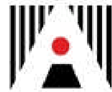

ANALYTICS INVESTMENT ADVISORS, LLC

Favorable Sectors

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In my January 15th Commentary (Buy & Don't Hold – Part 2) I establish a statistically significant relationship between relative strength and returns.[1] Subsequently, in my remarks on February 3rd I presented a reasonably positive outlook for the stock market in 2011. The intension of this month's commentary is to bring these two concepts together to indicate which sectors and styles are most likely to outperform the overall market in the next six to twelve months.

Stratification of all of the approximately 1000 currently traded ETFs by 74 Morningstar categories, and selection of only those with the highest trading volume in each category (1 million shares per day or more) resulted in 34 different ETFs in a similar number of unique categories, the top 15 of which are listed below. [2]

	Name	Ticker	Relative Strength	1 Year Return
1.	SPDR Energy Select	XLE	92.75	34.70
2.	DB Agricultural Fund	DBA	91.46	43.32
3.	Russia ETF Trust	RSX	88.58	25.49
4.	Semiconductor HOLDRS	SMH	88.28	34.56
5.	DB Commodity Index	DBC	87.29	26.98
6.	Russell 2000 Growth Fund	IWO	86.00	28.95
7.	Russell 2000 Index Fund	IWM	80.54	24.62
8.	Midcap SPDR	MDY	80.24	26.22
9.	SPDR Industrial	XLI	78.65	25.45
10.	Russell 2000 Value Fund	IWN	72.99	20.40
11.	Russell Value Midcap	IWS	72.29	23.25
12.	Power Shares QQQ	QQQQ	71.50	23.62
13.	SPDR Fund Materials	XLB	70.41	21.69
14.	Dow Jones US Real Estate	IYR	61.73	27.48
15.	SPDR Retail	SPY	59.78	17.62

[1] The correlation coefficient and R-Squared for 37 randomly selected ETFs was .834 and .695 respectively, and the regression coefficient was statistically significant (t-value = 8.8).

[2] A regression analysis of this subset resulted in an R-Squared of .64, a correlation coefficient of .80, and a t-value of 6.99 for the independent variable (relative strength).

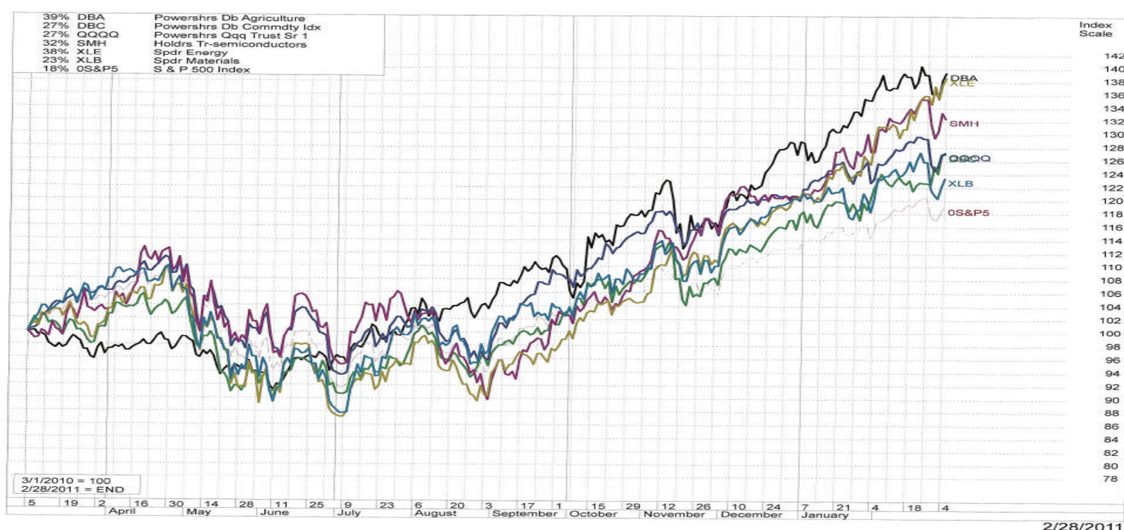
Given the established statistical relationship between relative strength and rate of return, the energy, technology, commodities, materials and real estate sectors, and large and small capitalized growth companies would appear to have the best potential for outperforming the overall market in the near future. Fundamental support and rationale for these conclusions are detailed below and assume that the volatility caused by recent events in Libya and Tokyo is temporary.

Energy (e.g. XLE) is a capital intense business where firms increase their exploration efforts as commodity prices rise. As production increases, profit margins also improve. While exploration projects are lengthy and prone to setbacks, cyclicality is common. Also, political risk needs to be considered. However, the long term outlook of increasingly short supplies of energy and growing international demand would seem to augur in favor of this sector as a core portfolio holding.

Technology (e.g. QQQQ, SMH) will do well as companies are compelled to spend to improve productivity and efficiency. Also, there continues to be strong demand for smart phones, both in developed countries and emerging markets, driven by better products and improved mobile internet applications. Fairly light inventories in the supply chain, and reasonable production capacity industry wide should provide a good foundation and basis for continued healthy hardware recovery. Longer term, cloud computing and virtualization are expected to give additional momentum to the next industry cycle.

Materials (e.g. XLB) will continue to improve on the back of the global economic recovery, combined with strong growth in emerging markets. Developing economies need commodities such as metals, steel and chemicals for new buildings and infrastructure. In addition, increases in consumption demand for goods such as automobiles and consumer electronics will drive demand for a variety of materials.

Agricultural *Commodities* (e.g. DBA) play an important role in the broad commodity indexes (e.g. DBC) and have gained momentum in recent years due to: 1) outstanding returns as demand for foodstuff and biofuel inputs have handily outstripped supply; 2) increasing agriculture prices which have driven investor interest; and, 3) the potential hedge against inflation as historically commodities have a 0% correlation with equities.



The above chart demonstrates the relative performance of these sectors to the S&P 500 total market index for the past twelve months as of 2/28/2011.