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THE MONEYLETTER®

STRATEGIES FOR SUCCESSFUL INVESTING

MARKET WISDOM

Caveat emptor in the…

SHORT TERM

Keith Richards

AS I WRITE THIS COLUMN, IN THE middle of January , a few of the short-to- mid-term indicators I watch are signalling the strong potential for a pullback. In fact, by the time you read this column the market may have begun a pullback.

Certain momentum studies (Stochastics, RSI, MACD) have been sloping down as the S&P has moved sideways; this phenomenon is known as "divergence" in momentum. What this means is that markets are losing steam.

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Another technical indicator I watch is called "moneyflow." This simply measures money – as indicated by volume multiplied by price - and its movement. If moneyflow is positive, that means more net dollars are moving into the stock market. If moneyflow is shrinking, money is leaving the market.

Moneyflow is slowing

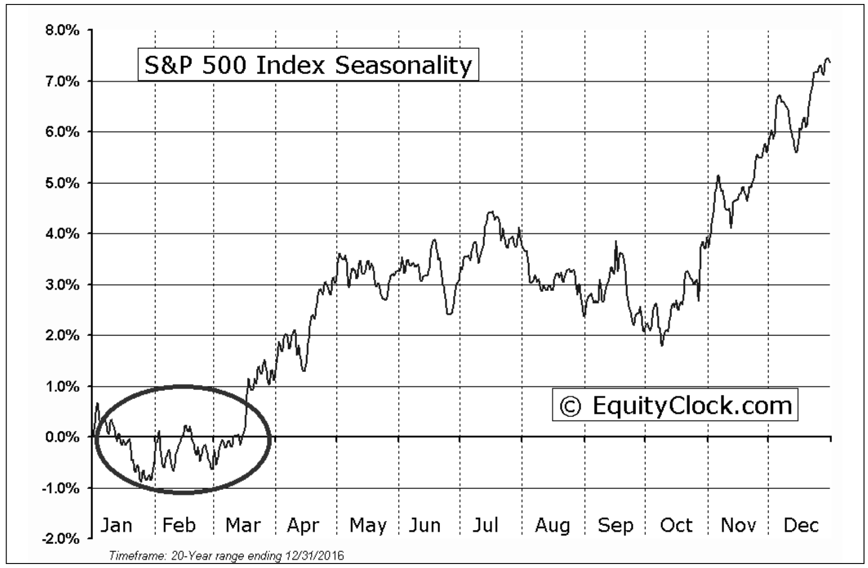
I watch cumulative moneyflow and moneyflow momentum. Recently I noted that short-term momentum for moneyflow into the market is failing. So even though the long-term picture is good for money entering the market—as indicated by a steady rise in cumulative moneyflow – I note that the momentum of capital being invested in the stock market has recently slowed. Slowing moneyflow may indicate that a pause in the markets is pending. By the way, you can visit my blog at www.valuetrend.ca and see these indicators on the charts I post in my bi-weekly commentaries.

Smart Money vs. Dumb Money

On the chart below, courtesy sentimentrader, note the extremely low confidence of Smart Money (commercial hedgers, etc.) - in contrast to the bullishness of Dumb Money (Retail investors). Smart Money represents those investors who tend to be – on average - better investors and make more timely decisions. They consist of commercial hedgers, pension managers and sophisticated traders. Dumb Money represents those investors who – on average – tend to be less informed, make bad timing decisions and act on emotions. They consist of small, retail investors, mutual fund buyers and odd-lot traders. When Smart Money is selling and Dumb Money is buying – and the spread between their buy/sell patterns is wide – this can be a signal that things may get rough on stock markets. That is what is happening right now.

