

Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

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Written by Brooke Thackray



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S&P 500 Technical Status

Not much has changed in the technical status of the S&P 500 over the last two months. We still have a trend of higher highs and higher lows and the S&P 500 is still above its 50 day moving average. In other words, the market is still technically sound. It is interesting to note that the volume of the shares traded on the S&P 500 have been on a steady decline while the market has been rising. The graph below shows the declining volume over the last three years (volume has been declining since 2009). Generally, when volume is rising at the same time as price, it is bullish and when volume is declining, it is showing a lack of conviction in the rally. Although this condition can persist for a very long time, lower and lower volumes cannot support a rising market indefinitely.



An ETF for all seasons

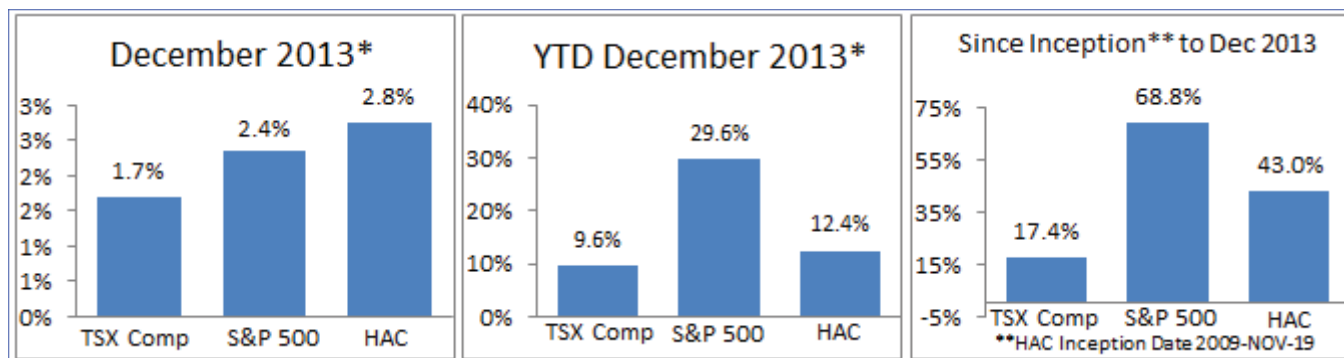
The **Horizons Seasonal Rotation ETF (HAC)**

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Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **December 31st, 2013**

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	14.6%
HUZ	Horizons COMEX® Silver ETF	6.3%
	United States Dollar Exposed Assets	
	Equities	
IWM	iShares Russell 2000 ETF	15.0%
QQQ	PowerShares QQQ Trust, Series 1	14.9%
HXS	Horizons S&P 500® Index ETF	14.4%
XLB	Materials Select Sector SPDR Fund	9.9%
XHB	SPDR S&P Homebuilders ETF	9.7%
XME	SPDR S&P Metals & Mining ETF	5.0%
XLF	Financial Select Sector SPDR Fund	4.9%
XLY	Consumer Discretionary Select Sector SPDR Fund	4.8%
	US Dollar Forwards (January 2014) - Currency Hedge **	0.2%
	Cash, Cash Equivalents, Margin & Other	0.2%
	Total (NAV \$130,057,176)	100.0%

** Actual exposure reflects gain / loss on currency hedge (Notional exposure equals 82.23% of current NAV)



* Source: Bloomberg, HAC based upon NAV

The objective of HAC is long-term capital appreciation in all market cycles by tactically allocating its exposure amongst equities, fixed income, commodities and currencies during periods that have historically demonstrated seasonal trends. The Thackray Market Letter is for educational purposes and is meant to demonstrate the advantages of seasonal investing by describing many of the trades and strategies in HAC.

Market Update

The year 2013 was a strong year for the S&P 500, producing a gain of 29.6%, and not so strong for the TSX Composite which produced a gain of 9.6%. The same phenomenon of the TSX underperforming occurred last year and the year before. In fact, the last time the TSX Composite outperformed the S&P 500 was in 2002. Canadians must be getting a complex.

