Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

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Market Update

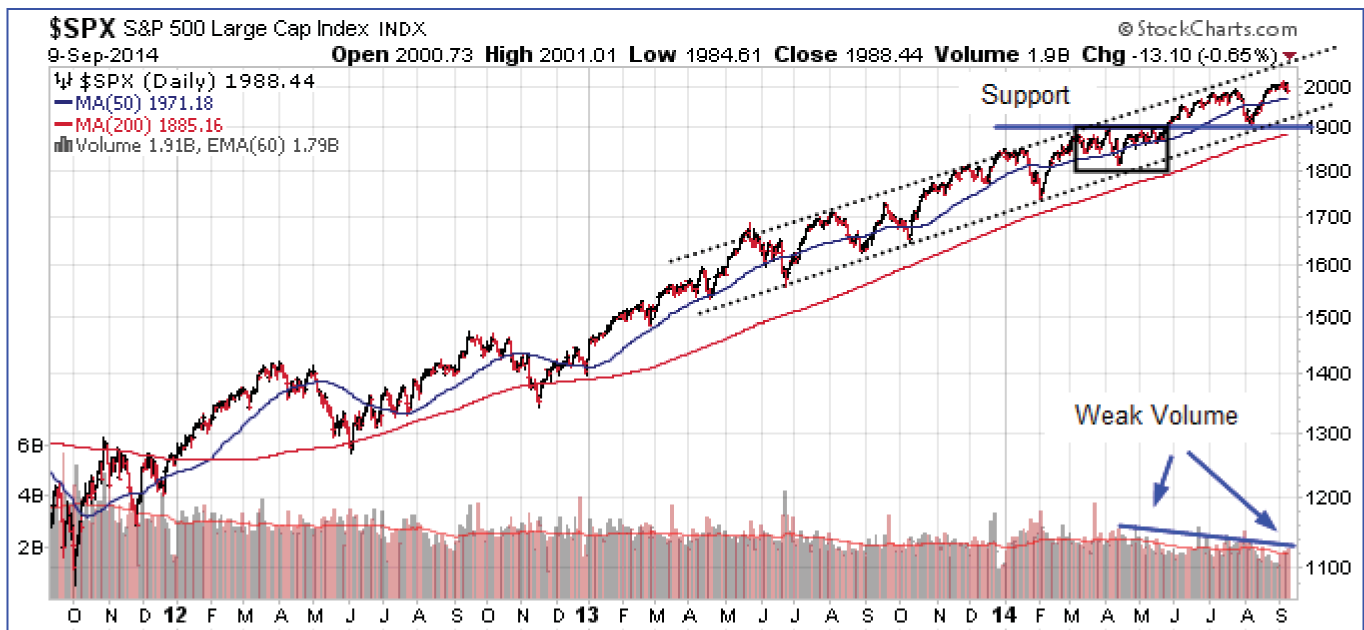
After a July correction, the stock market continued its upwards march in August. Stronger than expected earnings helped. As of the end of August, 68% of the reporting companies beat expectations, which is above the ten year average of 63% (Thomson Reuters). In addition, gradually improving U.S. economic data had a positive impact.

On a relative basis, Europe showed more signs of slowing down and with a weak inflation number coming in at 0.3%, the U.S. stock market and the U.S. dollar looked all the more attractive. One of the biggest reasons why the stock market moved higher was positive investor sentiment. Overall, investors are have become complacent and have strong positive expectations of future stock market returns.

S&P 500 Technical Status

The S&P 500 is still technically sound, with higher highs and higher lows, but there is cause for concern. The S&P 500 battled the 1900 level from March to June and once it broke above 1900, it created a new level of support. The concern is that while the S&P 500 has moved to new highs, volume has become anemic and is not supportive of the market's rise. Investors are not committed to the recent rally. The only time that the volume has picked up is in July when the S&P 500 was heading downwards. If the market does weaken, investors should be focusing on the 1900 level. If the S&P 500 were to break this level it would confirm a new downward trend.

