15	9	24
3	FTXL	First Trust Nasdaq Semiconductor ETF	14	19	33
4	FXD	First Trust Consumer Discretionary AlphaDEX® Fund	14	12	26
5	QQXT	First Trust NASDAQ-100 Ex-Technology Sector Index Fund	12	15	27
6	FDN	First Trust Dow Jones Internet Index Fund	12	15	27
7	FTXG	First Trust Nasdaq Food & Beverage ETF	12	10	22
8	QTEC	First Trust NASDAQ-100 Technology Index Fund	11	18	29
9	FBT	First Trust NYSE Arca Biotechnology Index Fund	11	12	23
10	FXG	First Trust Consumer Staples AlphaDEX® Fund	10	8	18
11	FTXN	First Trust Nasdaq Oil & Gas ETF	9	5	14
12	FTXH	First Trust Nasdaq Pharmaceuticals ETF	8	8	16
13	FXH	First Trust Health Care AlphaDEX® Fund	8	8	16
14	FTXR	First Trust Nasdaq Transportation ETF	7	10	17
15	FXO	First Trust Financial AlphaDEX® Fund	7	1	8
16	FXU	First Trust Utilities AlphaDEX® Fund	6	6	12
17	FRI	First Trust S&P REIT Index Fund	6	4	10
18	FXN	First Trust Energy AlphaDEX® Fund	6	2	8
19	FXL	First Trust Technology AlphaDEX® Fund	5	14	19
20	FTXO	First Trust Nasdaq Bank ETF	0	0	0

(For Illustrative Purposes Only)

**Adapting to Changes in Sector Leadership**

In accordance with the index methodology, the Dorsey Wright Focus Five is reviewed for potential changes in Relative Strength every two weeks. While the Index has the chance to reconstitute 26 times per year, it has only been reconstituted 19 times since its inception in February 2014, averaging two reconstitutions per year. The Dorsey Wright Focus Five experienced a higher-than-average number of changes in 2016 (4), 2020 (4), and 2022 (4), which can be attributed to elevated market volatility and shifts in long-term leadership. Within the 19 reconstitutions that have occurred since inception, the Dorsey Wright Focus Five Index has experienced 22 changes, where one change is defined as one sector-based ETF being added and another sector-based ETF being removed. Since the COVID-19 US equity market crash and rebound in 2020, the Dorsey Wright Focus Five has experienced 12 changes, accounting for 55% of the total changes since inception, as the index has continued to adapt to new sector leaders and laggards. Year-to-date through March 31, 2023, the Dorsey Wright Focus Five has already experienced three changes, outpacing the index's annual average with more than nine months left to close out 2023.

