

BULLSEYE

Highlights

Relative Strength

Building a Winning Team

Sports fans typically spend time thinking about their favorite team before a season begins. They measure the potential of their team in the pending season by the strength of its individual components: players, the coach, the general manager and the owner's budget. The fan's optimism about a team's potential is often driven by the steps the team takes to strengthen these components from one season to another—management's commitment to rebuild a team with younger players, to shore up key weaknesses or its efforts to change the chemistry of the entire team. While a fan may view these steps with optimism or pessimism, none of these actions will matter until the season begins and the team can be measured on the field. The team's standings will indicate how it is performing relative to other teams in its league. Management may take additional steps during the season to strengthen emerging weaknesses to further improve performance. The fan's excitement or disappointment about his team's performance during that season will depend on the short-term or long-term expectations the team's management established at the start of the season.

Relative Strength:

A measure of price trends (winning percentage) that indicates how a security (team) is performing relative to other securities (teams) in its category (league).

The fan's dilemma for their team is very similar to what an investor experiences with their portfolio. Just as a team's performance can be measured, so can the components of a portfolio. The potential of an investor's portfolio is often measured by its individual components: security or asset classes, asset allocation, portfolio management and risk levels. Expectations are typically established by market conditions and the investor's time horizon. Once the investor has committed to an investment design, the performance of securities or asset classes within a portfolio is typically measured against, or relative to, a market benchmark. The relative strength of the portfolio and securities within it can also be viewed over certain time horizons to help manage performance expectations.

Performance on the Field (Winning Percentage)

	1 Month	3 Months	1 Year	3 Years	5 Years
Team A	0.607	0.579	0.586	0.588	0.575
Team B	0.621	0.586	0.599	0.599	0.586
Team C	0.577	0.527	0.586	0.537	0.519
Team D	0.690	0.596	0.528	0.518	0.532
Team E	0.630	0.696	0.636	0.588	0.590
Team F	0.533	0.586	0.574	0.564	0.552
Team G	0.630	0.589	0.568	0.526	0.492
Team H	0.423	0.604	0.562	0.525	0.541

Performance in the Market (Returns)

	1 Month	3 Months	1 Year	3 Years	5 Years
3 Month T-bills	0.0%	0.0%	0.2%	2.4%	3.0%
Aggregate Bonds	-1.6%	0.2%	5.9%	6.0%	5.0%
U.S. Large Cap	0.2%	0.5%	2.5%	2.2%	2.1%
U.S. Small Cap	8.1%	3.9%	27.2%	-6.1%	0.5%
International	1.4%	1.8%	27.8%	-8.7%	0.9%
Emerging Market	3.5%	7.6%	73.5%	2.4%	13.3%
Hedge Funds	0.9%	3.1%	18.6%	2.6%	5.8%
Managed Futures	-2.5%	0.3%	-1.4%	11.7%	10.3%
Commodities	0.9%	8.4%	13.5%	-7.0%	-3.0%
Gold	-7.5%	9.2%	25.0%	19.8%	20.1%
REITs	6.9%	9.2%	28.6%	-13.6%	-0.1%

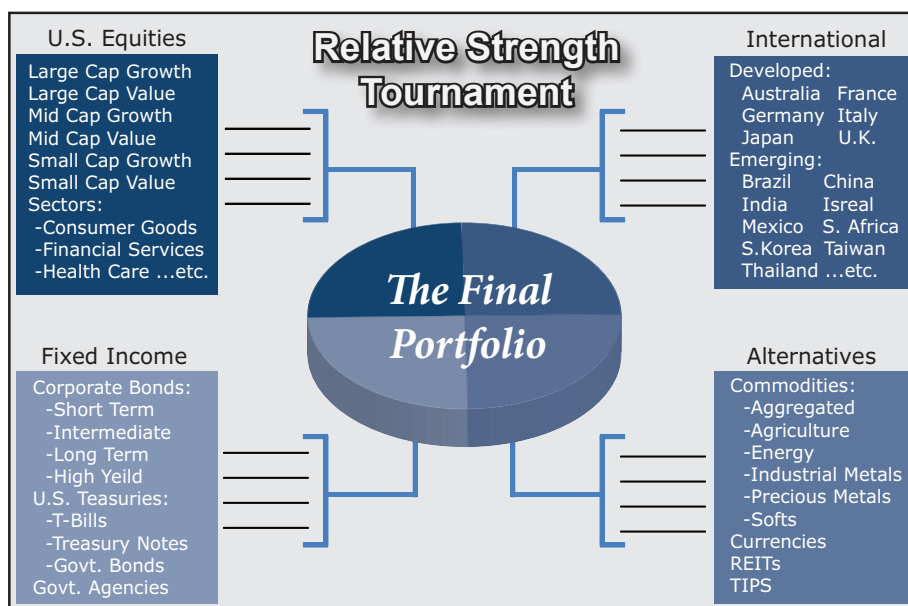
Note: These asset classes were used to create the "Relative Strength Team" (pg. 2).

