# Thackray Market Letter

**— Know Your Buy & Sells a Month in Advance —**

Published the 10th Calendar Day of Every Month

Volume 8, Number 2, February 2014


Written by Brooke Thackray

## *NOW AVAILABLE!*

The Thackray's 2014 Investor's Guide is now available. It includes new seasonal strategies for Emerging Markets, Disney, Boeing, Harley Davidson.....and many more.

## *NEW- Sector Spotlight*

On the last page of this newsletter is the Sector Spotlight, which is a more detailed look a seasonal sector of interest. This newsletter illustrates the seasonal and technical trends of the oil stocks sector.

## S&P 500 Technical Status

January was not a good month for the S&P 500 as it quickly broke through its 50 day moving average and ended up producing a 3.6% loss. The good news is that the market is now oversold (according to the RSI) and more importantly its uptrend is still intact. A lot of investment gurus were drawing a line in the sand for the S&P 500 at 1775, stating that if the S&P 500 were to break this level, then the market was headed down much further. In my monthly video, I used 1750 as the support line, but even then I did not declare the world to be over if this level were breached. The S&P 500 did break below 1775 that many called for, but then managed to climb above the "critical" level. There can always be a correction at any time during the year, but while we are in the favorable six month period for stocks, investors should favor being in the market, rather than exiting.

**An ETF for all seasons**

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

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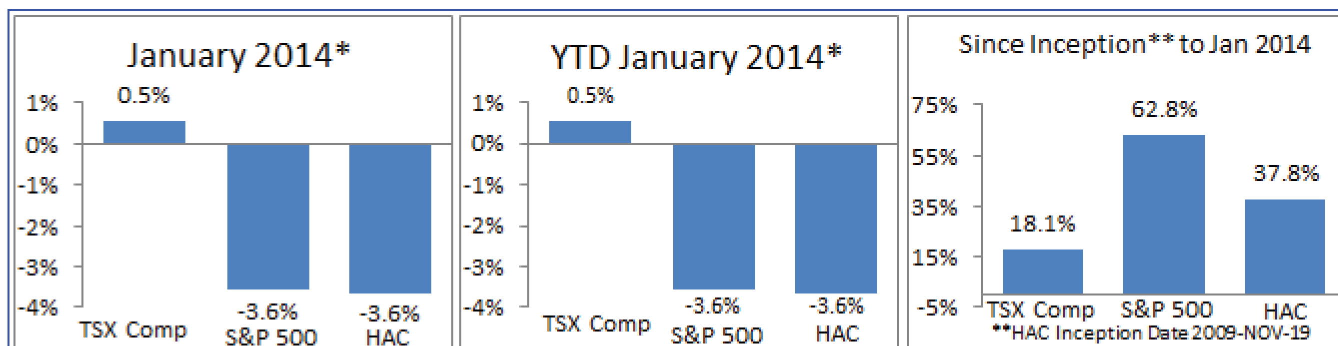
Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **January 31st**, 2014

| Symbol | Holdings | % of NAV |
|---|---|---|
| | Canadian Dollar Exposed Assets | |
| | Equities | |
| HXU | Horizons BetaPro S&P/TSX 60™ Bull Plus ETF | 10.0% |
| HUZ | Horizons COMEX® Silver ETF | 9.7% |
| HXT | Horizons S&P/TSX 60™ Index ETF | 5.9% |
| HXE | Horizons S&P/TSX Capped Energy Index ETF | 5.1% |
| HXF | Horizons S&P/TSX Capped Financials Index ETF | 1.1% |
| | United States Dollar Exposed Assets | |
| | Equities | |
| IWM | iShares Russell 2000 ETF | 14.2% |
| XLF | Financial Select Sector SPDR Fund | 10.0% |
| HSU | Horizons BetaPro S&P 500® Index Bull Plus ETF | 10.0% |
| XLI | Industrial Select Sector SPDR Fund | 9.9% |
| XLB | Materials Select Sector SPDR Trust | 9.8% |
| SMH | Market Vectors Semiconductor | 5.3% |
| OIH | Market Vectors Oil Service ETF | 5.0% |
| XLY | Consumer Discretionary Select Sector SPDR Fund | 5.0% |
| | Platinum Future Exp April | -0.2% |
| | *US Dollar Forwards (February 2014) - Currency Hedge ** * | *0.1%* |
| | Cash, Cash Equivalents, Margin & Other | -0.8% |
| | *Total ( NAV $124,971,745)* | *100.0%* |



