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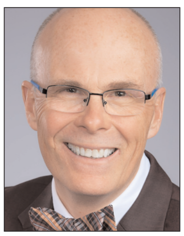
GROWTH STOCKS REMAIN HEALTHY LONG-TERM, BUT ARE LOSING STEAM

'Dumb money' heads where 'smart' won't tread



Keith Richards

Back in August, I wrote an article for *Investor's Digest* recommending that readers consider focusing a bit more on value stocks given the high valuations of the technology and "stay at home" names trading on the major markets. My advice turned out to be timely, given the weakness for those names starting in September.

Value stocks have been rising slowly but steadily during that same period, while growth names such as those seen on the NASDAQ have seen violent swings up and down. Don't misread my message. Growth stocks are still very attractive over the longer term. I just feel they are overvalued and overbought technically at this time. Growth stocks have been the place to be since the COVID crash.

The **iShares Morningstar Large-Cap Growth ETF** (JKE-NYSE/Arca, US$257.14) is very similar in appearance to the supposedly broader-diversified S&P 500 index. Note the surge in the angle of ascent on the growth stock index (see the chart on the right on the next page) since the March market meltdown. Interestingly, I am now seeing some signs of weakness in the growth index, and its siblings – the NASDAQ and S&P 500. All three of these indexes hold significant components of the new "stay at home" stocks and technology names. Here is where my concerns lie: There have been bearish divergences on the NASDAQ chart between momentum indicators and price action. This means that the growth and technology stocks are losing steam.

Same with the chart for iShares' growth ETF. Note how the three panes just below the price chart (stochastics, RSI, and MACD) are declining. Note the falling momentum in money flow in the top pane. Money is starting to leave the sector.

Moreover, there has been bearish smart and dumb money flow in the larger S&P 500 index lately, much of which has been driven by the growth sector. In a nutshell, what this means is that "smart money", meaning large institutions, pension managers, and professional traders, have been moving out of the market. This is happening while "dumb money", meaning retail investors, mutual-fund and ETF buyers, and small speculators, are continuing to buy growth stocks. I have written blogs on this phenomenon lately – you can read them by visiting our website at www.valuetrend.ca, and click on "SmartBounce blog".

While the longer-termed uptrend in growth stocks is undeniable, there is little doubt that the setup currently is for some sort of corrective action. Election patterns suggest continued weakness into early November. Perhaps by the time you read this article, the market will have already corrected, and the buying opportunity may have arrived. As I write this in late October, I view the growth sector (including NASDAQ and the S&P 500) as being in danger of some corrective activity.

What about value stocks? Now let's apply the same indicators to the **iShares Morningstar Large-Cap Value ETF** (JKF-NYSE/Arca, US$99.54). The chart on the right on the next page illustrates a moderately bullish-looking stochastics indicator, and a flat RSI. These indicators suggest there is little short-term upside potential for this ETF.

However, they are NOT diverging negatively like the growth stocks. This means they are NOT signalling a strong pullback in the manner that the growth index is potentially setting up for. In other words, in a market correction, it is likely they will be hit to a lesser degree. The MACD indicator appears quite bullish, having trended up against a moderately rising chart, and having just crossed its zero line. This suggests that the mid-to-longer-term view (greater than one month) could be bullish for value stocks. Money flow momentum, shown in the top pane, is oversold – the opposite of the growth index chart's overbought and declining indicator. That's another positive for buying value.

We moved closer to 30 per cent in cash in the second half of October within the ValueTrend Equity Platform. We anticipate negative price action coming into the U.S. election, and possibly after that date. Post-election volatility is dependent on how close the election results are, and if the results are contested. Growth stocks will be more vulnerable than value stocks should the market display weakness.

The good news: First years in a presidential cycle are largely bullish, no matter who gets elected. The period between late October and mid-November may present opportunities for buying stocks at lower prices than they have been at for a while. Buying into this volatility will allow investors to find good entry prices on positions that will enable participation in a market rally in 2021, particularly in the value stock space. Given the technical profile of value stocks at this time, it is my opinion that investors may be wise to add some value names to their portfolio. That's certainly what we've been doing!

See me at the MoneyShow!

I'll be talking about incorporating technical analysis into your assessment of stocks at a MoneyShow Canada Virtual Expo presentation taking place on Wednesday, Nov. 4, 2020 from 2 p.m. to 2:30 p.m. EST.

The description is as follows:

"Join Keith Richards to learn how ValueTrend scans for potential breakouts along with the criteria we look for in a potential stock candidate. A rebounding company or sector can be a magnificent thing to take advantage of, but signs of continued weakness can punish the security further.

"For this reason, you need an approach that marries company fundamentals with technical analysis. Only technical analysis can offer clues to the actions of the crowd and uncover key signs of the smart money buying into the real opportunities.

"Mr. Richards will teach you to use technical analysis to determine if a stock is truly breaking out with upside potential. He will show you how to identify the upside price targets along with the downside stop-loss discipline necessary to ensure you reduce your risk while maximizing your returns on breakout stocks. You'll enjoy his often-humorous approach as he discusses navigating the murky waters of the stock market."

To register for this free webinar, go to the MoneyShow website at www.moneyshow.com and register for my presentation.

Keith Richards is Chief Portfolio Manager & President of ValueTrend Wealth Mgmt. He can be contacted at info@valuetrend.ca. He may hold positions in the securities mentioned. 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. 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.