We are currently entering one of the weakest times of the year; the last part of September after options expiry. Given that investors have not shown a commitment to this market there is an increasing likelihood that the market could at least be in for some turbulence.



An ETF for all seasons

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

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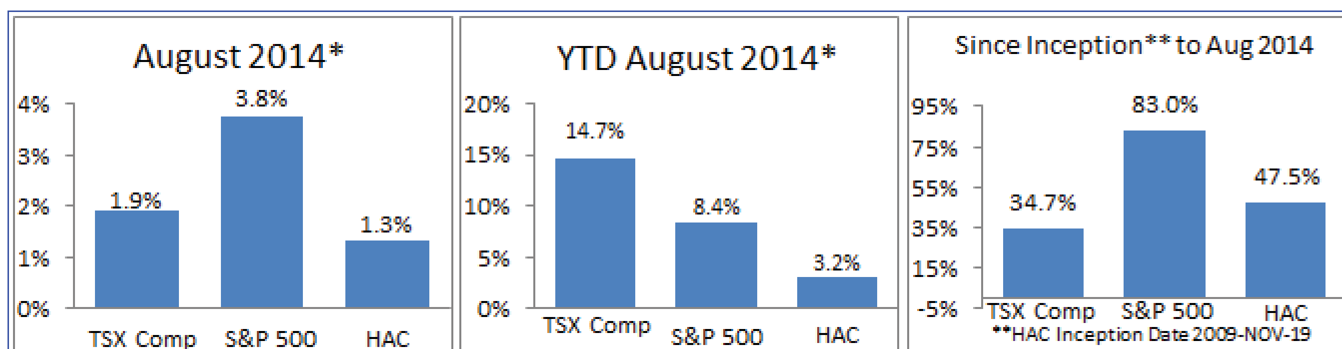
Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **August 31st**, 2014

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Fixed Income	
HFR	Horizons Active Floating Rate Bond ETF	22.1%
HBB	Horizons Cdn Select Universe Bond ETF	20.4%
	United States Dollar Exposed Assets	
	Fixed Income	
IEF	iShares 7-10 Year Treasury Bond ETF	7.9%
	Equities	
GDX	Market Vectors Gold Miners ETF	10.3%
XLP	Consumer Staples Select Sector SPDR Fund	5.3%
XLV	Health Care Select Sector SPDR Fund	5.2%
XLU	Utilities Select Sector SPDR Fund	5.2%
IYR	iShares U.S. Real Estate ETF	8.0%
	Commodity	
GLD	SPDR Gold Shares	10.0%
HUN	Horizons NYMEX® Natural Gas ETF	5.1%
	US Dollar Forwards (September 2014) - Currency Hedge **	0.4%
	Cash, Cash Equivalents, Margin & Other	0.2%
	Total (NAV $115,332,190)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 61.6% 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.

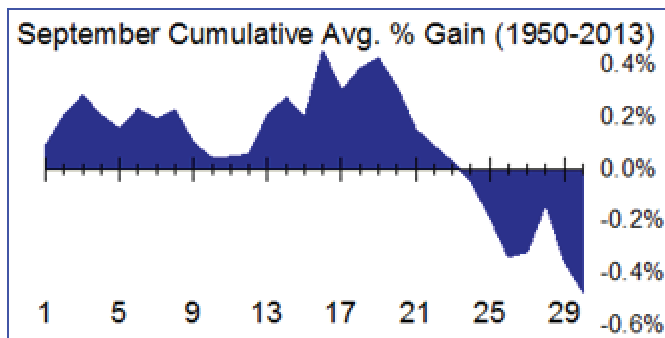
It is not just investors that are becoming more optimistic about the future, but some of the bearish analysts are throwing in the towel and joining the bull side. First it was David Bianco at Deutsche Bank and Barry Bannister at Stifel Nicolaus joining the bull camp and now Gina Martin Adams at Wells Fargo has changed her year-end target for the S&P 500 from 1,850 to 2,100 within one year. When the analysts start to jump ship, it makes you wonder if a market correction is in store. When everyone becomes a bull and only expects sunshine ahead, the market becomes susceptible to a sudden correction.