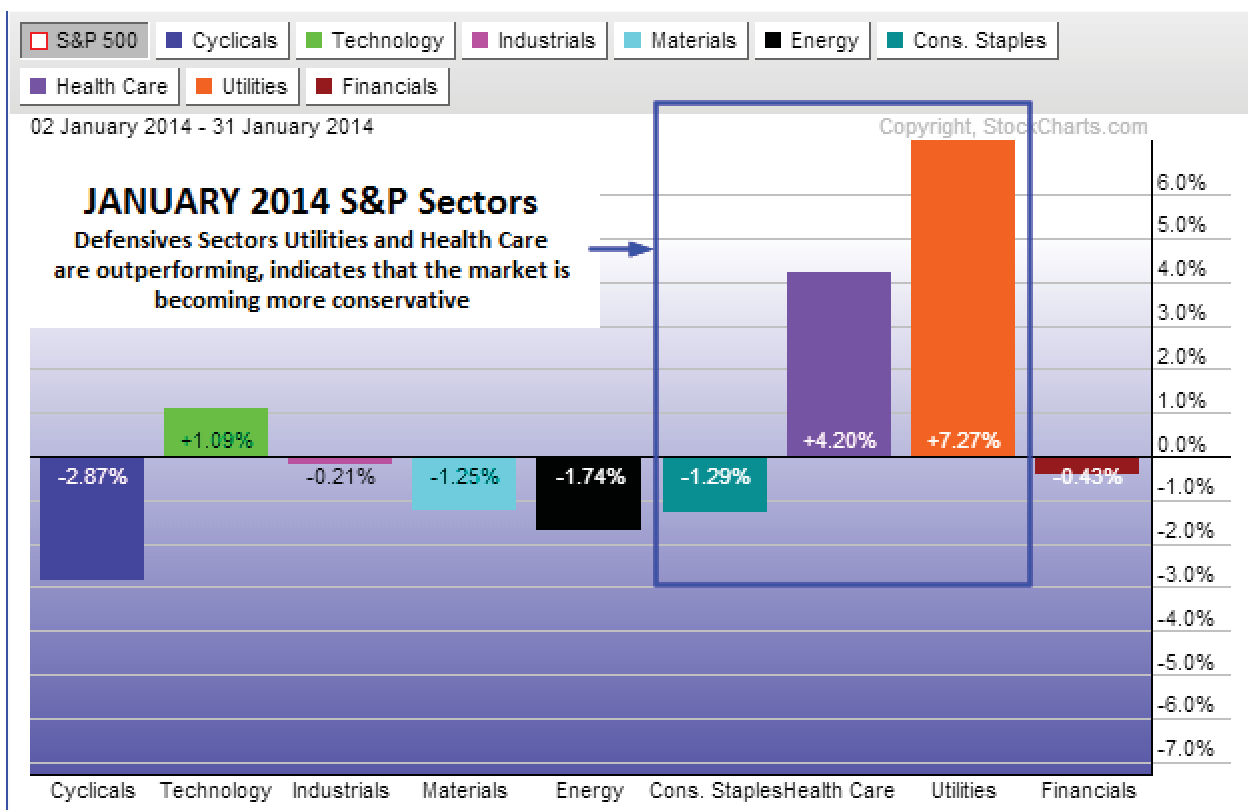

* Source: Bloomberg, HAC based upon NAV

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 U.S. economy is currently showing mixed results. It has fairly solid underpinnings with GDP growth of 3.2% in the last quarter of 2013, but more recently the economic numbers have been on the negative side. The Institute for Supply Management's manufacturing index declined, from 56.5 to 51.3 in December, which compares to the median forecast of 56 (Bloomberg survey). In February, the U.S. Bureau of Labor Statistics released a report showing that the economy added 113,000 jobs in January, trailing the median forecast of 185,000, which was a "big miss." Overall, the economy still has some upward momentum, but it is being called into question.

The road ahead may be bumpy as the month of February is on average, one of the weaker months of the year for the S&P 500, producing an average loss of 0.1% from 1950 to 2012, and only being positive 54% of the time. Despite the volatility in the markets and the correction of the U.S. stock market in January, HAC believes that the North American stock markets still have the potential to increase. It may be time to be cautious, but it is not the time to throw in the towel on equities.




So far, the S&P 500 has corrected 2.6% since the beginning of the year. The media keeps talking about a 10% correction and showing statistics of how many 10% corrections there have been on average per year over the decades. There is no doubt that these statistics are useful, but it does not necessarily mean that there is going to be a 10% correction. It is not a foregone conclusion. Maybe it is a 5% correction, or 8%, or it could be even more. The point is that we should not expect a 10% correction just because that is the media's benchmark.

From a seasonal perspective, we are still in the favorable six month period for stocks, which lasts from the end of October to the beginning of May. Although this period can and will have corrections in this time period, the market has a greater tendency to recover and perform well, compared to the unfavorable period for stocks from the beginning of May to the end of October.

The next two months of March and April are on average two of the stronger months of the year. With this favorable seasonal trend just around the corner, it does not make sense to become overly bearish on the market. It is more prudent to be cautiously looking for opportunities.

Through the recent turmoil, the stock market has started to become more conservative. Two defensive sectors, utilities and health care that typically underperform at this time of the year are outperforming. The *January 2014 S&P Sectors* column graph shows the relative performance of the S&P Sectors compared to the S&P 500. The utilities and health care sectors typically outperform in the summer months and not at the start of the year. When these sectors underperform at this time, it is a sign that the

market is moving into a defensive mode and a correction could be on the horizon. To set the record straight, this is not a timing indicator and does not necessitate that a large move to cash should be undertaken. A more serious correction could be months away.

We have seen the defensive sectors outperformance at the beginning of the year in the last two years. Each time it has led to a spring time correction. It should be noted that there are two differences this year compared the last two years.

