Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

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Special Note:

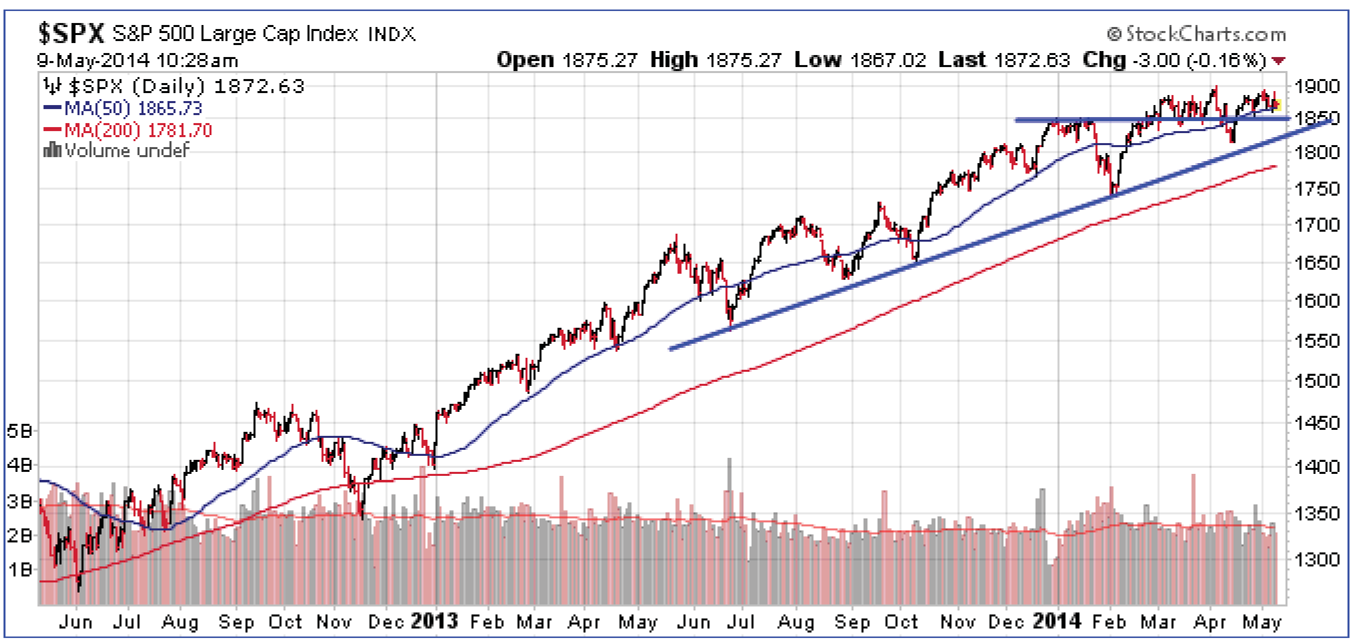
We have just entered the six month unfavorable season for stocks which started on May 6th. Given that there is a lack of positive momentum in the stock market and a lack of positive catalysts to drive the stock market higher.... seasonal investors should start to become more defensive by decreasing beta in their portfolios, investing in sectors of the market that perform well at this time of the year and raising cash levels.

Market Update

In the beginning of May last year, the media was overwhelmed with articles on "Sell In May." After sharp cor-

