Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

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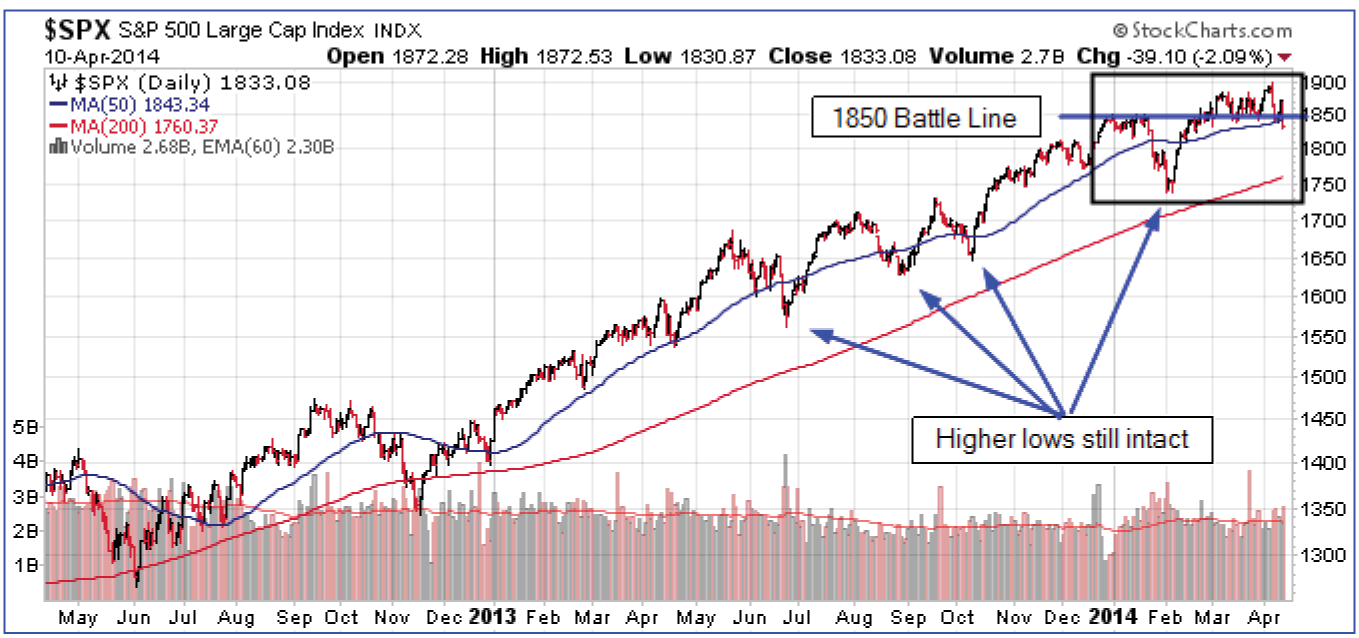
Market Update

As we are reaching the “Sell in May” season, investors are once again wondering if they should be reducing the risk in their portfolios. Last year at this time, the media was all over the “Sell in May” story. I have been writing about seasonal investing for many years, and I have never seen such media coverage on the topic. Last year the stock market did pull back in late May and June, only to rally higher in the late summer. After the rise in the stock market last summer, the average investor may not be so focused on the six month favorable and unfavorable seasons in the stock market. This is particularly true as the stock market has continued to move higher for an