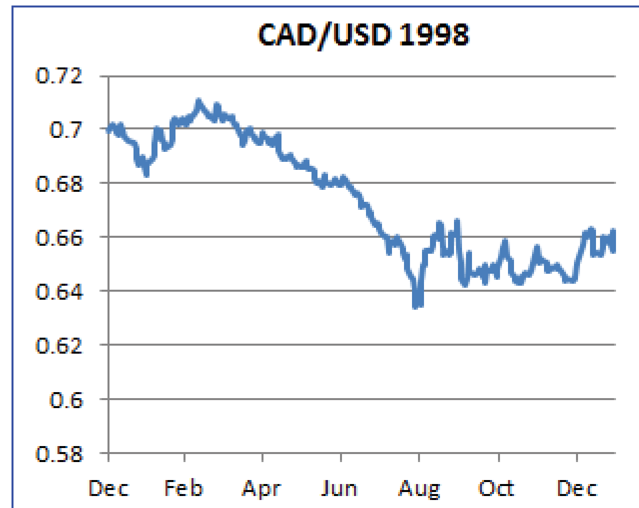
First, the consumer staples sector, which is classified as a defensive sector and outperformed with the other two defensive sectors at the beginning of the last two years, has underperformed this year. This can be explained by the sector's greater exposure, compared to the S&P 500, to overseas income, including emerging markets. As some of the emerging market currencies have plummeted, this has had a large impact on the potential earnings of companies in the consumer staples sector.

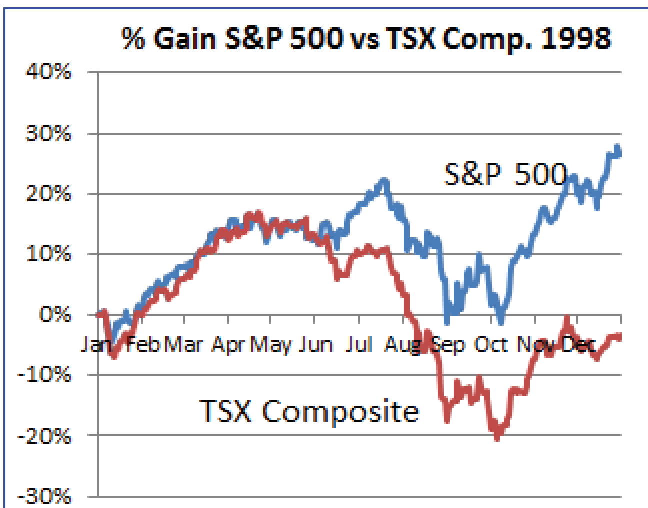
Second, the defensive sectors were outperforming in 2011 and 2012, when the S&P 500 was rising in the New Year. This compares to this January when the defensive sectors were outperforming and the S&P 500 was falling. Although this is more of a classical case of defensive sector rotation, it does not explain the magnitude of difference between the defensive sectors and the S&P 500 this past January.

The Canadian stock market finally outperformed the S&P 500 in January, and by a big margin. Canadians were starting to get a complex and wonder if the TSX Composite was ever going to outperform the U.S. market. Why did the Canadian market fare so well in January when the U.S. market performed poorly?

One of the main reasons was that the Canadian stock market was the beneficiary of the emerging markets suffering from the perceived effect of less Federal Reserve quantitative easing taking place and as a result the Canadian dollar depreciated at a rapid rate. The weaker Canadian dollar benefited companies that had their costs in Canadian dollars but exported their products abroad. Canadian based mining companies performed well relative to their U.S. counterparts.

It is interesting to note that the emerging market phenomenon that played out in January had a very different outcome to the "Asian Contagion" in 1998. In 1998, when the Asian emerging markets and Russia ran into trouble, investors determined that "resource countries" such as Canada were going to perform poorly and sold off the Canadian currency and the Canadian equity market (see graphs *CAD/USD 1998* and *% Gain S&P 500 vs. TSX Comp.*).




Notice how in 1998, both the U.S. and Canadian equity markets were performing approximately equal to each other up until June when the Canadian market started to underperform. When the crisis became full blown in July and August the Canadian market substantially underperformed and then continued to underperform until the end of the year.

This January, when the emerging market currencies sold off, the Canadian dollar also sold off, but Canadian equities outperformed the S&P 500. There are some obvious differences between 1998 and this past January, mainly this year the crisis was limited to a relatively few countries and the magnitude of the decline is much less. Nevertheless, comparisons can be made. In 1998, there was a real fear that the world economy was going to be impacted in a dramatic manner. This time round, the crisis so far has been seen as more of a minor "blip" for the developed countries

The big question remains, can the Canadian stock market continue to outperform the S&P 500? From a seasonal perspective, in the month of February the Canadian stock market has outperformed the S&P 500 58% of the time since 1978. In March, the rate of outperformance dips to 42% of the time, and in April 33% of the time. In other words, there may be a little bit of a tail wind here, but it does not last long.

If the emerging market situation were to become a full blown crisis, the world economy would be impacted and it would be unreasonable to assume that the Canadian equity market would be unscathed. Yes, the Canadian dollar might fall some more, but at some point the slumping global demand for resources would hurt the Canadian stock market more than the U.S.

From a risk perspective, if investors started to leave the cyclical sectors in favor of the defensive sectors, then it would be expected that Canada's resources stocks would underperform. This has happened at this time of the year, in the last two years and it is something that HAC is monitoring on an on-going basis.

The bottom line is that yes the Canadian stock market can outperform the U.S. stock market, but it is not something that an investor should take for granted. Investors should not expect the trend to continue indefinitely and should be willing to adjust their position when the trend changes. This is particularly true, after the month of February.

## *What the HAC is Going On?*

After outperforming both the S&P 500 and the TSX Composite in December, HAC performed equal to the S&P 500 and underperformed the TSX Composite in January. As mentioned in my last newsletter, attractive sectors in the market are industrials, financials and the energy sector. The industrial sector typically outperforms well until the beginning of May. The financial sector typically outperforms until mid-April and the energy sector starts its seasonal period later in February and lasts until early May. It is possible that all three of these sectors will finish their seasonal periods earlier than normal. This is especially true if the market continues to become more defensive, as was the case in the last two years. Although HAC favors the seasonal sectors that tend to perform well at this time, such as, industrials, financials, energy and materials, HAC is watching closely to see if they start to underperform the broad stock market. If the sectors show sustained underperformance HAC will take action and exit the positions.