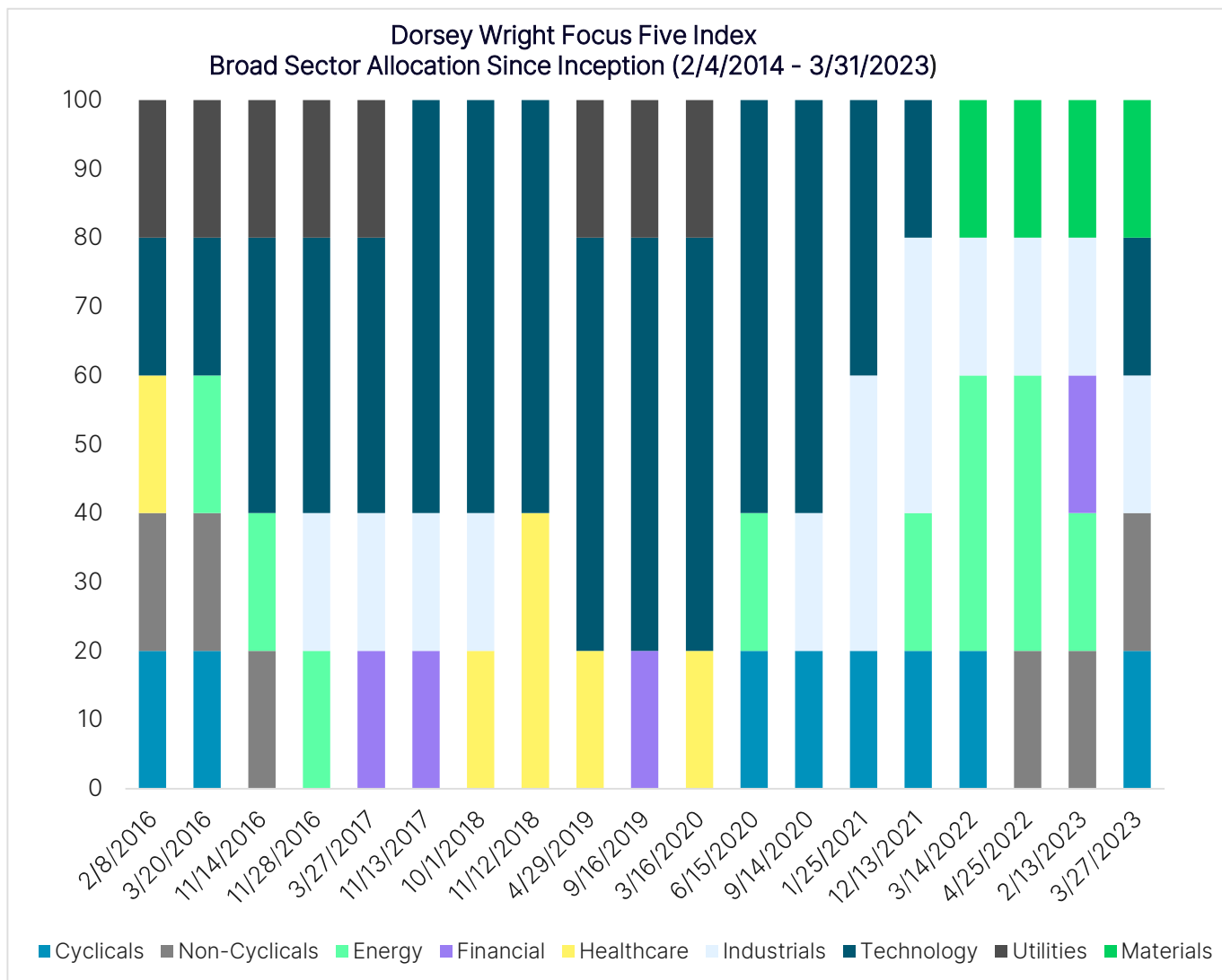
As mentioned, the Dorsey Wright Focus Five Index universe consists of 20 sector-based First Trust ETFs. The Index inventory can change as new sector products are launched, or existing sector products are no longer fit for the universe. Currently, the index universe does not contain any broad sector or sub-sector ETF representatives for the Communication Services sector.