A Management Tool

In a sports tournament, a team's ultimate goal is to win. Similar to a team's management, a portfolio manager may increase or decrease allocations to existing positions and constantly monitor different asset classes to identify emerging trends. Likewise, a relative strength portfolio manager uses a tournament approach to narrow a portfolio to a group of the strongest securities. In the first round of the tournament, securities are grouped and compared by within their asset class to identify the top-performing representatives. In the second round, relative strength is used to compare the strength of each asset class to allocate larger (strong relative strength) and smaller (weak relative strength) positions to these asset classes within the short, intermediate or long-term measurements either individually or combined, and they can run this test as frequently as they deem necessary.

Performance in the Market Returns ¹		
	60/40 Benchmark	Relative Strength Team
1 Month	0.50%	2.50%
3 Months	3.70%	8.00%
1 Year	18.00%	12.50%
3 Years	-0.10%	8.60%
5 Years	2.90%	13.00%

Relative Strength Team: The top asset classes in the market performance table (pg. 1) using a combination of applicable indexes measured by intermediate- to long-term relative strength.

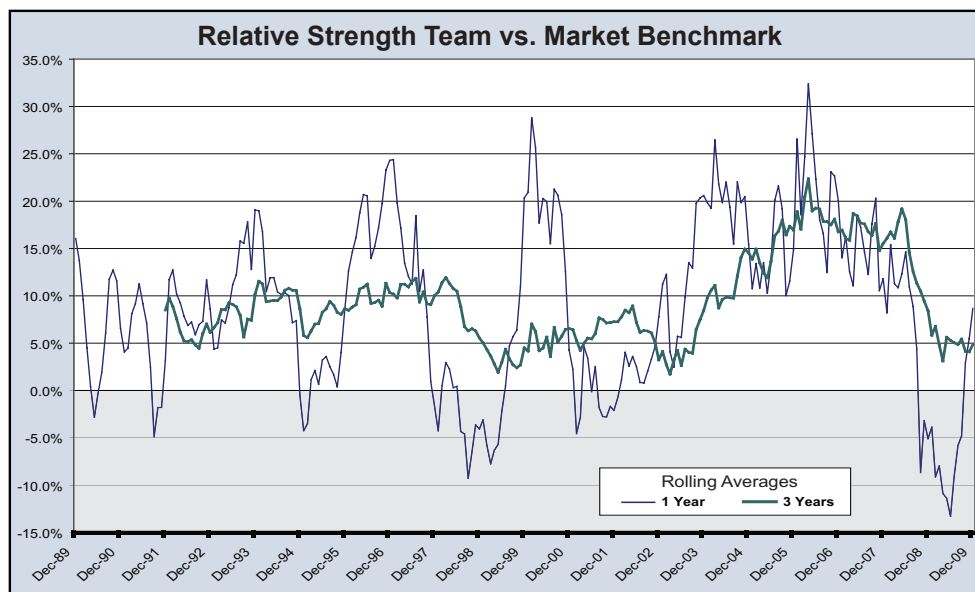


A Long-term Focus

It's quite rare to see a sports team repeat as champions year after year. Likewise, an investor's portfolio doesn't lead the market year after year. A manager who relies on relative strength to identify portfolio positions will occasionally underperform the market when trends are dramatically changing—the security market is cyclical and sometimes the relative strength measurement period may not align with those short-term changes.

Historically, there tend to be periods of underperformance of relative strength investing followed by periods of strong outperformance. The disciplined relative strength approach helps investors identify and combine the strongest securities, building a winning team over the long term.

The chart to the right illustrates the annualized performance difference of a relative strength approach versus a 60/40 market benchmark over one- and three-year holding periods.



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