S&P 500 Technical Status

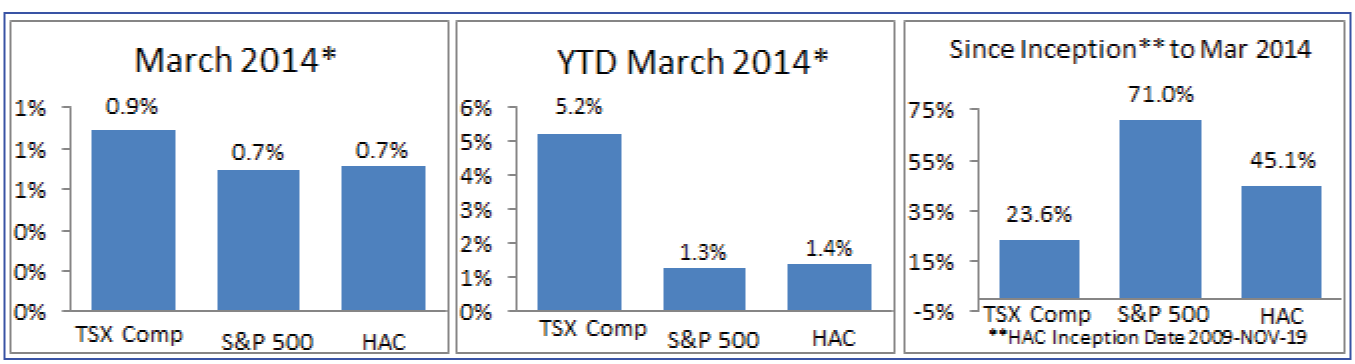
The Battle of 1850 — The S&P 500 reached 1850 in late December 2013. Since then it has crossed over and touched this level many times. As a result, the 50 day moving average sits just below this level. The market is currently looking for direction. As we are still in the favorable six month period for stocks, the market still has a seasonal tailwind to help it move higher. Once we enter into the unfavorable season for stocks, the market is more likely to correct and if it stays below 1850 for any length of time, the stock market will be in correction mode. Not to get too far ahead, but the next level of major support for the S&P 500 is at 1740, if it turns below this level in the unfavorable period the market will be in trouble. We still have some time left (not much) in the favorable season and the market is starting to become jittery. On Friday April 4th and Thursday April 10th, the S&P 500 dropped significantly on relatively minor negative news. When the stock market moves significantly downwards on slightly negative news, this is considered to be bearish. Investors should be preparing to become more defensive. As we move into the unfavorable period for stocks is in a few weeks, investors should be looking to reduce risk in their portfolios.



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

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXE	Horizons S&P/TSX Capped Energy Index ETF	10.2%
	United States Dollar Exposed Assets	
	Equities	
HSX	Horizons S&P 500® Index ETF	53.9%
XLF	Financial Select Sector SPDR Fund	15.0%
XLB	Materials Select Sector SPDR Trust	9.8%
XLI	Industrial Select Sector SPDR Fund	9.6%
	US Dollar Forwards (April 2014) - Currency Hedge **	0.4%
	Cash, Cash Equivalents, Margin & Other	1.0%
	Total (NAV $123,202,217)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 89.5% 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.

extended period of time.

The six month favorable/unfavorable cycle is a topic that I have spent a lot of ink on, over the years. I do not lay claim to discovering this cycle, many others have discussed it previously. I use slightly different entry and exit dates, as most others just use the full months of November to the end of April. My research has shown that there is value in adjusting the entry and exit dates to take into account the strong market trends at month end. Historically, since 1950, the best entry date in the market has been October 28th and the best exit date has been May 5th.

Some investors will challenge the six month cycle and state that "this year" is different and expect the market to move substantially higher. On average, the S&P 500 has been positive 62% of the time from 1950 to 2013 during the unfavorable six month period from May 6th to October 27th. This is not necessarily a good reason to expect strong results. Firstly, the success rate is much lower than the favorable six month period, which lasts from October 28th to May 5th, a period that has an 81% rate of success. Secondly, large losses occur more frequently in the unfavorable six month period, with the S&P 500 producing losses greater than 10%, seven times, compared to favorable six month period which only had a loss of 10% or greater, two times. Thirdly, the large gains above 10% are a lot more scarce in the unfavorable six month period and have only occurred eight times since 1950. This is substantially less than the success of the favorable six month period, where returns above 10% have occurred twenty-seven times.

The bottom line is that the unfavorable six month period for stocks tends to be a lot less rewarding than the favorable six month period and it is wise for seasonal investors to reduce the risk in their portfolios accordingly. Yes, there are times when the stock market rallies strongly in the unfavorable six month period, but these times are usually predicated by a snap back from a market bottom, or strong recovery from a recession. Strong returns outside of these parameters do occur, but are rare.

Although it is wise to reduce risk in a portfolio in the unfavorable period, there are still investment opportunities, both from a sector and a broad market level. The goal of this newsletter over the next six months will be to write about the opportunities as they develop.