One sector that typically performs well at this time of the year and is starting to show underperformance is the small cap sector (Russell 2000). Although this sector has been performing at market since the beginning of its seasonal period in mid-December, it is starting to show signs of underperformance. Seasonal investors should be looking to exit this sector. The underperformance of the small cap sector is another sign of the market becoming more defensive. When this happens it is best for investors to be cautious and decrease allocations to higher beta sectors and favor more broad market exposure.

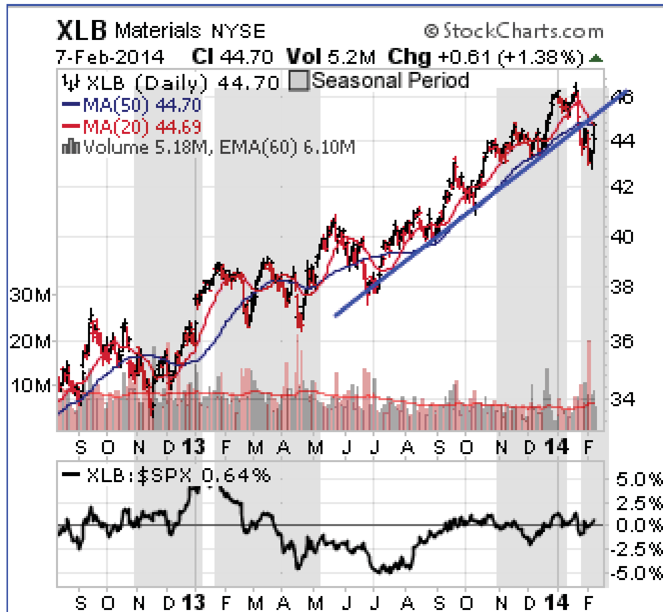
### *Industrials*
### *Uptrend still intact*

The industrial sector has been a solid performer since early 2013. Its uptrend is still intact and it is still outperforming the S&P 500. Currently, this is still a favorable sector.

### *Materials*
### *Broken upward trendline - but just started its second seasonal period*

The materials sector has recently broken its upward trendline, but since the start of its seasonal period on January 23rd, it has been slightly outperforming the S&P

500. Overall, it has been performing at market since the October. At this point in time, the sector should still be given some room to prove itself, but if it starts to underperform, investors should consider exiting the position.




## *Technology*
## *Seasonal Period Ended - but still performing*

The technology sector has been a fairly consistent outperformer relative to the S&P 500, since the beginning of its seasonal period in October. HAC closed out its technology position in January as the seasonal period was coming to an end. The sector has continued to perform well and those that still hold the sector should be looking to exit when the relative performance to the S&P 500 starts to fade and crosses its upward trend line.

## *Consumer Discretionary*
## *Strong Bull Growing Tired*

The consumer discretionary sector has outperformed the S&P 500 for over a year. At the beginning of January the sector started to underperform the S&P 500, largely based on declining retail sales. The sector is still in its seasonal strong period. The concern is that the sector has broken its uptrend line and the sector is not performing well relative to the S&P 500. With such a strong outperformance, for so long, the sector is vulnerable to weakness. Until the sector shows improvement, HAC has decided to maintain a smaller position in this sector than it would otherwise.

## *Retail*
## *Consumers Down But Not Out*

The retail sector typically starts its seasonally strong period on January 21st. This year before its seasonal start, the sector corrected mainly on the back of poor retail sales over the Christmas holiday and not so strong forecasts. Recently, the sector has just started to show signs of improved performance. As the sector was correcting in January and showing underperformance relative to the S&P 500, HAC did not enter the sector in January. Recently, the sector has started to show signs of once again of improved performance. HAC continues to monitor the sector's performance.

### *Financials Not Impressive So Far*

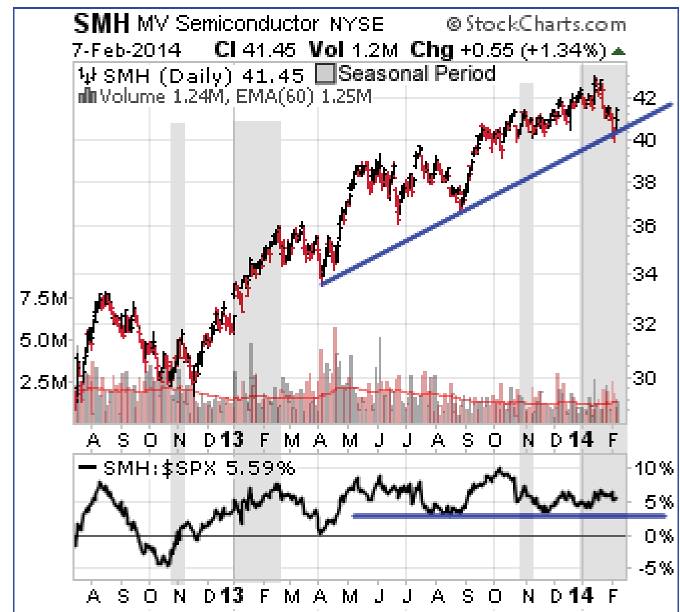
So far the financial sector has not put in an impressive performance, but on the other hand, it has not lagged. This is a sector that needs to be watched. If the market is going to perform well, the financial sector will typically be one of the stronger sectors.

