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BEYOND MPT

Technical analysis firm and money manager Dorsey Wright has gained adherents for its point-and- figure research.

By Mary Rowland

In my last column, wrote about a handful of RIAs who specialize in helping 401(k) participants choose investments for their plans. The topic was particularly interesting because of new U.S. Department of Labor rules on who qualifies to manage money for 401(k) participants. The rules, which are meant to implement the Pension Protection Act of 2006, have been proposed but have not yet become effective. Once that happens, I figure more advisors may want to dd this market niche to their practices.

One thing I discovered in talking with these advisors was that the majority of them—which might well be a coincidence—use the firm Dorsey Wright & Associates in Richmond, Va., for the technical analysis of the plans they manage. So I promised to see what I could learn about Dorsey Wright for this column.

Of course, I don't believe for a moment that technical analysis is a necessary element of managing a 401(k) plan. Still, I wondered how significant—if at all—this company's technical analysis is to these advisors' success.

I spoke at length with the firm's co-founder, Tom Dorsey. He was incredibly patient explaining how the system works, but after more than an hour on the phone with him, I still can't claim to understand and explain to you how it works or whether it is a good one for you to use. If I were a planner, I would require substantial training to use it.

Fortunately for me, I got a ton of mail about that column talking about the firm's technical analysis. What's interesting is that, even though not every reader agreed with or endorsed Dorsey Wright, none of them argued that buy and hold is a better option than technical analysis.

Here is what Dorsey explained to me: Dorsey Wright began by using a form of technical analysis called point and figure, first used by Charles Dow, founder of Dow Jones & Co. Dorsey's firm used it first for options trading. But it has moved beyond that by merging technical analysis with exchange-traded funds.

"It's like two rivers coming together," Dorsey says. "We have the largest portfolio and charting system in the world on the Internet—2,304 charts." Dorsey claims he was there at the creation of the first ETF, which traded on the Philadelphia Exchange and was known as a cash index participation unit. The Chicago Board of Trade sued to offer the security and won, Dorsey says. Then the Toronto Stock Exchange asked Philadelphia for the template and that was the ETF.

Next, iShares asked Dorsey Wright to help roll out its product. "Now all ETF issuers have come to us for models," Dorsey says.

One of the tools Dorsey uses is a measure called "relative strength," which he describes as an arm-wrestling match between every two securities that make up a group or an index. When he's finished, he knows which security has the greatest relative strength in the group, which one is second and so forth. "Before computer power came along, the interns used to do relative strength by hand," he says. "When ETFs came out with sectors, asset classes and so on, we could compare and contrast things we could never do before. We can compare mutual funds and ETFs and stocks."

Clearly, Dorsey doesn't put any credence in modern portfolio theory. "If you didn't see MPT was a loser before, 2008 proved it," he says. "The idea of putting 150 stocks in a managed account and stamping it with your approval is like investing in the S&P."

All of the advisors who wrote to me agreed with Dorsey that MPT is no longer useful. Of course, this is but a small group of advisors who are interested in alternative investment research. Roger S. Balser, an advisor in Avon, Ohio, wrote: "You are on the right track looking for ways to help your readers."

Balser said he, too, uses a variation of technical analysis, although he does not work with Dorsey Wright. "There are hundreds of thousands of interpretations for this methodology," he wrote. "Your readers need to explore processes other than buy and hold, which devastated portfolios in the 2008 market."

Several readers wrote to say that they have wholeheartedly embraced the Dorsey Wright methodology. Finding Dorsey Wright "has totally changed the way I invest for clients," reported Charles Scott of Pelleton Capital Management Inc. in Scottsdale, Ariz. "It is probably the single most important factor in me still being in this business."

Renee Pastor, a financial advisor in Metairie, La., writes, "There are many of us that 'drank the Kool-Aid' after getting our tails kicked in

2000-2003." She added that advisors who have adopted the Dorsey Wright method are extremely passionate about it.

Dorsey told me he started as a stockbroker at Merrill Lynch at the end of the 1974-75 bear market. "It was difficult prospecting people who had just been wiped out," he says. "I chose the options market because I thought I could be more of an architect."

Five years later, he was hired by Wheat First Securities in Richmond, Va., to start an options department for the firm. "I was given carte blanche," he says. "They told me 'Do whatever you want.'"

So Dorsey stopped to reflect on what he knew about the stock market from working at Merrill. "I knew nothing," he says. He knew the options department he would establish at Wheat First must do its own research and be self-contained. "I didn't want to be the puppet of some other research department," he says.

Dorsey hired someone who gave him a copy of How To Use The Three-Point Reversal Method of Point & Figure Stock Market Trading, written by A.W. Cohen. (I looked for this book online and found only two copies available. Not cheap.) Dorsey went to Virginia Beach for the weekend with his wife and read the first paragraph of the book. "I had an epiphany and I knew what I was here in the world to do. This was my mission in life—to teach everyone else." When he read the book, Dorsey says he understood that the fundamentals of stocks and other securities had nothing to do with the price, that the prices were elastic and had to do with supply and demand.

In 1986, Dorsey and his partner, Watson Wright, both 39 years old at the time, set up Dorsey Wright. "We were the first options outsourced strategy department." After the crash of 1987, Dorsey realized that the options business would never be the same and if they were to succeed, they had to use their technical knowledge to pick stocks.

Now, 24 years later, the business supports 16 families. It has had zero turnover since the startup, which I find incredible. I did find another firm online that also does point and figure research: www.investorsintelligence.com.

Dorsey Wright now has two businesses: It offers investment research services for numerous broker-dealers and large institutions around the world, based at the original headquarters in Richmond, Va. And it professionally manages equity portfolios for investors through a money management firm in Pasadena, Calif.

Few advisors I spoke with criticized Dorsey Wright's research so much as the money management arm. One money manager said the firm doesn't publish written performance figures and the verbal claims they make are not backed up by numbers. Instead, she said, the performance numbers are hypothetical, back-tested performance statistics.

Dorsey says that the firm advises every Wall Street broker in the business, but few financial advisors. He doesn't seem to have a high opinion of advisors and doesn't believe they do much of anything. Dorsey asked a financial planner: "What do you do for clients?" The planner's response? "We are like a personal trainer who makes sure the client does his 25 push-ups every day." Clearly, Dorsey doesn't see this as an adequate role.

One advisor who sent an e-mail said the real story behind Dorsey Wright is advisors like Ric Lager in Minneapolis who do training sessions for other advisors. "Ric Lager was educated by us and he is one of the best 401(k) managers out there," Dorsey says.

The Lager fan who wrote in added, "Ric Lager is the godfather of 401(k) advice and one of the people who made this whole model possible," because it takes time to become familiar with it and to figure out how to use it, and an advisor needs training for that. Lager conducts training sessions in different locations around the country.

Dorsey Wright charges a wirehouse a one-time fee. There is a different fee for a branch office. And the firm has developed "DWA Light" for individual investors at $35 a month. Dorsey Wright put together three portfolios for clients of Suze Orman, the personal finance author and television host, which they can use for as little as $100. "I think that's the future for individual investors," Dorsey says.

I know little about technical analysis and this story has piqued my interest. Please let me know if you use technical analysis to trade, if you are a buy-and-hold investor for clients or if you use something else.

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