Recently, the S&P 500 has been dancing around the 2,000 level. Although there is nothing magical abut this number, the major markets seem more often than naught, to bounce around major milestone numbers for a while, and even when they make it above the milestone, it is often re-tested.

Technical and Seasonal

As I have said before, technically the S&P 500 is in good shape, it has not violated its trend of higher highs and higher lows. It came close to crossing the major threshold of 1,900 in July, but managed to turn around to put in a solid rally.

Nevertheless, there is cause for investors to be extra cautious at this time: the worst one and half week period on average for the stock market is approaching. Everyone, including me, talks about how September is the worst month of the year. Over the long-term this has been the case, but what most investors do not realize is that the poor performance in September largely takes place towards the end of September, more specifically the time period from the day after options expiry (options typically expire on the third Friday of the month) until the end of the month. Using the S&P 500 from 1950 to 2013, the post options expiry period has produced an average loss of 0.9% and has only been positive 38% of the time. The average poor performance has been consistent across decades since 1950.



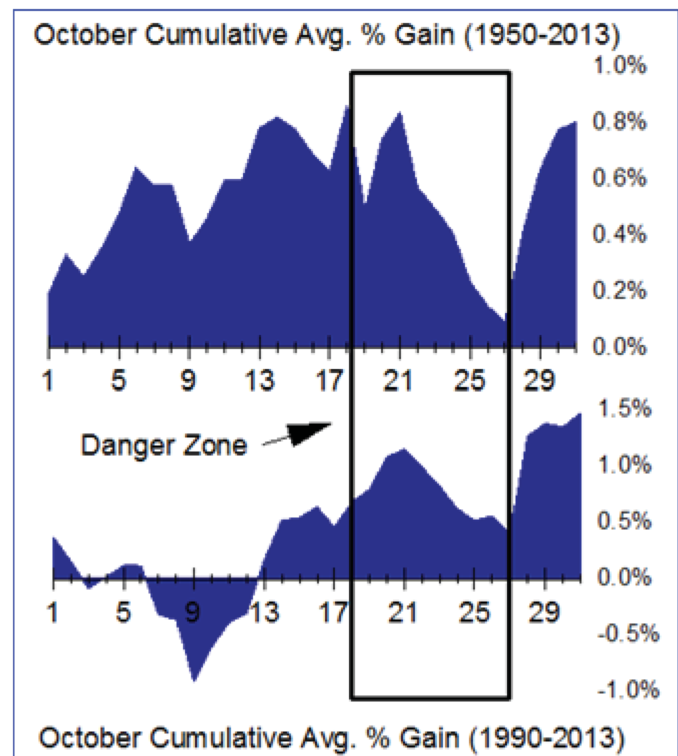
Interestingly, on average the first part of September has been positive. In the same yearly period as above, from the first day of September to options expiry day, the S&P 500 has had an average gain of 0.3% and has been positive 58% of the time.

If there is one time of the year that you do not want to take an excessive long position on the market, it is the last part of September.

What to expect in October

October has the undeserved reputation of being a bad month for the stock market. This reputation is not totally deserved as over the long-term, October has produced an average positive return (since 1950 it has produced an average gain of 0.8% and has been positive 59% of the time). What is correct, is that October has rightfully earned its "bad-month" reputation for its volatility. On average it is the most volatile month of the year and large drops have often occurred in the month, including the 1929 and 1987 crashes.