### *Canadian Banks Hanging In*

The Canadian banks have been performing at market (S&P 500). The sector is in its strong seasonal period, but has yet to show an outperforming trend. The sector has recently risen up to its 50 day moving average and is well below resistance. The sector is considered favorable at this time, but a positive outperformance trend has yet to develop.

### *Semiconductors–Performing Well, But Get Ready to Exit*

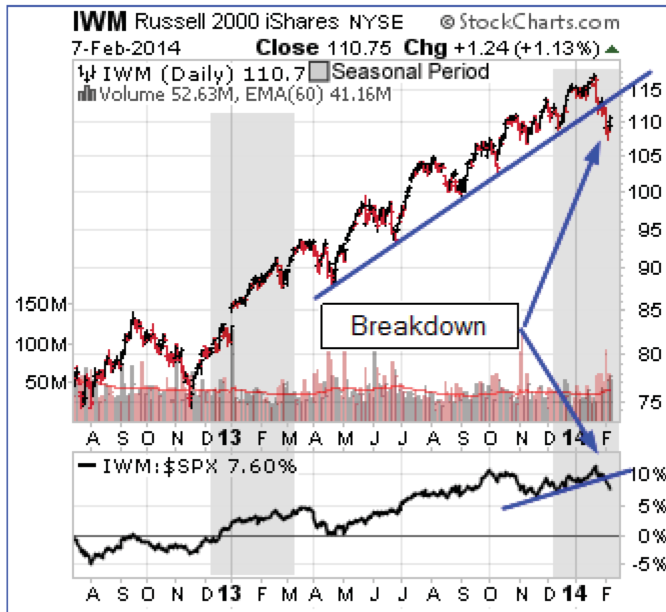
The semiconductor sector has performed well in its seasonal period and continues to do so. The end of the seasonal period is in a few days (February 15th), but the sector can continue its outperformance into the beginning of March. Investors should be on their toes and be prepared to exit when the sector starts to underperform the S&P 500.




### *Russell 2000 (Small Caps) Time to Leave*

The small cap sector of the market has been on an incred-

ible run for over a year. The sector has had a solid uptrend and has just recently broken below its uptrend line and its relative performance trend to the S&P 500. Given that we are less than one month away for the seasonal exit date for the sector, it is time to consider exiting the trade.




### *Silver*
### *Positive, Outperforming the S&P 500, But Still Unimpressive*

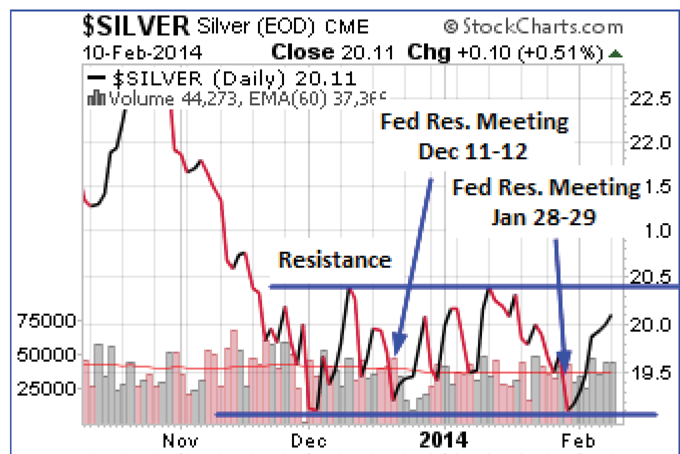
Silver bullion had a strong bounce off support at the end of 2013 and looked to perform well in its seasonal period which lasts up until March 31st.

So far silver has had a lack lustre performance. Yes, it has produced a positive return and outperformed the S&P 500, but it should be doing much better at this time of the year. In addition it should be outperforming gold bullion, but it is not. When silver fails to lead gold, very often the precious metals rally is at risk.

Silver bullion has been consolidating in a range from $19.20 to $20.40. It is interesting to note that within this price range, when the Fed meeting was approaching silver would start to correct a week before the meeting and then rally after the meeting. Although gold corrected similarly in December, it only had a minor tick down in late January before the next Fed meeting. The other sectors that should have also responded negatively to tapering; utilities and bonds, both performed fairly well into the January Fed meeting.

Given that the Fed tapering was a forgone conclusion, silver reacted in a negative fashion compared to the other sectors that were prone to correcting on a Fed tapering announcement. This shows the underlying weakness in performance of silver.

Although the seasonal period for silver can run from January 1st to the end of March, very often the silver will start to lose its lustre at the end of February and investors should be prepared to exit the sector if it starts to underperform the S&P 500. This is particularly true as we approach the next Federal Reserve meeting on March 18th-19th.