S&P 500 Technical Status

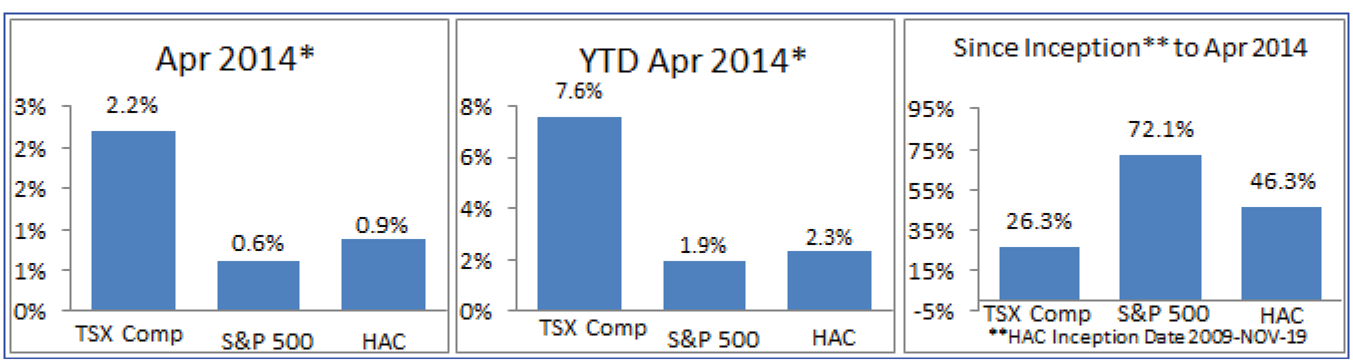
Technically, the S&P 500 has not broken down. The trend of higher lows has persisted for over a year. More recently the S&P 500 has been consolidating at the 1850 level or slightly above. From a price pattern standpoint, the S&P 500 is holding up.......but we have just moved into the six month unfavorable period. This is not to say that the S&P 500 cannot move higher, but a consolidation before the start of the six month unfavorable seasonal period often leads to a decline. The market is looking for direction, treading water, waiting for some sort of stimulus before moving up or down. Absent of any strong positive news, the S&P 500 is more likely to roll over and head lower. If the market is able to rally at this point, it is going to have difficulty getting past 1900. On the downside, if the S&P 500 breaches 1850, this will set a bearish tone and the market is likely to head lower.



Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **April 30th**, 2014

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXE	Horizons S&P/TSX Capped Energy Index ETF	15.7%
	United States Dollar Exposed Assets	
	Equities	
HXS	Horizons S&P 500® Index ETF	50.3%
XLB	Materials Select Sector SPDR Trust	9.8%
XLI	Industrial Select Sector SPDR Fund	9.8%
XLK	Technology Select Sector SPDR Fund	8.5%
XLP	Consumer Staples Select Sector SPDR Fund	5.1%
	US Dollar Forwards (April 2014) - Currency Hedge **	-0.3%
	Cash, Cash Equivalents, Margin & Other	1.1%
	Total (NAV $122,447,129)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 86.1% 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.

rections in the summers of 2011 and 2012, investors were concerned that another sharp correction was going to occur in the summer of 2013. A sharp correction occurred in June, but the markets rallied strongly into the July earnings season, with the S&P 500 producing a return of 5.2% in the first eighteen calendar days of July. This gain made up the lion's portion of the total gain during the unfavorable period for stocks from May 6th to October 27th. The reason that eighteen calendar days in July was chosen as measurement, is that this time period is a significant seasonal period to be long the S&P 500, in order to take advantage of the investors front running the July earnings season.

This year, although the media is still covering the "Sell in May" phenomenon, there is not the same heightened interest as there was in 2013. In all likelihood, investors are looking back to the summer rally that occurred last year, and do not want to step aside from the markets in case the same event occurs again. Seasonal investing is a long-term investment discipline. It is all about probabilities. Life would be too easy if investment strategies worked all of the time. From a risk-reward relationship, it is prudent to take into account the seasonal tendencies of the stock market when making investment decisions.

Is There Fuel in the Tank?

In the past I have written about the three E's (Earnings, Europe, Economy) being the main drivers of the stock market. The earnings season is largely behind us with 75% of the S&P 500 companies reporting as of May 2nd. The results were better than expected (the analysts set the bar low), with 68% of the companies beating expectations compared to the 10 year average of 63% (Thomson Reuters). On the revenue side, 51% of the companies beat expectations, compared to the 10 year average of 61%. Overall, the earnings have been positive, but given that we are in the late stages of the game for the earnings season, it is not expected that the last portion of the companies reporting will drive the markets in a substantial manner.