The S&P 500 is currently starting to show some signs of wear. After a strong rally in 2013, the S&P 500 has been battling at the 1850 level for over a month, and was fairly flat for most of March. The situation has a similar pattern to last year, the S&P 500 was flat for most of March and then corrected in the first part of April.

Although it is possible for the S&P 500 to reproduce the rally that started in the second half of April 2013, and lasted until late May, the scenario of a strong May is not expected. Last year, as the Federal Reserve tapering talk started at the beginning of May, large amounts of money left the bond market and entered the stock market, helping it to move higher. The Federal Reserve's action of tapering bond purchases will undoubtedly have a dampening effect in the stock market. Nevertheless, last May when investors were considering the upcoming tapering of bond purchases, they were more concerned with the bond market, believing that they had some time to spare in the stock market. This year, the tapering program is well underway and as a result, it is not expected that it will have the same short-term impact that it had last year, moving money from bonds to stocks.

On average, May 5th has been a good time to start to reduce risk during the unfavorable six month period for stocks. Sometimes it is better to reduce risk earlier and sometimes later, but over the long-term reducing risk at the beginning of May has proven to be a good seasonal investment strategy. On average, from 1950 to 2012, May and June have been two of the weaker months of the year. It is possible for the market to perform well in either May or June, but seasonal investors should have an exit strategy; whether it is exiting in late April/early May, or setting up a technical trigger for exiting positions or using trailing stops.

Although there are sectors of the market that can perform well in May and June, the next strong rally point for the S&P 500 is in late June, leading into Independence Day and up until mid-July as the earnings season gets underway.

Nasdaq–
Underperforming– More to come after April?

A lot of investors associate a strong Nasdaq performance with a risk-on market condition and vice versa. The Nasdaq has been on a strong uptrend since late 2012 and outperforming the S&P 500 since April 2013. Recently the winds have shifted and the Nasdaq has peaked and started to underperform the S&P 500 in March of this year. This is a concern for the overall market, as the Nasdaq often sets the trend for the broad market. The Nasdaq has support at 4,000 and if it breaks this level in a significant manner, it would be in a confirmed downtrend.

There may be some short-term reprieve as technology stocks have a track record of outperforming the S&P 500 for the second half of April, once earnings start to get underway.

Last year the Nasdaq started its outperformance in April and continued right through the summer months, indicating a risk-on market. This year the trend is not quite so certain and it is not one that investors should count on.

Small Cap Sector– Breaking Down?

Similar to the Nasdaq, the small cap companies are also a risk-on barometer. Last summer they also outperformed the S&P 500, indicating investor's appetite for risk. The Russell 2000 Index peaked in March and started to underperform the S&P 500. It then had a brief pullback before once again starting to outperform the S&P 500. Although a repeat of this pattern cannot be ruled out, this is not a typical pattern and given the current market conditions, it is much less likely this year. Investors are better off avoiding this sector, and looking for other opportunities.

What the HAC is Going On?

In March, as the market was looking for direction, HAC took action by simplifying the portfolio– reducing the overall number of sectors that it holds. HAC also took exited some positions that started to show weakness before the end of their seasonal end date.

Some of the key changes were:

- ***Switch core focus from TSX Composite to S&P 500***
  - ***On average, starting in March the S&P 500 tends to be a better seasonal investment compared the TSX Composite.***
- ***Sold Semiconductor position (SMH)***
  - ***HAC did well holding its semiconductor position past its seasonal end date in mid-February. It took this action based upon strong momentum. HAC exited the position in early March.***
- ***Sold Consumer Discretionary***
  - ***Normally the consumer discretionary sector is a hold until late April, but this year it broke down early and as a result HAC exited the position in early March***
- ***Energy sector composition change***
  - ***Sold Market Vectors Oil Service and bought Horizons S&P/TSX Capped Energy Index ETF***
- ***Sold Horizons Comex Silver ETF***
  - ***Sold silver position early in March as the sector started to show signs of weak performance***
- ***Sold Platinum position***
  - ***In mid-March platinum continued to show signs of weakness and HAC exited the position***
- ***Bought Canadian dollar long position***
  - ***The Canadian dollar has a good track record of outperforming the USD in April. HAC entered into a Canadian dollar position to take advantage of this trend. It is expected that the position will be exited towards the end of April.***

Sector Trends

Financials– Time to exit

The financial sector has been performing at market recently, but starting to show signs of weakness. Given that the seasonal period ends on April 13th, investors should not overstay their welcome.