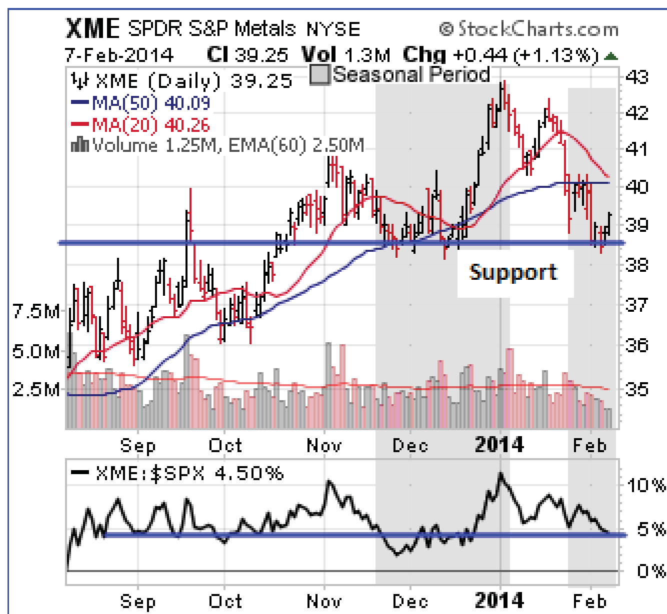

The risk to exiting early is if Yellen at her first meeting decides not to continue tapering, which would be very bullish for silver. Almost everyone is expecting her to continue on the path already set, and taper, but there is a chance she will pull back. My educated guess is that she will taper once again and if the economy is struggling at the next meeting at the end of April, she will change the tone at that time. The Federal Reserve needs some con-

sistency and after talking taper until September and then not tapering and then tapering, they do not want to change plans too quickly again.

On a brighter note, if silver were able to break above the $20.40 resistance level, this would be very positive for silver and investors would be wise to ride the momentum up until the sector starts to underperform the S&P 500.

### *Metals and Mining*
### *U.S. Metals & Mining, Performing at Market, but Recently Underperforming*

The metals and mining sector performed poorly in the U.S., in the month of January, but the same sector in Canada fared much better because of its currency advantage. The U.S. ETF, XME is currently sitting above support and is trading below its 50 and 200 day moving averages. The sector, with all its ups and downs, has been performing at market over the last few months. More recently, it has been showing signs of weakness relative to the S&P 500. HAC made a decision in January to get broader sector exposure through XLB, rather than XME. If the metals and mining sector performance improves, HAC may take a position in the sector.

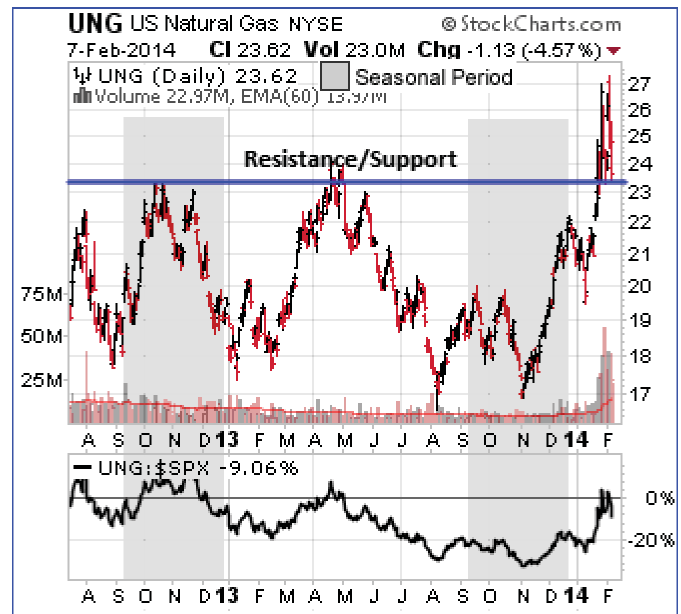



### *Homebuilders*
### *Time to Move On*

In mid-January HAC exited its position in the homebuilders sector. Through its ups and downs, the homebuilders sector has performed at approximately the market. When this market finishes its seasonal trend, it is usually best to exit. This year is no exception. The sector had a very strong bull run in 2011 and 2012. In the last year the sector responded has underperformed the market. Given that the sector has on average not made a gain from February to September, from 1990 to 2012, there is no point in remaining in this sector at this time.

### *Natural Gas*
### *Cold Weather Driven*

After a successful seasonal trade from the beginning of September to December 21st, I suggested that seasonal investors should exit the natural gas sector as it tends perform poorly after December 21st. The exit date appeared to be bang-on, as the sector started to correct after a strong run in December– that was until a wave of polar vortices came down from the north and put a freeze on the North-East coast. The cold drove up the demand for natural gas and the price resumed its march upwards.



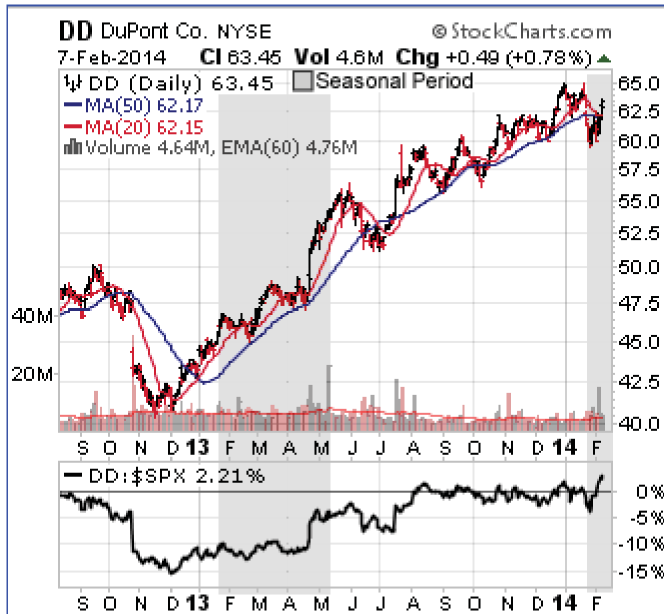

Seasonal trades work based upon long-term trends, but

when a large exogenous events, such as a series of polar vortices occurs, the trade can be negated.