There has been very little news out of Europe, because there has not been any really bad news. In fact, most investors are of the viewpoint that generally Europe is on the mend. Bond yields have been falling, with Italy recently setting a record low yield for its 10 year bond of 3.11% on April 15th, and Spain's 10 year yield falling from 4.7% to 3.1% over the last year (Economist May 8th). The problem is that inflation is falling and there is a real fear of deflation. The ECB has been talking about increasing its money supply to solve the situation. Although this will help, it is possible that it will be too little too late. Once deflation gets a toe-hold, it is difficult to root out. There is also the prospect of diminishing returns. As we have experienced, each quantitative easing round produced less of an impact. It is a very real possibility that cranking up the printing presses will only have a transitory effect: temporarily boosting the economy and the markets. In the end, there may be some positive benefit from the ECB's actions, but do not expect too much.

Most investors would say that the economic picture has been improving in the U.S. Recently, the U.S. ISM Manufacturing Index rose more than expected, from 53.7 (March) to 54.9 in April (consensus 54.3).

The U.S. GDP (year-over-year) is currently at 2.3% and the unemployment rate at 6.3%. The latest U.S. jobs report, at the beginning of May, was stronger than expected, coming in at 288,000, which was well above expectations at 218,000. It was interesting to see that the stock market did not respond strongly to the upside on the employment report. Yes, there was some negative news buried in the report, with the labor participation rate dropping to 62.8% from 63.2%. If the labor force participation rate did not decline, the unemployment rate would have increased to 6.8%. Nevertheless, a strong job markets number typically propels the market upwards, which is not the reaction that occurred when the S&P 500 ended up slightly negative for the day.

When the stock market responds negatively, to a positive event, it is a bearish indicator.

The economic outlook going forward is positive, maybe too positive. There still seems to be some hope that the economic activity is going to get even better as the economy recovers from the bad weather of December 2013. There is no doubt that the extreme weather in December affected the spending patterns of consumers, but how long can investors expect to hang on to a past excuse. At this point, hope is fading and the expectation is that shortly we will not hear anything about the impact of the previous bad weather. Nevertheless, residual positive expectations of strong performance in the stock market remain. The risk is to the downside. With high positive expectations, the reaction to the downside will be steep if the numbers start to fall short of the high expectations.

Why This Year May Be Different

Over the last few years the stock market has experienced a correction in the spring/summer and then a rebound. Should we expect the same again? Yes and No.

Yes, there is a large chance that we will experience a correction. The S&P 500 has not had a correction of 10% or more, in two-and-a-half years, well beyond the average. In addition, the S&P 500 has been performing well, with a strong run of 30% in the S&P 500 in 2013. We are overdue for a correction. Just because there has not been a correction, does not necessarily mean that there will be one, but more and more investors will start to expect a 10% correction, once the markets start to weaken. Negative investor expectations can help to keep a stock market correction going.

What may be different this year is that we may not have a sustained rally after the correction.

If we look back to 2010 to 2012, the trend has been that stock market has a correction in the spring/summer and then a rally. These summer rallies were either the result of increase in quantitative easing or the rumors of quantitative easing. In 2013, the market experienced a severe correction in June and then rallied strongly in the first three weeks of July. One of the major reasons for the rally was the flow of money from bonds to stocks. With the talk of tapering getting underway, the bond market collapsed. Wanting to put their money to work, investors placed their money in equities and the inflow caused the markets to rally.