Many Canadian investors feel that it must be Canada's turn to perform well— saying, “we deserve it.” Unfortunately, investing does not work that way. It is totally possible that Canada underperforms once again. Canada's outperformance is largely dependent on outperformance of gold and oil. These sectors represent a much bigger percentage of the Canadian stock market compared with the U.S. stock market. Canadian banks also have a larger weighting in the market index compared to the U.S., and although the differential is not as big as oil and gold, Canadian banks can help with outperformance. The Canadian stock market will outperform not because it is Canada's turn, but because the constituents of its market are outperforming. From a seasonal perspective, it is important to focus on the sectors of the Canadian market that tend to outperform at different times of the year. Overall, the TSX Composite has the highest probability of outperforming the S&P 500 in the first four months of the year.

In recent months, we have had fairly strong US employment reports, that is up until Friday January 10th, when the US Economy added just 74,000 compared with an expected 197,000. The harsh December weather probably had an impact, but nevertheless Friday's employment report was a lot worse than expected.

Although this is only one employment report, if the next one or two numbers are also poor, then the market might start to run into trouble. Right now, the bad news is not so bad because it means that the Fed may delay its tapering. If weaker than expected economic numbers continue, then investors will turn their focus to the impact of a weaker economy instead of the Fed delaying tapering.

We have just entered the earnings season for January. The S&P 500 Q4 earnings are expected to grow at 7.7%, while revenue is expected to have grown at 0.4% (Thomson Reuters). After Alcoa's miss last week to kick off the earnings season, we have a number of big banks reporting this week, including JPMorgan & Chase, Wells Fargo on Tuesday, Bank of America on Wednesday, Citigroup and Goldman Sachs on Thursday and Morgan Stanley on Friday. If the banks come out with positive earnings and the market moves forward, this will be positive. When the

US financial sector is one of the top performing sectors, this tends to provide support to the market as is the case currently.

Although we are in the six month favorable period for stocks, February can be a weak month. From 1950 to 2012, the S&P 500 has produced an average loss of 0.1% and has been positive 54% of the time, making it one of the weaker months of the year. Nevertheless, it is not necessarily prudent for seasonal investors to radically shift their portfolios to cash in the favorable time period for stocks (October to the beginning of May). Although investors should act in a conservative fashion, any down-drafts should be seen as a chance to enter favorable sectors at better prices.

What the HAC is Going On

HAC had a strong December with a well diversified portfolio, with most seasonal investments outperforming the S&P 500. Overall, the stock market behaved in its typical December pattern, with a strong finish in the second half of the month that is often associated with the Santa Claus rally.

HAC's January portfolio will be quite different compared to December as the stock market tends to change its seasonal behaviors at the start of the New Year.

The metals and mining, industrials and materials sectors all performed well in December, which is seasonally typically. But as I have written previously, all three of these sectors can pause and underperform the market for the middle three weeks in January. So far, these sectors are performing as expected. The big question remains: how are they going to perform in their second seasonal period that starts in the third week of January?

Over the last four years, in the beginning part of the year, all three sectors, metals and mining, materials and industrials have outperformed the broad market to varying degrees, but they have all peaked and started to underperform the S&P 500 at some point in the first few months of the year. Investors would be prudent to pay attention to the trend over the last few years with the sectors initially outperforming at the start of their seasonal periods and then underperforming the market before the end of their seasonal periods.

So where did the money go when the three cyclical sectors started to underperform in the last few years? Uncharacteristically, it went into the defensive sectors, which typically do not perform well in the spring. I have been writing about this phenomenon over the last two years. When defensive sectors outperform in a seasonal

period of the year when they typically underperform, it is a warning sign, even when the market is moving higher. I am getting ahead of myself as there is currently no indication that the same situation is going to occur once again. It is something that investors should be watching out for and I will endeavour to track in this newsletter over the next few months.