HAC held a position in the financial sector (XLF) at the end of March.

Materials–
Will the rally last? Don't count on it.

Industrials–
Performing at market, but seasonal period ends soon

In its autumn seasonal period the industrial sector outperformed the S&P 500. More recently, it has been performing at market. When a sector transitions from outperformance to a longer period of market performance and then ends its seasonal period, the next trend is typically underperformance. Investors should be looking to exit this sector at the end of its seasonal period or earlier if it starts to break down.

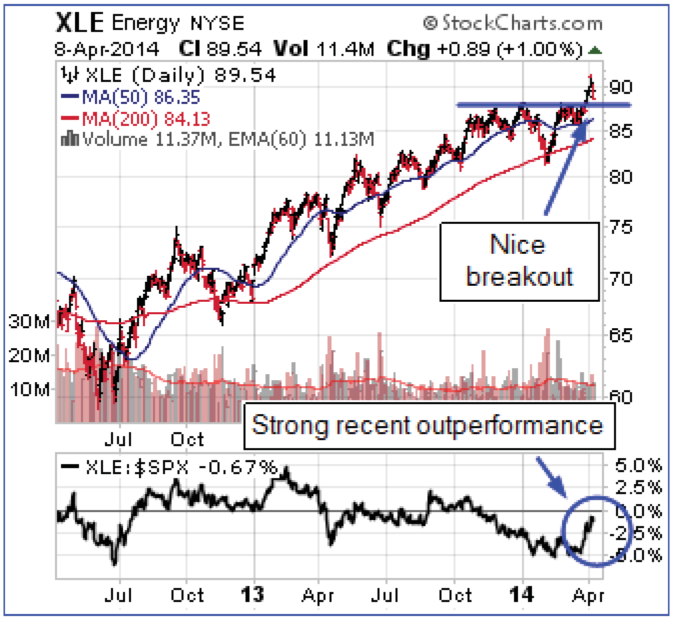
HAC held a position in the industrial sector (XLI) at the end of March.

Recently, the materials sector has changed from outperformance to market performance. This sector tends to perform well into the beginning of May. At that time the chemicals sector tends to start to underperform the market and it is best to exit the sector. Dupont is the largest stock in this sector and investors should monitor its performance relative to the S&P 500. If it shows signs of weakening, investors should consider reducing their materials position.

HAC held a position in the materials sector (XLB) at the end of March.

Energy–
Strong absolute and relative performance

The energy sector has had a strong rally recently. April is typically a strong month for the energy sector. The seasonal period for the sector is from February 25th to May 9th (*Thackray's Investor's Guide*, page 25). In the last two years, the energy sector underperformed at this time of the year. So far this year the trade has worked out very well.



Canadian Energy Sector

The Canadian energy sector has been outperforming the broad stock market since the beginning of the year. Recently, the sector has turned up the heat, ramping up its relative performance to the S&P 500. The seasonal period for the sector ends May 9th. If the sector is still performing well at the beginning of May, investors can place a trailing stop, looking to exit when the sector's performance starts to weaken.

HAC held a position in the energy sector (XHE) at the end of March.

Gold Stocks–
Not the season for gold stocks

It is not the season for gold stocks, but given the interest in this sector it is worth updating the sector's performance. Gold stocks corrected in March and have been putting in a bit of a bounce in the first part of April. Gold stocks rallied hard in January as their valuation became compelling and investors looked to start the year in the underperforming sector. The question remains, should investors jump on the rally? From a seasonal viewpoint, the answer is simple– no. It is possible that the sector continues to rally, but we are not in the seasonal sweetspot for the sector. The risk/reward position is not strong enough. Investors will be better served waiting for the approaching seasonal period in July.

HAC did not hold a position in the gold sector at the end of March.

Technology–
A quick bounce?

