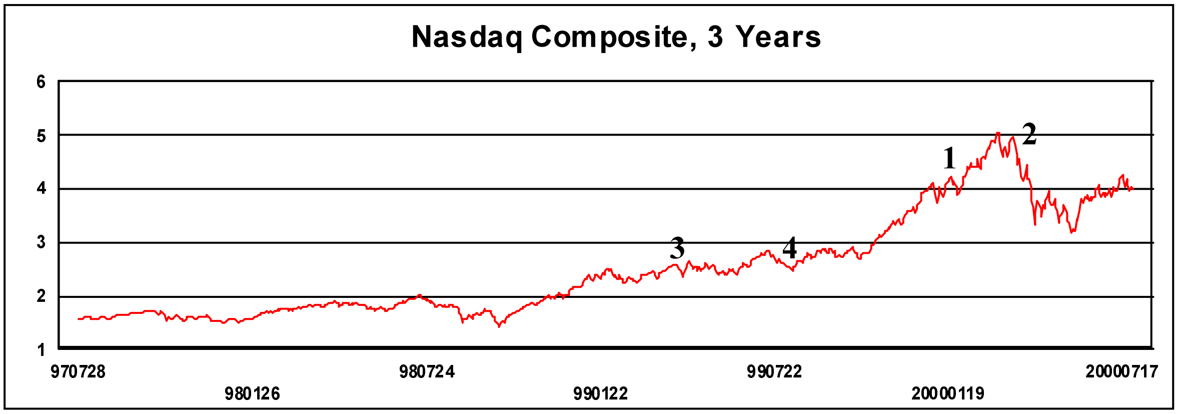
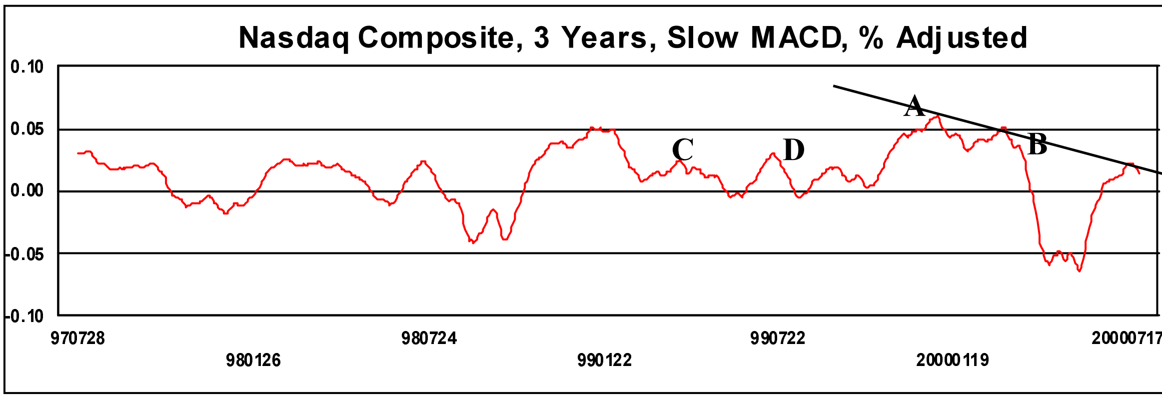
Did the Nasdaq Composite negative MACD divergence warn us of the recent Nasdaq crumble ?

by Howard Spieler





One of Systems and Forecasts favorite charting tools is the percentage adjusted MACD line. This new line, when plotted, gives us a more historically accurate MACD chart which adjusts for large price movements made in the Index over the past several years. It also gives your chart a smoother appearance, identifying the long term trends and eliminating the short term noise made by daily price movements and volatility.

If you refer to points 1 and 2 on the chart above, you will see two new highs made on the Nasdaq Composite, approximately January and March of this year. However, if you draw your attention to points A and B on the lower chart, you see a classic MACD divergence, or “failure”. This failure occurs when your price makes a new high, but your MACD line does not. This usually is a tip off that the longer term trend is losing momentum, yet it is not immediately reflected in the pricing of the Index. After the failure at Point 2, the Nasdaq Composite declined by over 30% in what was a dreadful 2nd Quarter for the technology sector.

On the flip side, we also like to look for a positive divergence, or “confirmation” on MACD to precede a strong market advance. If you refer to the Nasdaq price chart, points 3 and 4 identify two new highs made on the Index. These two new highs are confirmed by two highs in the MACD pattern, labeled as points C and D. That positive confirmation led to a surge in the Composite that nearly doubled when the Nasdaq peaked in April 2000.

At the present time, the MACD line appears to have peaked and turned down (Note the resistance level connecting the tops). Is this a possible warning that the Composite has lost momentum, and we are due to test recent lows? Only time will tell.