Metals and Mining –

Next seasonal period starts January 23rd but watch out for early finish

The metals and mining sector has been a drag on the Canadian stock market, mainly as the result of gold producers falling precipitously in 2013. It is possible that this sector will underperform once again this year. Economies around the world have been showing signs of improvement and yet the metals and mining sector has not performed well.

A few years ago China was consuming commodities at a voracious pace with constant GDP growth rates above 10%. Today their growth rate has slowed to 7.8% and there are still significant questions about their growth going forward. They have largely overbuilt infrastructure on bad loans, creating excess supply. A lot of analysts put too much faith on the Chinese authoritarian government being able to react and fix the situation when needed. China could easily run into trouble. The point is that the major consumer of commodity products, China, may not bring favourable conditions in 2014 for the metals and mining sector. If commodities have not responded well in good times, what will happen if growth starts to slow?

The US metals and mining sector has a different composition than the Canadian sector, but both country sectors have similar trends. The analysis below is based upon the US metals and mining sector.

In 2013, the metals and mining sector performed very well towards the end of the first seasonal period that lasts from November 19th to January 5th and as a result the sector outperformed the S&P 500. During its pause period, where it can often underperform from January 6th to January 22nd, it has currently started to pull back. The good news is that the second part of the metals and mining seasonal sector trade is just around the corner (January 23rd) and provides another opportunity for the sector to perform well.

The pattern of outperformance from November into the beginning of January and then underperforming in the second part of the seasonal period, occurred last year and is something that investors should be watching out for this year. Although there is no guarantee that the same

phenomenon will take place once again, investors should still take note.

It should also be known that the second seasonal period from January 23rd to May 5th is weaker than the first seasonal period, November 19th to January 5th. From 1990 to 2012, the first seasonal period has produced an average gain of 7.6% and has been positive 79% of the time (data based on S&P GIC metals and mining sector). This compares to the second seasonal period in which the sector has produced an average gain of 5.3% and has been positive 53% of the time. In its second seasonal period, the metals and mining sector has produced returns with a wide range, sometimes strongly outperforming the S&P 500 and other times strongly underperforming. The sector has a beta of 1.6 compared with the S&P 500 and as a result, investors should be cautious with this sector. Although the sector may once again produce positive returns in its second seasonal period, if the sector does start to underperform the market, investors should be ready to exit the position.

HAC entered into a position in XME in November and benefitted from its strong performance in December.



Industrials –

Next seasonal period starts January 23rd but watch out for early finish

The industrial sector once again outperformed in the first seasonal period of strong performance from October 28th to December 31st. The big question is how is it going to perform in the second seasonal period, from January 23rd to May 5th. In the last two years the seasonal trade has finished early. Although there is nothing to indicate that

the trade will once again finish early, investors should be monitoring the trade to see if the industrial sector once again starts to underperform the S&P 500 before the exit date of May 5th.

HAC entered into a position in XLI in late October and sold the position in late December. During this time period XLI outperformed the S&P 500.



Materials –

Next seasonal period starts January 23rd but watch out for early finish

The materials sector displayed the same performance trend as the metals and mining sector, with a strong first seasonal period (October 28th to January 6th) and an early finish to its outperformance trend in the second seasonal period (January 23rd to May 5th). The difference between the performance of the sectors was that the metals and mining sector performed poorly on an absolute basis over the next few months, whereas the materials sector provided a fairly strong performance during the summer months. Like the metals and mining sector and the industrials sector, investors should be watching to see if the same trend of weaker performance in the spring occurs.

HAC entered into a position in XLB in October. HAC benefited from the position when it outperformed the S&P 500 in December.



Technology –

Get ready to power off – seasonally strong period ends on January 17th

The technology sector trade worked in 2011/12 mainly as a result of strong performance in January. Although the trade underperformed the S&P 500 in 2012/13 in its seasonal period, it still produced an absolute gain. The main reason that it underperformed the S&P 500 was the poor performance of Apple.