The technology sector has a strong seasonal period from October 10th to January 17th. In that time period, the sector has outperformed the S&P 500. The sector peaked, relative to the S&P 500 in January, close to the end of its seasonal period. More recently, the sector has been developing a broadening pattern, which is typically bearish. Nevertheless, the technology sector has a very short seasonal period in the second half of April (*Thackray's 2014 Investor's Guide*, page 55).

HAC did not hold a position in the technology sector at the end of March.

Canadian Dollar– Finally strong performance

In January 2014, the Canadian dollar took a beating. At the end of the month, it started to recover sharply. Until recently, it has been in a trading range from $0.89 to $0.91, and in April it has broken above this range. Overall, this is a bullish scenario for the Canadian dollar. Although April is a strong month for the Canadian dollar, the trend tends to reverse in May. Seasonal investors have been cautioned– do not overstay your welcome.

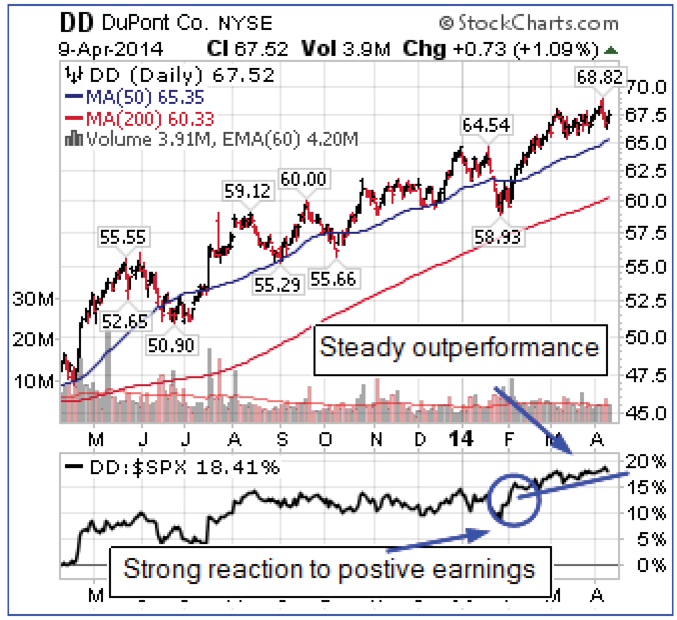
HAC held a net long position in the Canadian dollar at the end of March.

Stock Section

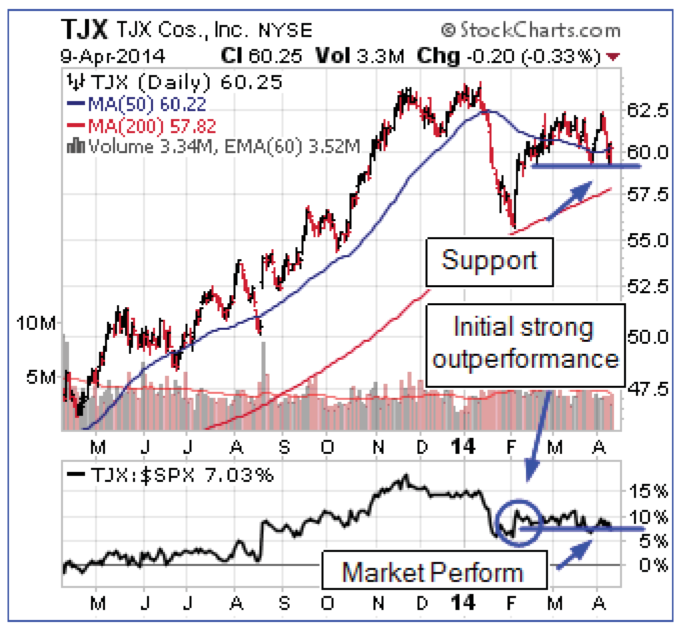
Dupont

Dupont is a favorite with many seasonal investors due to its strong success rate. This year the stock responded strongly to positive earnings and after an initial bump, the stock has been steadily outperforming the S&P 500. The trade ends soon, and investors should consider exiting the position. It is not that the stock just goes flat after the end of its seasonal period, on average it has a very poor track record. From May 6th to December 31st (from 1990 to 2012) Dupont has produced an average loss of 3.0% and has only been positive 39% of the time. In other words, it is best to avoid Dupont after May 5th

HAC did not hold a position in Dupont at the end of March.