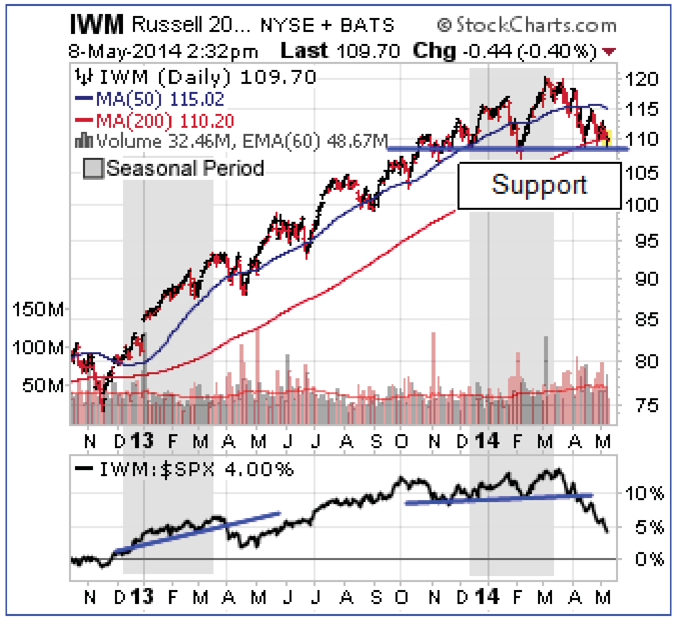
Although drivers of the market often come "out of the blue," this year we are not setup the same way as the last three years for a sustained stock market rally over the summer months. There is not going to be an increase in quantitative easing. The most investors can hope for is less tapering of bond purchases by the Federal Reserve, which is entirely possible. There is no doubt that this would help the markets, but the longer-term effects are in question.

There is probably not going to be a massive outflow from bonds to stocks this year. The bond market has already largely priced in the effects of continued tapering. The "easy to move money" in bonds, left last summer as the bond market collapsed. Overall, bonds have shown strength over the last few months as investors have started to become more cautious. Bonds still have the potential to run further.

Indications that the stock market could be in for a period of weakness

I use several indicators to check the health of the stock market. In my May videos (released earlier this week) I briefly discussed how the defensive sectors were outperforming the other sectors of the market and how this often foreshadowed a correction in the broad market when it occurred in the six month favorable season for stocks (to view videos, go to alphamountain.com).

Another market relationship indicator that I use is the performance of small caps relative to the S&P 500. The seasonally strong period for small caps is from December 19th to March 7th. When the small cap sector outperforms outside of this period, it indicates the market's appetite for risk. In 2013 we saw the small cap sector perform well in its seasonal period, pause and then outperform in the summer months. The outperformance in the summer indicated that there was an increased appetite for risk, pushing the market higher.



What about 2014? So far, after a successful seasonal trade that ended in the early part of March, the small cap sector has been performing very poorly. Yes, the sector is outside its seasonally strong period, so that its underperformance should not necessarily be a surprise. What is a noteworthy is the magnitude of the underperformance. With small caps substantially underperforming, it could be indicating a weaker market ahead.

Another indicator that I use and that is currently indicating a waning appetite for risk is the relative performance of high quality corporate bonds versus high yield corporate bonds, often called junk bonds. When high yield bonds are outperforming high quality bonds, it is an indication that investors have a higher appetites for risk. In this scenario, investors are willing to forego safety in order to achieve a higher return.

Although we have seen an increase in bond prices recently, high yield bonds (JNK) have started to show weaker relative performance compared to the high quality corporate bonds (LQD). This is indicating an overall erosion in the appetite for risk. What does this have to do with equity markets? The appetite for risk tends to mirror itself in both the equity and bond markets. Divergences in the market relationship tend not to persist too long and it is usually the bond market that is correct. There is a lot more money in the bond market than in the stock market, and the bond market is often esteemed to be the "smart money." The bond market is currently indicating a decrease in the appetite for risk; advice stock investors should heed.

What the HAC is Going On?