So far this year the trade has worked on an absolute basis and on a relative basis compared to the S&P 500. Being so close to the end of the seasonal period, investors should be looking to exit the trade if it starts to underperform the S&P 500.

HAC entered into a position in XLK in October and has since switched to QQQ as part of the technology exposure. Both XLK and QQQ have outperformed the S&P 500 since October.

Agriculture –

Seasonal period finished – but sector could have one last short run

The seasonal period for the agriculture sector finishes at the end of the year. This year the sector corrected sharply in the spring, but started to outperform the S&P 500 at the start of its seasonal period at the beginning of August. In October, it underperformed and then in November and December it performed at market. Overall, for the whole seasonal period, it outperformed the S&P 500.

The agriculture sector can have one last run into mid-February, so if investors are still holding the sector, they should be looking to exit the sector if it underperforms the S&P 500 or at the latest, in mid-February.

HAC entered into a position in MOO in the beginning of October and sold in December.



Small Caps –

Continuing its trend of outperformance – Exit date March 7th

The small cap sector had a strong year in 2013 and outperformed the S&P 500. The sector usually performs well from December 19th to March 7th. In 2013, the sector corrected relative to the S&P 500 in March (after the end of its seasonal period), and then once again resumed its

outperformance relative to the market. The small cap sector has once again been outperforming the S&P 500 since the beginning of its seasonal period. Although the sector can still perform well after the beginning of March on an absolute basis, on average, it tends to perform at market until June. Although it is possible to continue holding this sector past March if it has strong momentum, investors should be looking to exit the sector if it underperforms the S&P 500. There is no sense in holding a sector in a time period when it typically only performs at market, if it is in fact only performing at market.

HAC entered into a position of IWM in mid-December and benefited from its position in the last half of December as the small cap sector outperformed the S&P 500 in this time period.



Retail –

Under pressure but next seasonal period starts on January 21st

The retail sector tends to perform well the month before Black Friday and from January 21st to April 12th. After outperforming the S&P 500 in the autumn trade, the retail sector started to correct in December. Recently the retail sector has been hit by weaker than expected Christmas sales and lowered guidance going forward.

Although a correction before a seasonal trade can often help set the trade up well, there is currently a lot of negativity with the retail sector and the trade may start late this year. Investors should be looking for the sector to start outperforming the S&P 500 before entering into a position.



Financials –

Seasonally strong trend started early again – continues until April 13th

In my last newsletter I discussed how the financial sector can start its seasonal run early. This year the sector did in fact start its outperformance early.

This week many of the large banks release their earnings, which will greatly influence the relative performance of the financial sector compared with the S&P 500.

HAC entered into a position in XLF in mid-December and has benefited from its seasonally early performance. XLF has outperformed the S&P 500 since mid-December, up until the end of the year.



Natural Gas –

Seasonal trade ended on December 21st – You should be out!

In my last newsletter I stated that it was best to get out of natural gas on December 21st. I called the exit strategy, a hard exit as investors should exit the sector regardless of the technical picture. As I stated previously, the short time period from December 22nd to December 31st is typically negative, in fact, natural gas makes a good short during this time period. Sometimes with a seasonal trade, investors can hang on and slowly exit as the relative performance slowly rolls over, but the natural gas trade is different as it often sharply reverses in December, and as a result, requires decisive action to exit on December 21st.

HAC exited UNG just before December 21st, profiting as natural gas outperformed the S&P 500 during the seasonal time period for natural gas.



Silver –

Not Gold – Silver trade lasts until March 31st, but may finish early

In my last newsletter I stated that silver was forming a bottoming pattern and that very often silver put in a bottom in the last few days of the year. Towards the end of 2013 silver was quite volatile as year-end bargain hunters moved to lock positions in the white metal before the books closed. In the New Year, silver has pulled back as investors considered the consequences of tapering. More recently, after the poor jobs numbers on January 10th, silver jumped back up again. The silver trade is going to be at the mercy of investors weighing the probability of

tapering. Increased odds of tapering will stifle silver's potential to increase. Decreased probabilities of tapering will help increase its price. Overall, the trade is expected to perform well as it often does at this time of the year.