**Figure 3: Index Changes (since inception)**

IN			OUT		
Effective Date	ETF Name	Symbol	Effective Date	ETF Name	Symbol
2/8/2016	First Trust Utilities AlphaDEX® Fund	FXU	2/8/2016	First Trust NYSE Arca Biotechnology Index Fund	FBT
3/21/2016	First Trust Energy AlphaDEX® Fund	FXN	3/21/2016	First Trust Health Care AlphaDEX® Fund	FXH
11/14/2016	First Trust NASDAQ-100 Technology Index Fund	QTEC	11/14/2016	First Trust Consumer Discretionary AlphaDEX® Fund	FXD
11/28/2016	First Trust Industrials/Producer Durables AlphaDEX® Fund	FXR	11/28/2016	First Trust Consumer Staples AlphaDEX® Fund	FXG
3/27/2017	First Trust Nasdaq Bank ETF	FTXO	3/27/2017	First Trust Energy AlphaDEX® Fund	FXN
11/13/2017	First Trust Technology AlphaDEX® Fund	FXL	11/13/2017	First Trust Utilities AlphaDEX® Fund	FXU
10/1/2018	First Trust NYSE Arca Biotechnology Index Fund	FBT	10/1/2018	First Trust Nasdaq Bank ETF	FTXO
11/12/2018	First Trust Health Care AlphaDEX® Fund	FXH	11/12/2018	First Trust Industrials/Producer Durables AlphaDEX® Fund	FXR
4/29/2019	First Trust Utilities AlphaDEX® Fund	FXU	4/29/2019	First Trust Health Care AlphaDEX® Fund	FXH
9/16/2019	First Trust Financial AlphaDEX® Fund	FXO	9/16/2019	First Trust NYSE Arca Biotechnology Index Fund	FBT
3/16/2020	First Trust Health Care AlphaDEX® Fund	FXH	3/16/2020	First Trust Financial AlphaDEX® Fund	FXO
6/15/2020	First Trust Consumer Discretionary AlphaDEX® Fund	FXD	6/15/2020	First Trust Health Care AlphaDEX® Fund	FXH
6/15/2020	First Trust Energy AlphaDEX® Fund	FXN	6/15/2020	First Trust Utilities AlphaDEX® Fund	FXU
9/14/2020	First Trust Nasdaq Transportation ETF	FTXR	9/14/2020	First Trust Energy AlphaDEX® Fund	FXN
1/25/2021	First Trust Industrials/Producer Durables AlphaDEX® Fund	FXR	1/25/2021	First Trust Dow Jones Internet Index Fund	FDN
12/13/2021	First Trust Nasdaq Oil & Gas ETF	FTXN	12/13/2021	First Trust Technology AlphaDEX® Fund	FXL
3/14/2022	First Trust Materials AlphaDEX® Fund	FXZ	3/14/2022	First Trust NASDAQ-100 Technology Index Fund	QTEC
3/14/2022	First Trust Energy AlphaDEX® Fund	FXN	3/14/2022	First Trust Nasdaq Transportation ETF	FTXR
4/25/2022	First Trust Food & Beverage ETF	FTXG	4/25/2022	First Trust Consumer Discretionary AlphaDEX® ETF	FXD
2/13/2023	First Trust Financial AlphaDEX® Fund	FXO	2/13/2023	First Trust Energy AlphaDEX® Fund	FXN
3/27/2023	First Trust Nasdaq Semiconductor ETF	FTXL	3/27/2023	First Trust Nasdaq Oil & Gas ETF	FTXN
3/27/2023	First Trust Consumer Discretionary AlphaDEX® Fund	FXD	3/27/2023	First Trust Financial AlphaDEX® Fund	FXO

Currently, the Dorsey Wright Focus Five Index has a 20% allocation to the following sectors based on Dorsey Wright’s broad sector classification system: Basic Materials, Industrials, Non-Cyclicals, Cyclicals, and Technology. While there is no way of knowing just how long today’s sector trends will remain in place, we know that the Dorsey Wright Focus Five will continuously measure, monitor, and eventually attempt to adapt to new market leaders over the long term using Relative Strength rotation spelled out in the Index’s rules-based, objective methodology.

