Nasdaq

NASDAQ'S DORSEY WRIGHT CELEBRATES 10 YEARS SINCE FIRST ETF (PDP) LAUNCHED TIED TO ITS MOMENTUM STRATEGIES

BACKGROUND /

Dorsey Wright & Associates (DWA), a Nasdaq Company, is known for its expertise in relative strength-based research along with point and figure charting. DWA has upwards of 30 ETFs tracking its methodologies that have been packaged into indexes, all of which use some form of momentum ranking system for the underlying investment strategy. One of the long standing momentum ETFs in the line up is the PowerShares DWA Momentum Portfolio (ETF Ticker: PDP) that tracks the Dorsey Wright Technical Leaders Index (Index Ticker: DWTL). PDP just celebrated its 10-year anniversey (was originally launched March 1, 2007). PDP was the first momentum ETF to be launched and currently has around $1.4 Billion in AUM. On 3/1/17, it traded at a new all time high just shy of $46.00.

The investing process that DWTL adheres to is systematic in nature and uses relative strength to rank the holdings within the universe. Numerous studies show that having consistent exposure to the highest relative strength-ranked securities yields better investment results than exposure to poorly ranked securities. This entire process is part of Dorsey Wright's proprietarily-built ranking methodology, which involves taking each member of the universe and ranking them against each other to determine which securities are winning the "arm wrestling" match in the market. These stronger performing securities are the members of the universe that will be part of the portfolio. The index, and therefore the fund, rebalances on a quarterly basis and holds the top 100 ranked holdings out of the universe. The consistent rebalance process helps make sure the portfolio stays allocated to those securities that continue to demonstrate leadership. Chart 1 depicts performance of DWTL vs SPX (S&P 500) over the last decade.
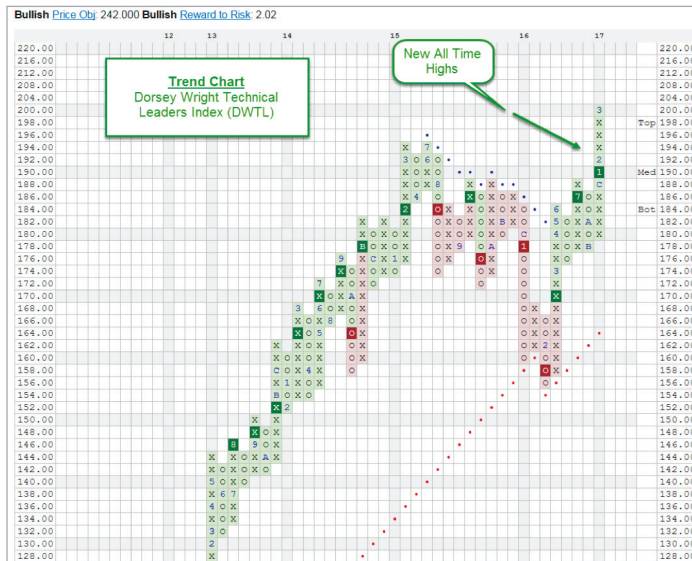
Chart 1

DWTL vs SPX
3/1/07 - 2/28/17
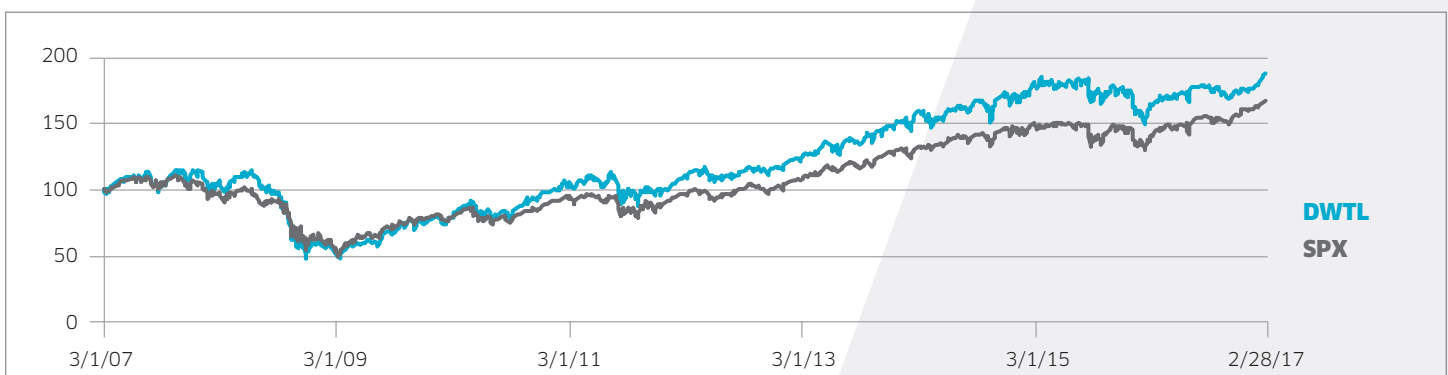
DWTL: POINT & FIGURE CHART – NEW ALL TIME HIGHS /