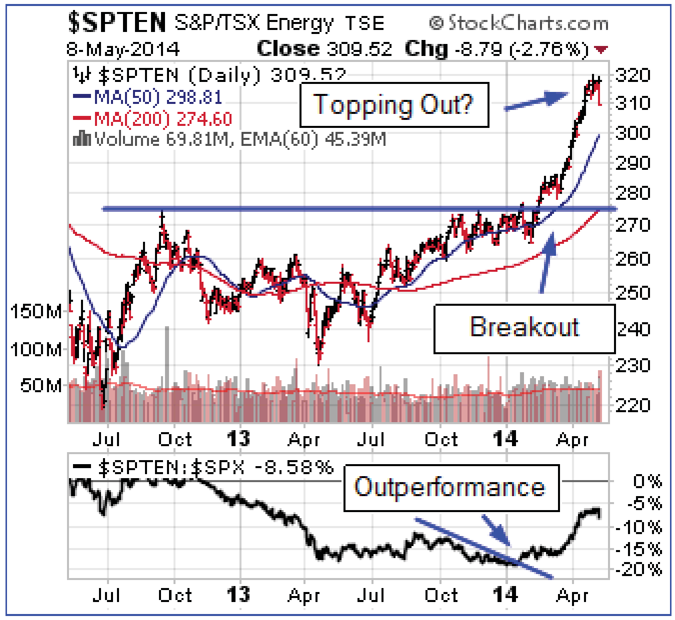
On average, April is one of the better performing months of the year. For the S&P 500, from 1950 to 2012, April was the second best month of the year, producing an average gain of 1.5% and was positive 68% of the time. In April of this year, both the S&P/TSX Composite and the S&P 500 showed some volatility but ended up with gains, with the S&P/TSX Composite outperforming the S&P 500. During the month, HAC maintained a simplified portfolio, focusing on broad market positions. HAC monitored the markets for weakness ahead of the start of the unfavorable six month period that starts in early May. The stock markets did not show any signs of a significant break to the downside and as a result, HAC remained fully invested for the month.

In March and April, the S&P 500 was in a consolidation pattern and showed little progress. The stock market has been looking for direction and given that we are entering the six month unfavorable period for stocks (May 6th to October 27th), the risk reward relationship favours a conservative equity position. HAC is expecting to transition the portfolio to a more conservative posture as the unfavourable six months season for stocks starts in early May. This includes raising cash, reducing beta and investing in targeted sectors of the market that perform well in the unfavourable season.

Sector Trends

Canadian Energy

The Canadian energy sector trade has performed very well during its seasonal period, which finishes in the beginning of May. Yes, it can continue higher, but with its recent parabolic move it is difficult to say how much higher. Just recently, the sector has been showing signs of fading its outperformance. Investors should be looking to exit the sector.



Industrials

The industrial sector often drives the U.S. market. It performed well in its first seasonal leg from October 28th to December 31st, producing a strong absolute return and outperforming the S&P 500. In its second seasonal leg from January 23rd to May 5th, the sector has been performing slightly better than market. The seasonally period for this sector has ended and investors should be looking to exit.

Materials

The materials sector performed well in its first seasonal leg and has performed very well in its second seasonal leg, from January 23rd to May 5th. Although this sector has performed well, it has reached the end of its seasonal period and investors should consider exiting the trade.

Investors Note: 74% of XLB is made up of chemical companies and given that the chemical sub sector has a very poor track record in June, seasonal investors should be looking to divest of XLB before June.

Financials

The financial sector typically finishes its seasonal period on April 13th. This year the sector started to abruptly underperform the S&P 500 in late March. The financial sector is often considered a market leader and if it is one of the top performing sectors it is a bullish signal for the market, vice versa. The financial sector peaked shortly before the S&P 500, which set an all time high on April 4th. The seasonal trade for U.S. financials ended in April and investors should have already reduced/exited their exposure.

For the record, HAC sold its position in XLF in early April.

Government Bonds

The seasonal period for government bonds is from the beginning of May to the beginning of October. Government bonds have been performing well since the beginning of the year. Recently IEF (U.S. Government Bonds) has had a technical breakout above its resistance level. This is a good sign for the beginning of the seasonal period.