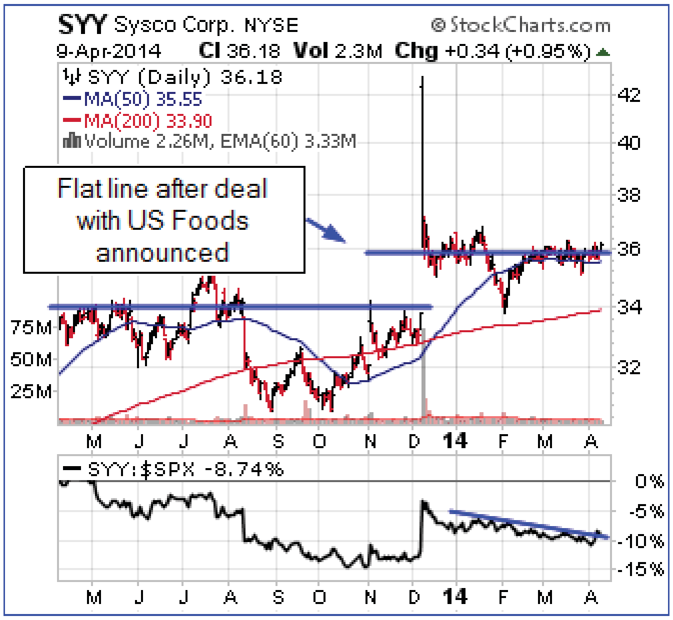
TJX



After correcting in January, TJX responded positively at the beginning of its seasonal period on January 23rd. After an initial "pop," TJX has been performing at market. It is currently on its support line, and given that the seasonal period ended on March 30th, seasonal investors should have already exited the position.

HAC did not hold a position in TJX at the end of March.

Sysco



The Sysco seasonal strategy is a new strategy in my book. Sysco tends to perform well from April 23rd to May 30th. In this time period, from 1990 to 2012, it has produced an average gain of 4.8% and has been positive 57% of the time. Being in the food distribution business, Sysco is a defensive stock and tends to perform well in the transition periods, in the time periods when the market is transitioning from the favorable to the unfavorable six month periods and vice versa.

In December 2013, the stock jumped in value as Sysco announced an earnings accretive merger with US Foods. The stock has since flat lined and been underperforming the S&P 500. This consolidation should setup well for its seasonal period that starts in late April.

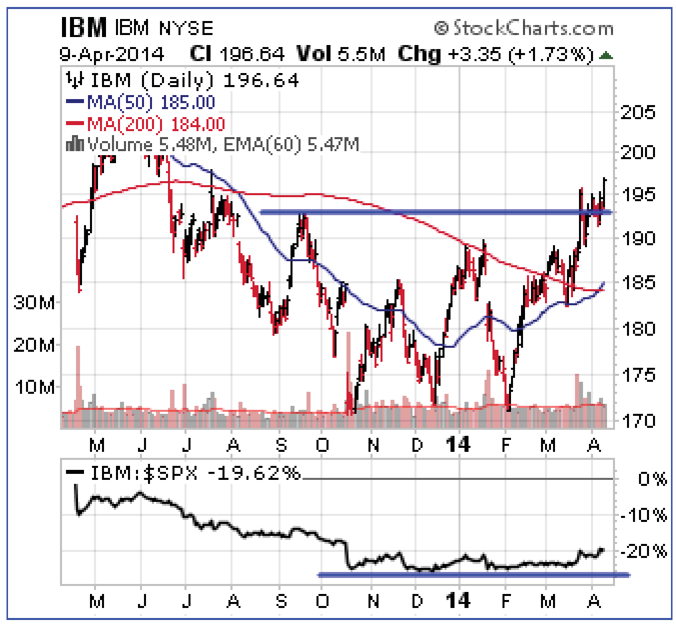
HAC did not hold a position in SYY at the end of March.

Waste Management

The seasonal period for Waste Management is from February 24th to May 14th (*Thackray's 2014 Investor's Guide*, page 21). This year the stock bottomed right at the start of its seasonal period and started to outperform the S&P 500 at the same time. The stock is currently just below the resistance level of $42.25. If it is able to rise above this level, it should have a good final run in its seasonal period.