Over the years a number of academic studies have shown, on a longer term basis, that momentum tends to outperform other factors such as value and growth. As markets cycle there are always going to be certain periods of underperformance for any factor. Typically a time period when momentum underperforms is off a bear market bottom or when there is lack of sustained leadership by a particular sector(s) of the market. On the other hand, when there is a dispersion amongst a given universe relative strength can take advantage by keeping the portfolio allocated towards those securities that are outperforming their peers. When analyzing the below graph, we can certainly see some great examples of when DWTL has outperformed and also when it has underperformed. The most recent period of underperformance was in 2016 when there was a lack of sustained leadership in the U.S. equity markets. A prime example of this was the sharp rally the energy sector staged after the steep declines seen the previous year. This was one of the main reasons for the underperformance in 2016 given the fact most momentum portfolios had little to no exposure in energy to start the year. Thus far into 2017, momentum is off to a strong start so the previous trend of underperformance may be beginning to turn.
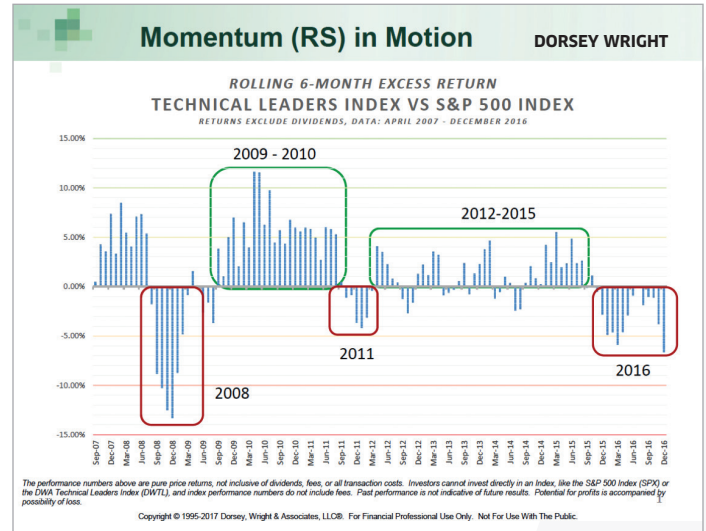
DWTL – ALLOCATIONS AND PERFORMANCE IN 2017 /