**Figure 4: Historical Sector Allocation**

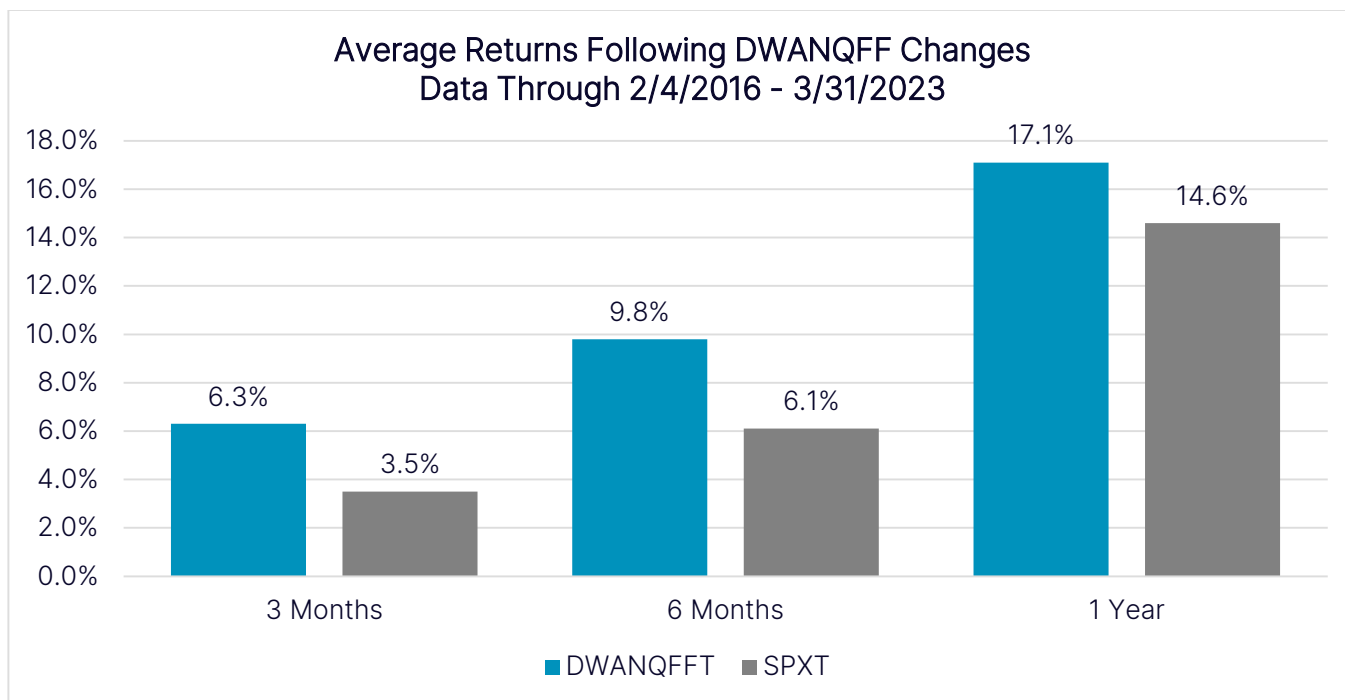
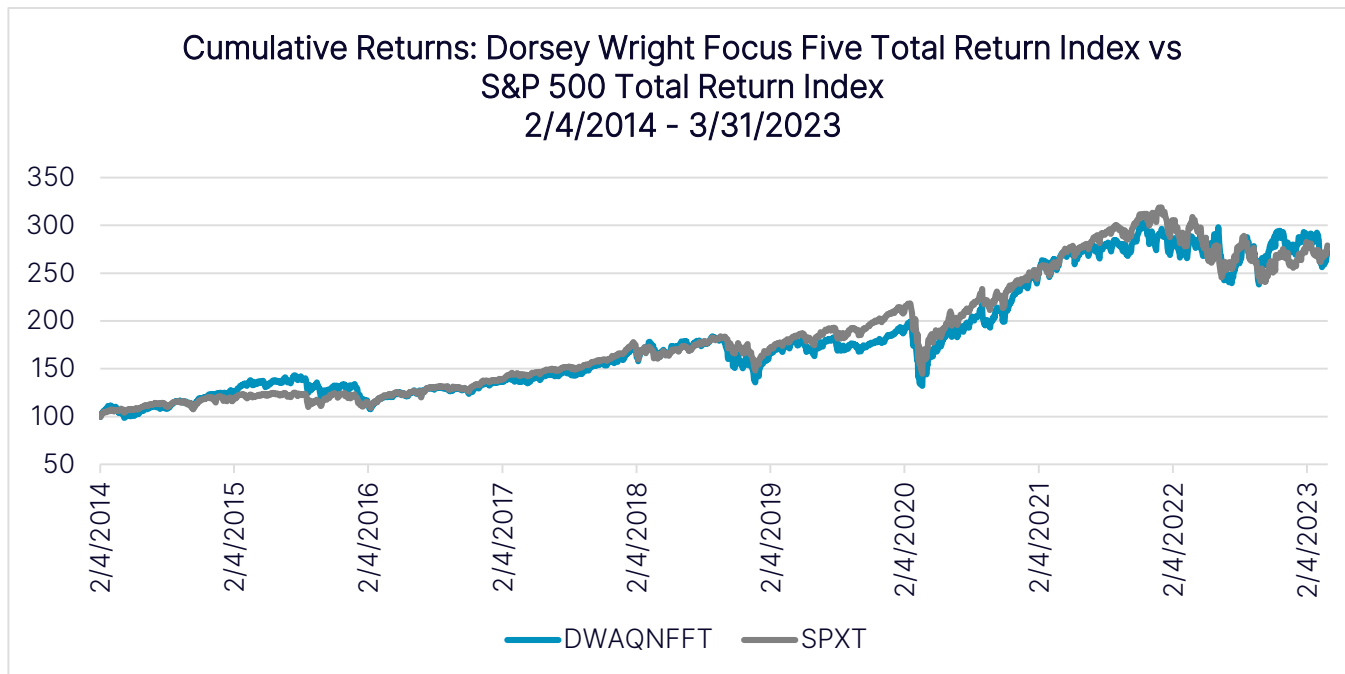


