

# Investor's Digest

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## Keep an eye on the NASDAQ

(and the big tech and biotech stocks influencing it)

The NASDAQ has been making new highs at the time of writing this article. Shares of Facebook Inc. (FB, US\$165.61), Amazon.com Inc. (AMZN, US\$1052.80), and Netflix (NFLX, US\$189.08) hit fresh highs in late July - shaking off the weakness in that market during the second quarter. Interestingly, that marks the end to the period of seasonal strength for the technology sector, which runs between the middle of April and the middle of July. The sector tends to pull back into the end of July as investors take profits in some of the high-flying positions. Based on the current levels of the FANGs (Facebook, Amazon, Netflix, and Google, or Alphabet Inc. (GOOG-NASDAQ, US\$947.80)) and other technology stocks - a correction is certainly not out of the question.

Among the arguments that the tech stocks will continue to make gains, the index is trending up. Money flow is positive. That means that money is still entering the major components that comprise the NASDAQ index (for example, the FANGs). This is positive for long-term investors. However, there are signs of slowing momentum. And that could spell short-term danger for these stocks.

Take note of the negatively diverging stochastics, RSI (relative strength index) and MACD (moving average convergence divergence) indicators, on the chart below. In other words, these indicators are trending down, even as the index makes new highs.

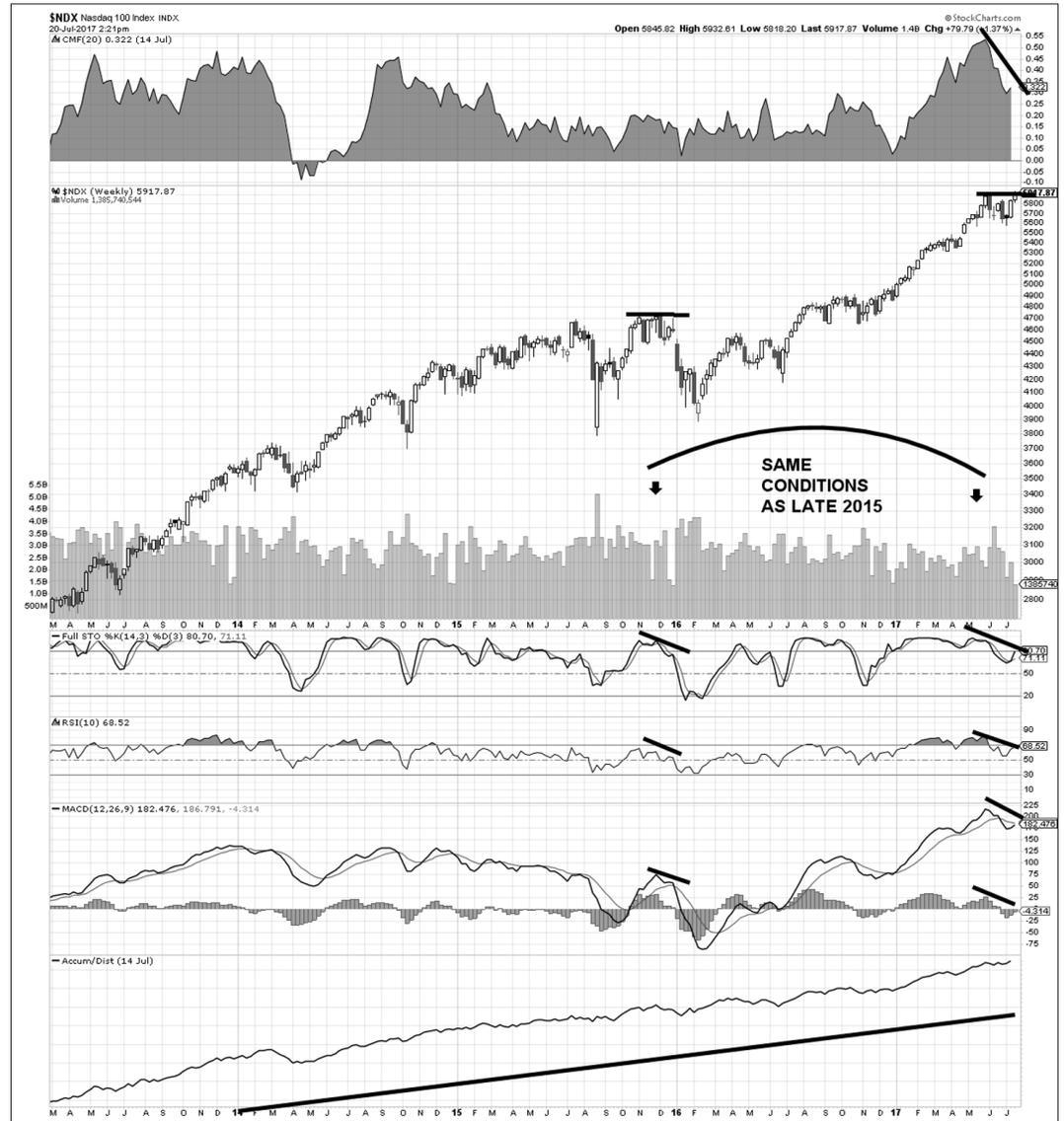
I've drawn the trend line on the chart below—which you will

note is trending downward. Money flow momentum (in the top pane) and volume are slowing as well. These things tell us that enthusiasm might be waning a bit on these high-flying stocks.

Money is still going into the sector, but at a much slower pace. And that matters. Here's why:

These same momentum indicators were negatively diverging after the NASDAQ achieved a new

high, and began consolidating in 2015. What followed was a healthy, but significant, correction of about 15 per cent on the NASDAQ in late 2015. You can see this on the chart—note the same



pattern of diverging momentum and money flow in late 2015 that I've pointed out.

Does this chart suggest with any certainty that a correction will occur on the NASDAQ? No – this is a probability, not a prediction. The NASDAQ could keep going up.

The currently waning momentum of price action (per the momentum indicator divergence) is telling us that there is a better-than-average chance of a correction happening on that index in the near term. If you take seasonal trends into account, the case for a correction gets stronger.

The next period of strength for both the NASDAQ Composite and the technology sector runs from the beginning of October until early February, the period when cyclical stocks come back into favour.

Long-term investors probably don't need to be too concerned here, but for those who think in shorter-term horizons, there is a potential for a 10 per cent correction or more for the NASDAQ—perhaps similar to that of late 2015.

We reduced our tech holdings in light of this potential. We now only hold about four per cent U.S. technology in our Value-Trend Equity Platform. We'd be happy to buy them back on a correction. I can't say for sure that this was the right move, given the bigger upward trend that this sector has been in.

Nevertheless, there is enough evidence for a potential correction in the NASDAQ, and particularly the technology sector, to make us want to reduce our portfolio risk at this time. Perhaps you should too.

### **Keith on BNN**

Keith will appear on the popular BNN call-in show, Market Call, on Wednesday, Sept. 6 at 5:30 p.m. Phone in with your questions on technical analysis for Keith during the show. Call toll-free at 1-855-326-6266. Or email your questions ahead of time (specify they are for Keith) to [marketcall@bnn.ca](mailto:marketcall@bnn.ca).

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