## *Stocks*

### *Dupont*
### *Strong Chemical Reaction at the Beginning of its Seasonal Period*

Dupont bounced right on cue at the beginning of its seasonal period. Its solid earnings was driven mainly by its agriculture business, which more than offset the weakness in its traditional chemicals business. Currently, the stock is performing well and is above its 50 day moving average.

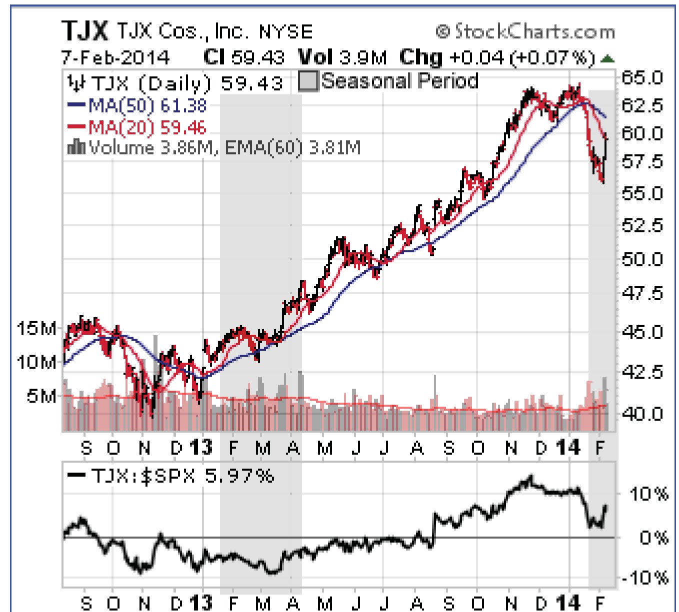



### *Caterpillar*
### *Climbing Uphill at the Beginning of its Seasonal Period*

The Caterpillar seasonal strategy was a new strategy in my 2014 book– so far so good. Caterpillar got off to a good start when it released better than expected earnings. In 2013, the stock built up a solid base and it is only in 2014 that it has been able to break above its resistance level. Caterpillar has been outperforming the S&P 500 since November.

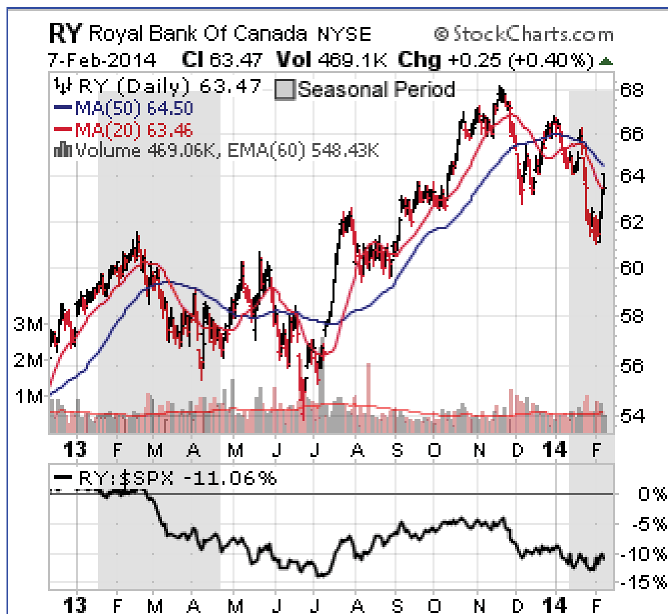
### *TJX*
### *Buyers Snap Up Bargain*

After a poor Christmas retail period many retail stocks performed poorly, including TJX. The stock fell sharply into its earnings period, only to bounce up sharply just after its seasonal period started, when TJX released better than expected earnings.




### *Royal Bank*
### *Nothing So Far– But Give it Time*

Relative to the S&P 500, Royal Bank has been performing with the S&P 500 in its second seasonal period starting on January 23rd and which continues to April 13th. At this time the trade has to be given time to prove itself.




I do believe that there is an over confidence in Federal Reserve and its ability to reduce its quantitative easing program. This experiment has never been done on this scale before and it is very difficult to predict its outcome, even for the Fed.

There are two camps on the effectiveness of the Federal Reserve's quantitative easing program. Some investors, and the Federal Reserve, claim it has had a large impact on stimulating the economy. Other investors, including myself, believe that there has been a large side-effect of stimulating the economy, which is artificially pushing the stock markets higher with cheap money. If the later is true, then it is going to be difficult for the Fed to reduce its stimulus without having a substantial impact. Investors are all hoping that the Fed is going to be able to pull off the task at hand, let's just hope that it is not just wishful thinking.

### *Last Minute Thoughts*

The stock markets seems to have digested the emerging markets "situation" quite well– so far. Yes, the stock markets and some currencies corrected, but all in all, it seems like investors have moved on.

The U.S. and Europe seem to be going in different directions. The U.S. is acknowledging that its economy is improving and is willing to taper its quantitative stimulus program, while Europe is seeing slower growth and worried about deflation.

In mid-January, International Monetary Fund Managing Director Christine Lagarde urged developed countries around the world to fight of the risks of deflation in a "feeble" global recovery. Although Lagarde is not the sole voice for Europe, others have expressed similar concerns.

It is hard for this divergence to continue indefinitely, especially if the U.S. continues with its tapering agenda. As liquidity is reduced, the emerging markets will inevitably be affected.

As money has been leaving the emerging markets, they have been raising their interest rates to protect their currencies. This action is going to ultimately stifle growth in the emerging markets. As the emerging markets slow, the customer base for the U.S. is going to be decreased and will in part effect its growth.