HAC entered into a position in HUZ towards the end of December.



Homebuilders –

Outperformed the S&P 500 since the beginning of the trade, but more recently has started to underperform



Last year and the year before, the homebuilders sector performed very well during its seasonally strong period from October 28th to February 3rd. In 2013, at the end of its seasonal period, the homebuilders sector continued

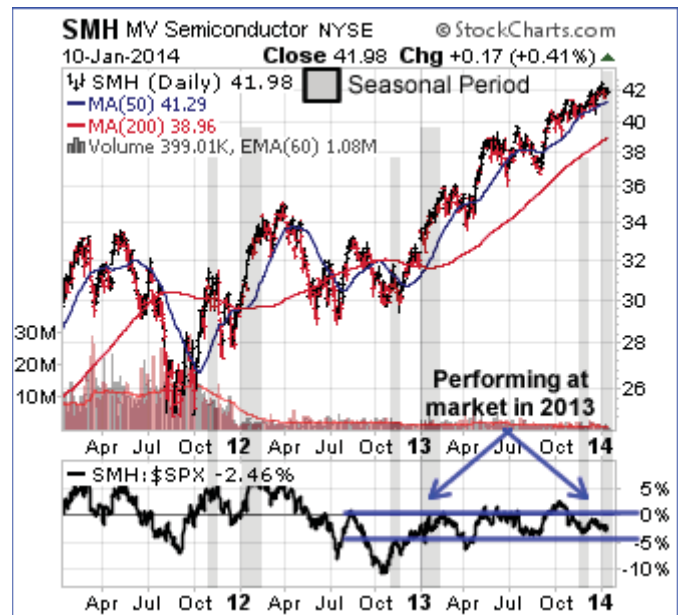
to perform well throughout the summer. Since the end of October, the sector has been outperforming the S&P 500. Most recently, in January the sector has been underperforming the S&P 500. Investors should consider exiting the homebuilders sector if it has sustained underperformance relative to the S&P 500.

HAC entered a position in XHB in late October and has benefited from the sector outperforming the S&P 500.

Semiconductors–

Good strategy to pick up technology allocation– Semiconductor seasonal period lasts until February 15th

The semiconductor stocks tend to perform well at the beginning of the year and the period of seasonal strength lasts until mid-February. This fits very well with the technology sector's tendency to finish its seasonal period in mid-January. The extended semiconductor seasonal period provides an opportunity to rotate a partial allocation from the technology sector into the semiconductor sector.



Canadian Banks- Is there more room left? Next seasonal entry point is January 23rd.

The Canadian banking sector has had a strong run since mid-summer based upon strong earnings, expectations of increased dividends and the possibility of stock splits. In its first seasonal period from October 10th to December 31st, the Canadian banking sector managed to outperform both the TSX and S&P 500, despite a pull-back in early December.

The graph below measures the Canadian banks versus the

S&P 500. In 2012 the Canadian banks performed well in the first seasonal period from October 10th to December 31st and then underperformed in the second seasonal period from January 23rd to April 13th. In 2013, the Canadian banking sector outperformed in its seasonal period from October into November and then pulled back.

HAC participated in the banking sector trade from October to November with positions in ZEB and HXF.



**Consumer Discretionary –
Steady performer**



The consumer discretionary sector has been a steady performer and has outperformed both the S&P 500, both in and out of its seasonal periods in 2012 and 2013. It is still in a solid uptrend and trading within a fairly tight range.

HAC entered into a position in XLY in late October.