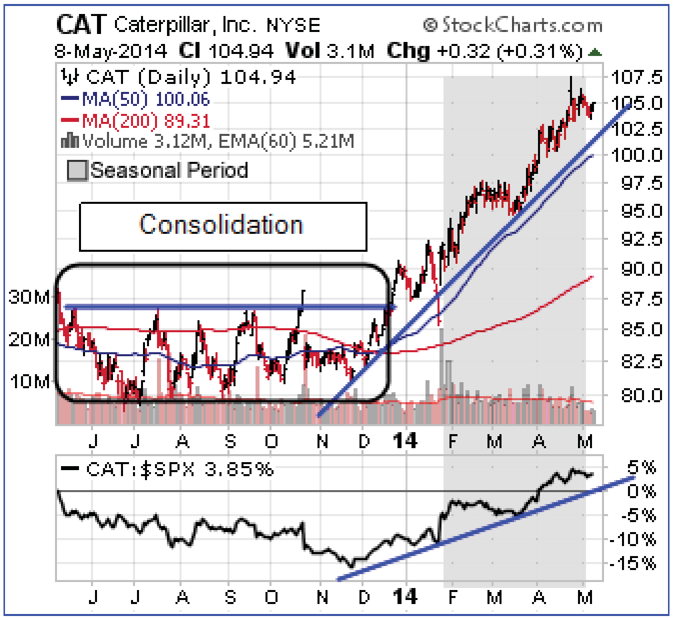
At the end of April, HAC did not hold a position in IEF.

Stock Section

Caterpillar

Caterpillar set up well for its seasonal trade, as it went through an extended period of consolidation in 2013. It then went on to break resistance in late 2013 and outperform the S&P 500. It has strongly outperformed the S&P 500 in its seasonal period, but given that its seasonal period has ended. Investors should be looking to exit this position.

At the end of April, HAC did not hold a position in Caterpillar.



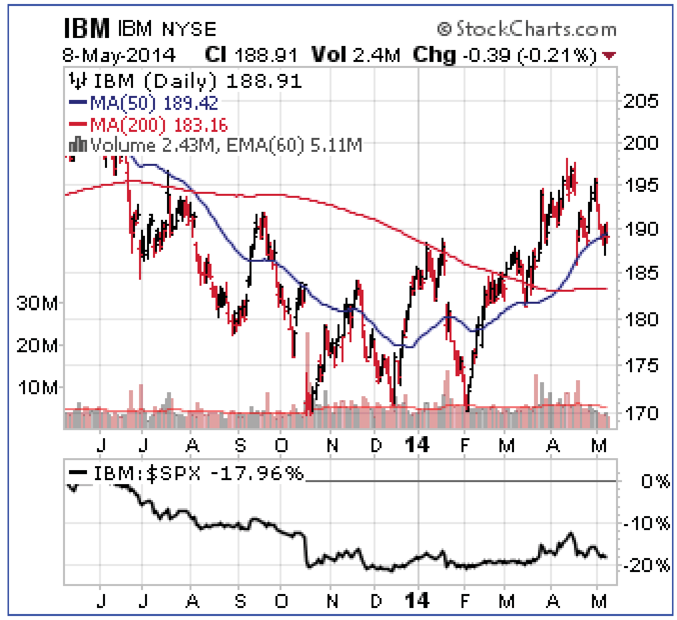
Boeing Airlines

From a seasonal standpoint, Boeing has been performing well. The stock has a seasonal period from March 13th to June 15th. It started its outperformance relative to the S&P 500 right on seasonal que and continues to outperform.

Recently, as the small caps have been fading in their performance, large caps such as Boeing, as a group have been outperforming. The seasonal exit date for Boeing is June 15. The same day as the start of the Paris Air Show (which starts mid-June every year). It is not a coicidence that the Boeing trade finishes when the Paris Air Show starts. This is very typical for seasonal trades, as the stock/sector tends to outperform coming in to the event that investors anticipate will provide positive news. Seasonal investors get into the stock/sector before other investors and leave when interest has peaked.

At the end of April, HAC did not hold a position in Boeing.

IBM



IBM has a seasonal period from April 14th to May 19th. Typically, the stock gets a lift from its earnings release in mid-April. This year, IBM released earnings that fell short of expectations and as a result, IBM has underperformed.

At the end of April, HAC did not hold a position in IBM.