The slowing emerging markets will take quite a bit of time before they will have a direct impact on U.S. growth and as a result, it is not on investors' radar at this time.

### *Energy Stocks Sector*

Energy stocks have two seasonal periods that are based primarily on two different demand seasons for product. The first seasonal period starts in late February on weakness in demand for heating oil and strengthens into May on gasoline inventory build prior to the start of the driving season in May. The second seasonal period starts in late July and runs into the beginning of October as the result on increasing demand for heating oil. In addition, oil companies typically build their inventories in October and then draw them down to a low inventory at the end of the year, in order to avoid paying inventory taxes that many of the states/counties/municipalities charge on year-end inventories.

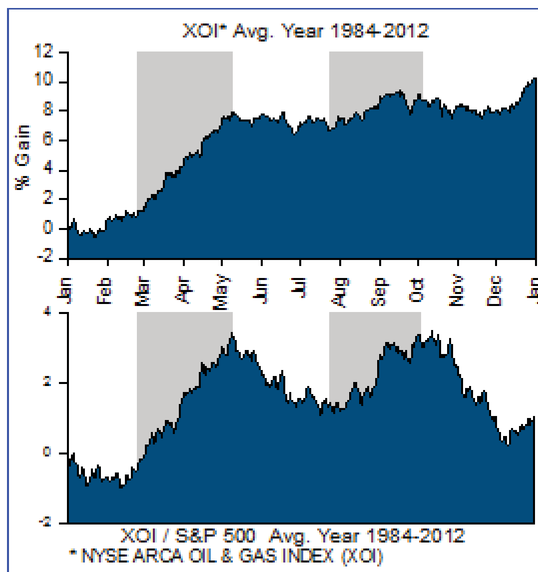
### *Seasonal Performance*

Energy stocks tend to perform well from February 25th to May 9th. In this time period, from 1984 to 2013, the NYSE ARCA OIL & GAS INDEX (XOI) has produced a average gain of 7.3% and has been positive 83% of the time. It is important to note that the trade has underperformed the S&P 500 in the last five years. This has resulted from a variety of different reasons, including investors finding more "torque" in other sectors of the market as the market skyrocketed upwards (2009), the energy sector peaking early in its seasonal period (2011), the market favoring of the defensive sectors in the spring time because of the concerns of a market correction (2012 and 2013). It is not to say that one of these scenarios cannot occur again, but on the other hand, the long-term seasonal trend still exists and should not be discounted as the fundamental demand and supply relationships for oil are still the same.

NYSE ARCA OIL & GAS INDEX (XOI) vs. S&P 500 1984 to 2013

| Feb 25 to May 9 | S&P 500 | XOI | Diff |
|---|---|---|---|
| 1984 | 1.7% | 5.6% | 3.9% |
| 1985 | 1.4 | 4.9 | 3.5 |
| 1986 | 6.0 | 7.7 | 1.7 |
| 1987 | 3.7 | 25.5 | 21.8 |
| 1988 | -3.0 | 5.6 | 8.6 |
| 1989 | 6.3 | 8.1 | 1.8 |
| 1990 | 5.8 | -0.6 | -6.3 |
| 1991 | 4.8 | 6.8 | 2.0 |
| 1992 | 0.9 | 5.8 | 4.9 |
| 1993 | 0.3 | 6.3 | 6.0 |
| 1994 | -4.7 | 3.2 | 7.9 |
| 1995 | 7.3 | 10.3 | 3.1 |
| 1996 | -2.1 | 2.2 | 4.3 |
| 1997 | 1.8 | 4.7 | 2.9 |
| 1998 | 7.5 | 9.8 | 2.3 |
| 1999 | 7.3 | 35.4 | 28.1 |
| 2000 | 4.3 | 22.2 | 17.9 |
| 2001 | 0.8 | 10.2 | 9.4 |
| 2002 | -1.5 | 5.3 | 6.9 |
| 2003 | 12.1 | 5.7 | -6.4 |
| 2004 | -3.5 | 4.0 | 7.5 |
| 2005 | -1.8 | -1.0 | 0.8 |
| 2006 | 2.8 | 9.4 | 6.6 |
| 2007 | 4.2 | 10.1 | 5.8 |
| 2008 | 2.6 | 7.6 | 5.0 |
| 2009 | 20.2 | 15.8 | -4.4 |
| 2010 | 0.5 | -2.3 | -2.8 |
| 2011 | 3.1 | -0.6 | -3.7 |
| 2012 | -0.8 | -13.4 | -12.5 |
| 2013 | 7.3 | 3.8 | -3.5 |
| Avg. | 3.2% | 7.3% | 4.1% |
| Fq>0 | 77% | 83% | 77% |

Shaded cells: Positive



### *Technical / Seasonal Strength*

In both 2012 and 2013, in the time period heading into the winter/spring seasonal period, the energy sector was performing strongly on a positive uptrend and performing at market. At the start of the seasonally strong period the sector performance faded and started to underperform the S&P 500. In both years, the cyclical sectors started to underperform in late winter as the market started to uncharacteristically favor the defensive sectors at this time of the year. Currently, the energy sector is continuing its underperformance streak that it started in early 2013 (it did manage to outperform the S&P 500 briefly in its summer seasonal period). This protracted underperformance is setting up well for the beginning of the seasonal period that starts later this month. When a sector underperforms before the start of its seasonal period, this can often act like a compressed spring, helping to power the sector higher in its seasonal period.

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