Energy-

Underperforming but seasonal period coming soon

In the last two years, the winter energy trade started early, in January, and then ran into February and then faltered. This year it looks like the energy trade is not going to start early. The sector has been forming a rising wedge pattern, which is considered to be bearish, and it is underperforming the S&P 500. It is possible that the trade turns around earlier, but it looks like the energy sector is going to start its seasonal period in late February, which is the typical time for it to start.



Stocks

Dupont-

Entry January 28th

After outperforming the S&P 500 from April to August of 2013, Dupont has been performing at market. It typically starts its seasonal period on January 28th and lasts until May 5th. Last year it performed at market until late April and then got a boost from a strong earnings report.

It is best not to enter into the Dupont trade before its earnings announcement in January as the company often bottoms out after earnings.



TJX Companies –

After a strong three years of performance, TJX is no longer a discount stock, but a seasonal opportunity just ahead – Entry January 22nd

TJX’s seasonal trend that lasts from January 22nd to March 30th, has been helped by very strong performance over the last three years, as the stock outperformed the S&P 500 by over 100%.

Strong performance over this time does not mean that the seasonal trend will not work. TJX has a strong track record of outperformance in its seasonal period. Currently, the retail sector is under a bit of pressure from less than expected sales at Christmas. It is possible that the retail sector will start its seasonal period late this year.



Caterpillar –

Entry January 23rd

The Caterpillar seasonal trade is a new stock trade in my Thackray’s 2014 Investor’s Guide. The seasonal period for Caterpillar takes place from January 23rd to May 5th. In 2012, Caterpillar performed well at the start of its seasonal period and then faded as the market became concerned with economic growth. In 2013, the same trend occurred but the strong performance did not last as long. In both cases Caterpillar started to outperform the S&P 500 in October. This time, Caterpillar started to outperform in December. The stock currently has a solid technical pattern, but investors should be watching for an early finish to Caterpillar’s seasonal trend.



Royal Bank –

Entry January 23rd

Royal Bank tends to perform well from October 10th to November 28th and then from January 23rd to April 13th. In both 2011 and 2012, Royal Bank performed well during its first seasonal period and faltered at the beginning of the next year. The Canadian banks started to perform strongly in August 2013 based upon their strong earnings. Royal Bank participated in this rally, but started to underperform coming into the last week of November.

Although Royal Bank has been underperforming the market recently, it does not mean that it cannot outperform once again in the second seasonal period. The sweet-spot to this trade occurs in late February and investors should be looking for Royal Bank to start outperform before this time.



Last Minute Thoughts

As I taper my food intake in the New Year (I prefer taper to diet), I cannot help but think of the outcome with the Federal Reserve doing the same with their asset purchasing program.

In my last newsletter I stated that I thought the Federal Reserve would not start tapering until March. I was surprised when they announced that they would start in January, but the main point is that the market took it in stride, which is a good thing.

The Fed is claiming that tapering is not the same as tightening. Technically they are correct, but in substance, they are not. If the market has had the influence of a quantitative easing program for an extended period it will be part of its base expectation. It is all relative and reducing quantitative easing will have exactly the same impact as tightening.

So far the behavior of the market has not been effected. It is going to be interesting to see how the market responds after several “taperings.” If the economy expands and the market keeps increasing, expect several more taperings. The Fed might as well act when the going is good. In the past the Fed has been very cognizant of the “wealth effect” and has been very reluctant to do anything that would hurt the stock market (despite what they say). Time will tell how the new leadership will deal with this situation.

It is possible that a few taperings may take place before the market really reacts. The first tapering went well. When the next Fed meeting arises, expect more analysts to make comments that tapering is good because it means that the economy is growing and a growing economy is always good.

Let’s be honest with ourselves, a large part of the stock market rally has been driven by cheap money and quantitative easing. It is not possible that tapering is beneficial to the stock market, at least not in the short-term. It is probably after a few taperings and liquidity is drying up that the impact will be felt on the stock market.

In the mean-time we are in the favourable season for the stock market and although there may be a dip in the next couple of months, the market is expected to be higher in April.

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