HAC did not hold a position in WM at the end of March.

IBM

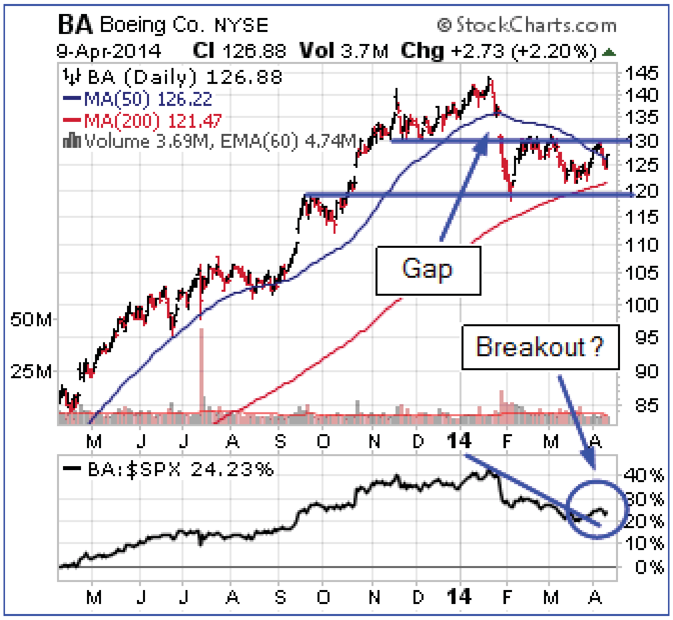


IBM tends to outperform the market around three of its earnings periods, including from April 14th to May 19th. (*Thackray's 2014 Investor's Guide*, page 47). Currently, IBM is pushing up against resistance. If it is able to break this level, IBM should perform well relative to the S&P 500, in its seasonal period.

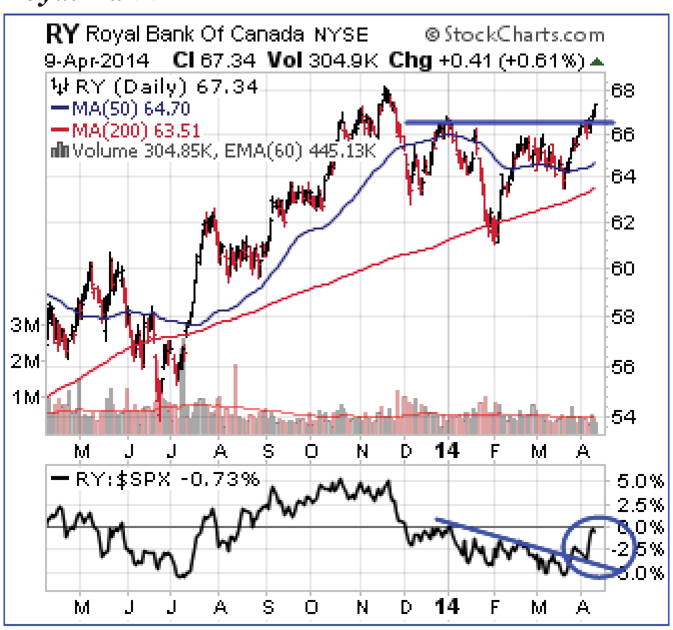
HAC did not hold a position in IBM at the end of March.

Boeing Airlines

The Boeing seasonal strategy is a new strategy in my book (*Thackray's 2014 Investor's Guide*, page 33). Although every year the cycle of orders for aircraft will be different, depending on what product is being released, Boeing tends to perform well from March 13th to June 15th, leading into the Paris Air Show. Boeing has been underperforming the S&P 500 since January, but has recently started to show early signs of a breakout. In a positive environment, look for Boeing to challenge the bottom level of the gap at $130.