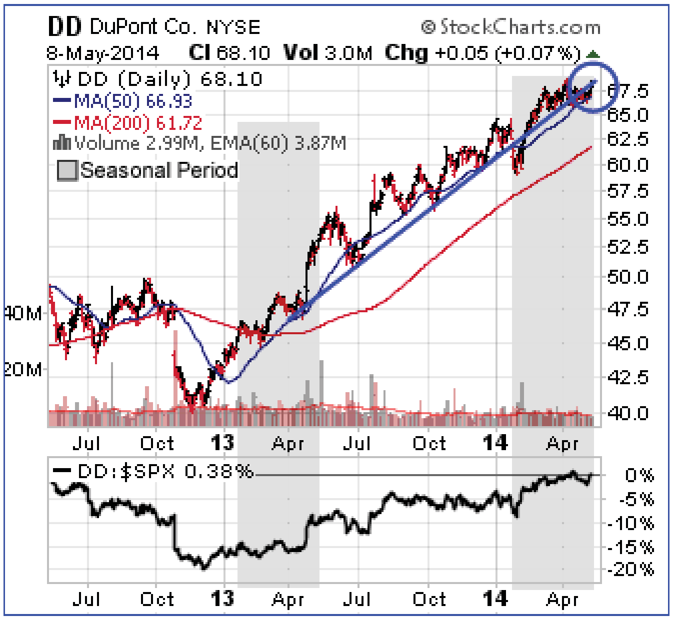
Sysco

Sysco has a seasonal period from April 23rd to May 30th. So far in its seasonal period it is outperforming the S&P

500. Investors should be looking to exit the trade on weakness as the seasonal period for Sysco ends shortly.

At the end of April, HAC did not hold a position in Sysco.

Dupont



For whatever reason, Dupont is a perennial favorite with investors. It could have something to do with its near perfect performance during its seasonal period (see *Thackray's 2014 Investor's Guide*, page 19). Last year, Dupont performed very well in its seasonal period. It also performed very well outside its seasonal period, and once again in its seasonal period. Dupont is undergoing a lot of restructuring under its new CEO and analysts like what they see. As a result, Dupont has had sustained strong performance. Nevertheless, seasonal investing has helped to choose the sweet spots along the way.

The seasonal period for Dupont has finished. Given the seasonal weakness in chemical stocks in June, if investors have not already exited the position, they should be looking to do so.

At the end of April, HAC did not hold a position is Dupont.

Waste Management

After an initial drop at the beginning of its seasonal period, Waste Management outperformed the S&P 500. Waste Management has recently outperformed based upon its strong earnings release on April 24th. The seasonal trade ends on May 14th and investors should be looking to exit the position.

At the end of April, HAC did not hold a position in Waste Management.

Costco

The Costco trade is setting up well this year. The seasonal trade lasts from May 26th to June 30th. Costco has corrected relative to the S&P 500, since late October. The good news is that it has recently broken the underperformance trend. When a stock underperforms and then consolidates, it typically sets up well for its upcoming seasonal period.

On an absolute basis, the Costco is just above support. If it were to break below $110, this would be bearish and investors should rethink the seasonal trade.

At the end of April, HAC did not hold a position in Costco.

Last Minute Thoughts

Yellen - What Color Are Her Wings?

Although Yellen is out of her honeymoon period, investors still do not know how she will react under pressure. So far, under her direction, there have not been any really big moves in the economy or the stock markets. She has kept the course that Bernanke has laid out. Everyone knows that Yellen is a "dove," but just how much of one remains to be seen. When she took office, she set the tone with dovish comments that pleased the market. Later, on March 19th, Yellen answered a question from a reporter that presented a less "dovish" stance than expected. When she was asked when interest rates were going to rise, she responded by stating, six months after the Federal Resereve asset purchases ended. More recently, she has backed down from that statement and has not backed a mechanical timetable.

Given her well prepared opening statements when she took the position of Federal Reserve Chair, it should be expected that she is at least as dovish as Bernanke. This translates into: if the economy does better than expected, Yellen will probably not speed up the process of ending tapering or adjusting interest rates. If the economy performs worse than expected, Yellen will probably ease up on the tapering process.

If the markets start to get volatile this summer, it will be the first opportunity to see Yellen in action. The question remains, how dovish is Yellen? Once she has to leave her comfortable perch, we will find out the color of her wings. Her wings could be a lot whiter than we all expect.

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