A cautionary tale

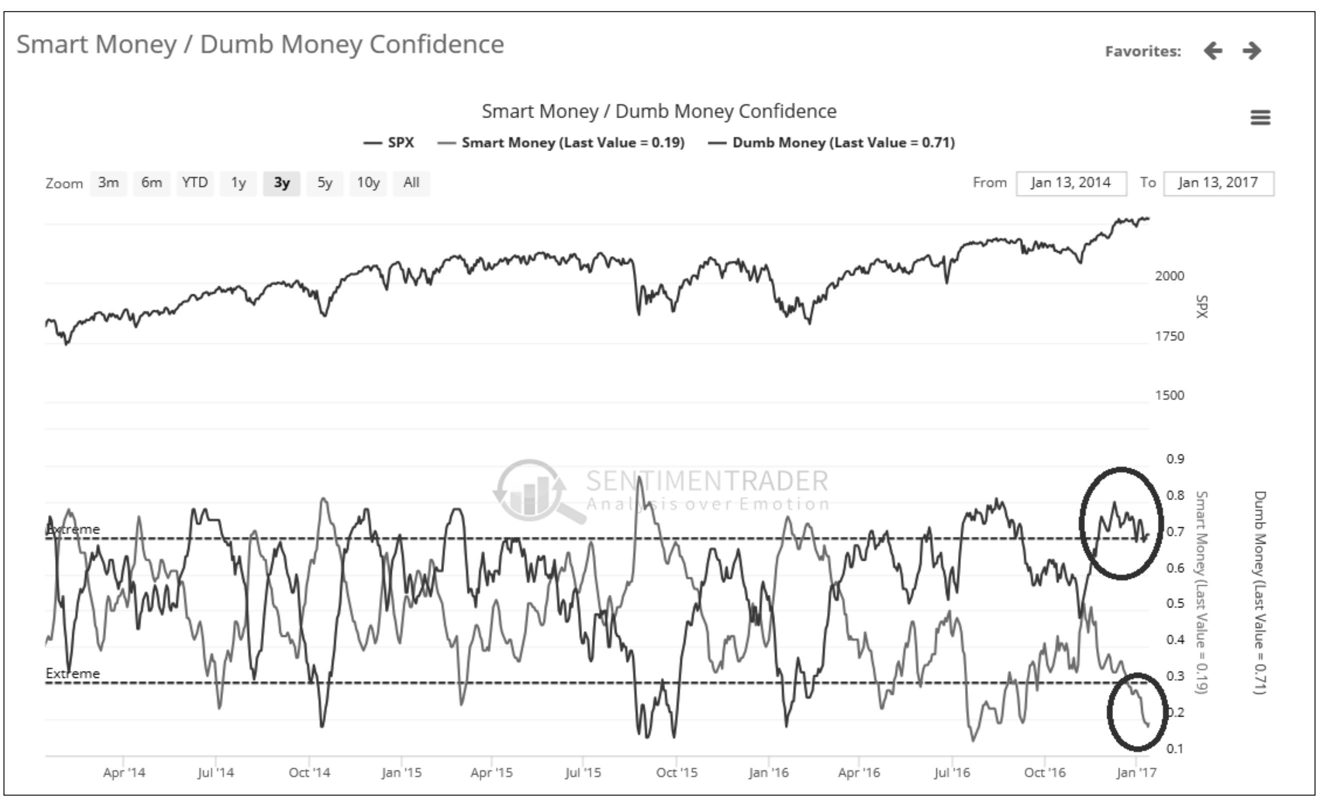
A few other sentiment studies I follow are signalling caution right now. These indicators include the confidence of advisors in the market (most investment advisors are less sophisticated and less accurate in market forecasting than the public might perceive), and the Risk Appetite Index (the ratio of money entering or leaving "risk on" vs. "risk off" assets). Both of these indicators are in the "danger zone" - that is, too many advisors like the market, and too much risk is being taken on by investors. Finally, www.sentimentrader.com notes that short interest on the widely traded SPDR S&P 500 Trust (SPY_US) ETF is 24 per cent below its 3-year historic average. Short interest on this ETF hit a similar low level in June 2007. What does this mean? It tells us that nobody thinks this market has downside. And you just know that that can't be true!



Big picture is bullish

Normal seasonal tendencies are for markets to get a bit choppy from mid-January in through much of February. Historically, markets have shown a tendency to peak by or around Inauguration Day. Given high fundamental valuations on the stock market (PE ratio, etc) and the above technical factors, I'd suggest we're in for a short-term pullback into and possibly through much of February. Sectors that tend to peak at this time of the year include technology and biotechnology, which are groups contained in the broader-based NASDAQ, plus homebuilding and silver.

The bigger picture remains largely bullish. Nonetheless, it might not be a bad idea to lower your exposure to these sectors in light of the potential near-term market risk. Raising cash from these groups might afford you the opportunity to buy into more seasonally attractive sectors in the



coming month or so. I'll be focusing on transportation, industrial and energy stocks over the coming months. Any near-term sell-off that provides good entry points into stocks in those sectors might be an opportunity for investors who hold a bit of cash over the coming weeks. ▼

Keith on BNN

I'll be on BNN televisions call-in show, MarketCall on Monday Feb. 6th, 2017 at 6:00pm. Tune in to BNN to catch me live on BNN's premier call-in show, where viewers like yourself can ask my technical opinion on the stocks you hold.

Call in with questions during the show's live taping between 6:00pm and 2:00 pm. The toll free number for questions is 1 855 326 6266. You can also email questions ahead of time to marketcall@bnn.ca – it's important that you specify they are for me.

Keith Richards, Portfolio Manager, can be contacted at krichards@valuetrend.ca. *He may hold positions in the securities mentioned. Worldsource Securities Inc., sponsoring investment dealer of Keith Richards and member of the Canadian Investor Protection Fund and of the Investment Industry Regulatory Organization of Canada. The information provided is general in nature and does not represent investment advice. It is subject to change without notice and is based on the perspectives and opinions of the writer only and not necessarily those of Worldsource Securities Inc. It may also contain projections or other "forward-looking statements." There is significant risk that forward looking statements will not prove to be accurate and actual results, performance, or achievements could differ materially from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements and you will not unduly rely on such forward-looking statements. Every effort has been made to compile this material from reliable sources; however, no warranty can be made as to its accuracy or completeness. Before acting on any of the above, please consult an appropriate professional regarding your particular circumstances.*