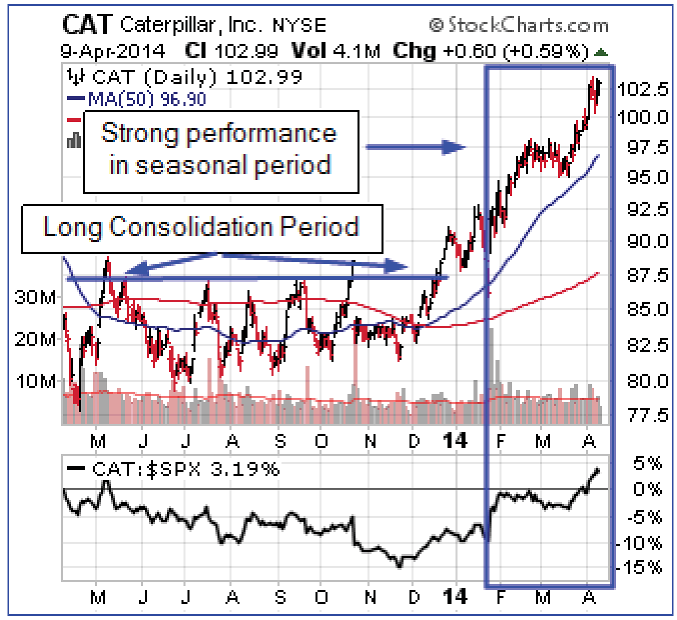
Royal Bank



Royal Bank has performed very well recently and is technically looking strong. The seasonal trade ends April 13th (*Thackray's 2014 Investor's Guide*, page 23). Sometimes the stock will run into mid-May. Investors should be looking to exit this position on weakness.

HAC did not hold a position in RY at the end of March.

Caterpillar



The Caterpillar trade is a new sector trade for the Thackray's Investor's Guide (see page 5 of the *Thackray's 2014 Investor's Guide*). Caterpillar tends to perform well from January 23rd to May 5th. In this time period, from 1990 to 2013, Caterpillar has produced an average gain of 14% and has been positive 83% of the time. The last two years, when cyclicals did not perform well in the springtime, the Caterpillar seasonal trade produced a loss. This year the trade is back on track. Look to exit the trade in late April or the beginning of May.

HAC did not hold a position in CAT at the end of March.

Last Minute Thoughts

The Federal Reserve seems to have convinced investors that tapering its bond purchases is not the same as a monetary contractionary policy. Analogies are often used to try and demonstrate this effect, such as comparing contractionary policies to applying the brakes in a car and reducing stimulus as taking your foot off the gas pedal. I don't buy this nonsense. If you have had excessive stimulus for an extended period of time, the market comes to expect this as status quo and any reduction in stimulus is treated as a negative effect on the market.

I remember when investors used to argue that when China's GDP growth decreased below 10%, it was not a big deal as 8% growth was still a large number on an absolute basis. It is the relative change on the margin that has the impact. China has suffered as its growth has slowed. Investors have started to realize how much leverage is in the Chinese markets as credit winds down with slower growth.

In the past, I have written about both the removal of Federal stimulus and the Chinese contraction. The reason I am discussing tapering again, is that it is inevitable that at some point tapering is going to have a negative effect on the stock market. Yes, there are assurances that the policy will change if the economy warrants it and investors have been comforted.

I am not so comforted, even by the dovish Yellen. Obviously the Federal Reserve and the government can measure changes in the economy, but it is difficult to determine how and when the market is going to react to a contractionary policy such as reducing stimulus. In January, major stock markets around the world got a scare when a few emerging market economies dropped significantly as the tapering of quantitative easing program started to hit home. The markets have recovered, but when is the next "leg of adjustment"? Right now investors are still in a euphoric state and are bullish on the market. This scenario can change in a blink of an eye, especially given the complacency in the market. As we enter the unfavorable six month period for stocks, the market is even more prone to a "leg of adjustment".

Over the last few years we have seen summer rallies, which have been based on more stimulus, rumors of more stimulus and an uncharacteristic large flow of money from the bond market to the stock market. Given that there is a very low chance of increasing stimulus and it is expected that we will not have the same rotation from bonds to stocks that we saw last year, it is not expected that the market will have a strong summer rally.

Of course there will be market rallies in the summer months, but outside of periods where the rallies tend be seasonally significant, seasonal investors are best to have a portfolio that has reduced risk and focuses on sectors that tend to outperform during the summer months.

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