Let's fast forward to the current market environment in order to help give some perspective on how DTWL is performing so far this year. To begin, we will give a breakdown of current allocations as of 2/28/17. The largest allocations are currently Industrials (25%), Consumer Services (22%), and Financials (20%). The smallest allocations are in Utilties (3%) and Oil & Gas (1%).
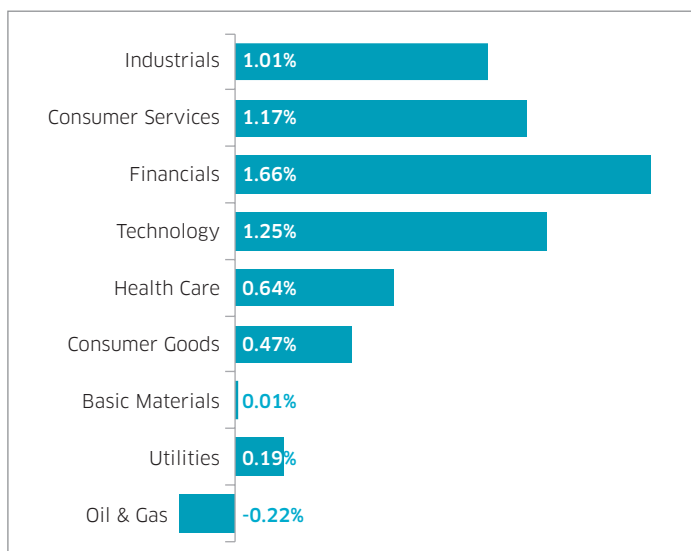
DWTL - Allocations
2/28/17
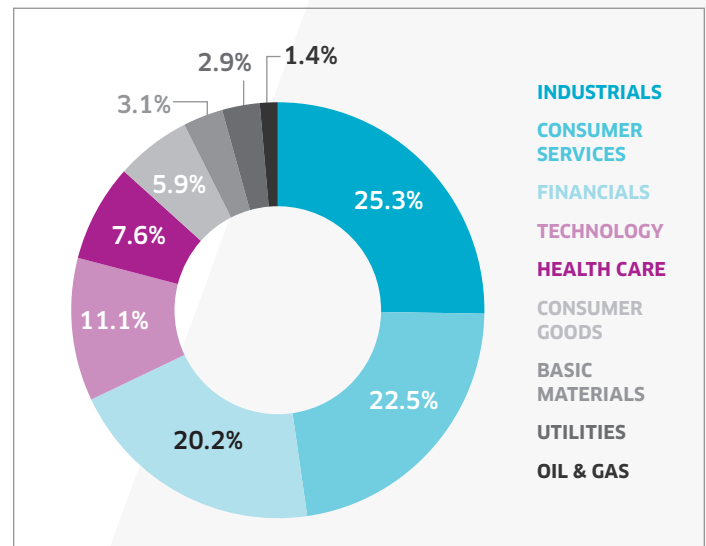
On a total return year-to-date basis DWTL was up +7.62% (as of 2/28/17) which compares quite favorably to the +5.94% from SPX. Thus far into 2017, DWTL is primarily being driven by Financials (+1.66%), Consumer Services (+1.17%), Industrials (+1.01%), and Technology (+1.25%). The only Industry with a negative contribution to return as of the end of February is Oil & Gas (-0.22%). In terms of individual holdings within Financials, MarketAxess Holdings has produced a total return of +27.89%, while Ameriprise was up +14.84%. The Technology sector saw strong gains from AMD (+26.51%) and Cadence Design (+20.84). Healthcare saw strong returns from Idexx Laboratories (+25.00%). In Basic Materials, which was one of the underperforming areas of the portfolio, Consol Energy was down -15.10%. The Oil & Gas portion of the book was hurt by Cheasapeake Energy Corp which lost -22.14%.

Chart 5

Portfolio Contributions

Industrials	1.01%
Consumer Services	1.17%
Financials	1.66%
Technology	1.25%
Health Care	0.64%
Consumer Goods	0.47%
Basic Materials	0.01%
Utilities	0.19%
Oil & Gas	-0.22%

CONCLUSION /

Many research studies over the years have shown that momentum outpeforms other factors such as value and growth. Here is a link to a repository of said research on the Dorsey Wright website: http://www.dorseywright.com/resources/documented-relative-strength-research. In the above research piece we stated momentum strategies typically do well during periods of sustained market leadership and also when there is dispersion among a universe of securities to which the portfolio can allocate. On the other hand, momentum tends to underperform during choppy or trendless markets. The PowerShares DWA Momentum Portfolio (ETF Ticker: PDP) that tracks the Dorsey Wright Technical Leaders Index (Index Ticker: DWTL) is a long standing momentum ETF that gives investors access to a systematic, rules-based investment methodology. PDP was the first momentum based ETF that launched and it just eclipsed its 10 year anniversey. Happy birthday, PDP!

Thus far into 2017 momentum has been outperforming other factors such as value and growth (as can be seen by DWTL outperforming Nasdaq's US 500 Large Cap Value and Large Cap Growth Indexes by 2.79% and 1.05%, respectively). Based on the underperformance momentum experienced during 2016, the strong start to this year may be a sign momentum is coming back into favor.