**Dorsey Wright Focus Five Index Performance vs. the S&P 500 Index**

It is important to note that Relative Strength-driven strategies such as the Dorsey Wright Focus Five Index often experience changes alongside periods of underperformance while trends shift gears. That said, it is the process of rotation out of sector laggards and into sector leaders that drives the long-term success of such momentum-based strategies. Changes confirm that the Index adapts to new market trends and allows the strategy to capture the “next big thing” regarding sector leadership. It is after such changes take place that the index tends to outperform. On average, the Dorsey Wright Focus Five Index has gained 6.3% 3 months out from a change, 9.8% six months out, and 17.1% one year out. In comparison, the S&P 500 Total Return Index gained 3.5%, 6.1%, and

14.6%, respectively, over the same period. Year-to-date through March 31, 2023, the Dorsey Wright Focus Five Total Return™ Index (DWANQFFT™) has fallen by -1.5%, underperforming the S&P 500 Total Return Index (SPXT)'s return of 7.5% by over 8%. However, this three-month lookback is a relatively short-term snapshot, and we have found that the Relative Strength approach shows its power over a longer-term horizon. Cumulatively over the last rolling three-year period following the COVID-19 market bottom, the Dorsey Wright Focus Five has outperformed the S&P 500 Index by over 13% on a total return basis. Since its inception on February 4, 2014, through the market close of March 31, 2023, the Dorsey Wright Focus Five Total Return Index has returned 11.6% on an annualized basis, while the S&P 500 Total Return Index has returned 11.9% over the same timeframe.

Figure 5: Index Performance



**Summary:** The Dorsey Wright Focus Five™ Index (DWANQFF™) is designed to measure the performance of five sector-focused funds from a universe of First Trust exchange-traded funds (ETFs) that demonstrate powerful Relative Strength characteristics. Between November 2017 and January 2021, the Dorsey Wright Focus Five maintained a steady overweight to the broader Technology sector, which dominated the other broad sectors regarding Relative Strength and leadership. In 2021, however, the Technology sector weakened significantly, causing the Dorsey Wright Focus Five to begin its gradual rotation out of Technology, which eventually hit 0% in March 2022. Following the US equity market rebound experienced throughout the first quarter of 2023, the Dorsey Wright Focus Five rotated back into Technology, where it currently maintains a 20% allocation in addition to 20% Basic Materials, 20% Industrials, 20% Consumer Non-Cyclicals, and 20% Consumer Cyclicals as of March 31, 2023.

**Accessing the Index:** The Dorsey Wright Focus Five Index (DWANQFF) is available to investors through the First Trust Dorsey Wright Focus Five ETF (Nasdaq: FV). For more information on the ETF, visit the First Trust site here: <https://www.ftportfolios.com/retail/etf/etfsummary.aspx?Ticker=FV>.

Source: Nasdaq Global Indexes, Nasdaq Dorsey Wright, Bloomberg, FactSet

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