Every academic study that I have read on the favorable six month period for the stock market, looks at the results of investing from November to April, and leaves out October. Although it could be argued that on a complete month basis this strategy makes sense, doing so has left significant returns on the table. On average, the best date to start the favorable six month period has been October 28th. From 1950 to 2013, investing in the S&P 500 for the last four days of October has produced an average gain of 1.0% with a positive frequency of 58%.



Some analysts have included a technical overlay to assist in timing the market entry for the start of the six month favorable period, mainly using a MACD indicator. The problem with using a timing indicator to delay the entry into the market is that large returns can be missed. As previously mentioned, October is a volatile month and often the market can rise very rapidly at the end of the month. For those investors waiting for an indicator trigger, large returns can be missed. The best strategy for a seasonal investor is to be largely in the market for October 28th, regardless of technical confirmation.

It is interesting to note that on average most of the gains in October have been made in the last few days of the month. In both time periods starting in 1950 and 1990 to 2013, the first part of October on average has also been positive, but with different patterns of cumulative gains. In more recent years, the first part of October has been negative, but short-term bottoms have been formed around the 10th of the month. The trouble spot for October over the time periods of 1950-2013 and 1990-2013, has been middle part of the month, from the 19th to the 27th. Both time periods starting from 1950 and 1990, have produced positive returns only 44% and 46% of the time respectively. Although there may be an opportunity to start entering the market in early October, seasonal investors should be cognizant of the middle part of October, or the "Danger Zone" where most of the time losses have been made.

What the HAC is Going On?

Although HAC produced a positive return in August, it lagged the S&P 500 and the TSX Composite. The main reason for not keeping up to the indexes was HAC's overall defensive position in the markets, including holding some cash. In the six month unfavorable season for stocks, HAC is typically more defensive than the market, and as such, it would be expected that its performance would lag the market if a strong performance month would occur within the six month unfavorable season for stocks. The S&P 500 recorded a very strong gain of 3.8% in August. This is the strongest return in August in the last fourteen years.

In addition, many of the sectors that HAC held in August, produced positive returns, but lagged the overall market because of the overall increase in risk appetite of investors pushing up the sectors of the market that are not typically leaders in the summer months.

To add to the confluence of negative effects, HAC has had a sizeable position in gold bullion and gold stock ETFs. It is the favorable season for the gold sector and HAC has successfully invested in the gold sector at this time over the last few years. This year, the gold sector has not lived up to its seasonal expectations and has recently had a negative impact on HAC.

Sector Trends

Gold losing its lustre - Blame the U.S. dollar and consider leaving the seasonal trade early

Gold was initially set up well before the start of its seasonal trade. In June gold and gold stocks bounced, but the rally lost its momentum in July. Gold has not performed well in its seasonal period and the main culprit has been the U.S. dollar. Actually, it has been the circumstances around the globe that have lead to the strengthening of the U.S. dollar and as a result, the deteriorating price of gold.

The U.S. dollar typically, does not start a seasonal strengthening period until later in November or even sometimes as early as September 26th. This year it has been different, Europe is slowing down and adding its own version of quantitative easing, the Ukraine-Russia conflict is dragging out, the Middle East is a mess with Islamic terrorists, and most recently, polls are indicating a real possibility of Scotland voting to be an independent state. All of these events are helping to push the USD upwards. The above graph shows the strong performance of the U.S. dollar relative to a basket of world currencies. Despite its decline, gold has actually held up quite well given the circumstances.

There is a concern that gold started its seasonal period early and is finishing its seasonal period early. Recently, gold broke below $1275, the level of support that a lot of analysts had been watching for quite some time. With gold trading below this level, it will now act as resistance.

The real critical level for gold bullion is the low set back at the beginning of June. If it breaks below this level, it will be indicating weakness ahead.

The seasonal period for gold bullion ends on October 9th, but investors should seriously consider exiting earlier. In strong bull markets, gold strength can continue into the beginning of October (we are currently not in a gold bull market). Investors should consider exiting gold bullion positions in September upon further weakness.

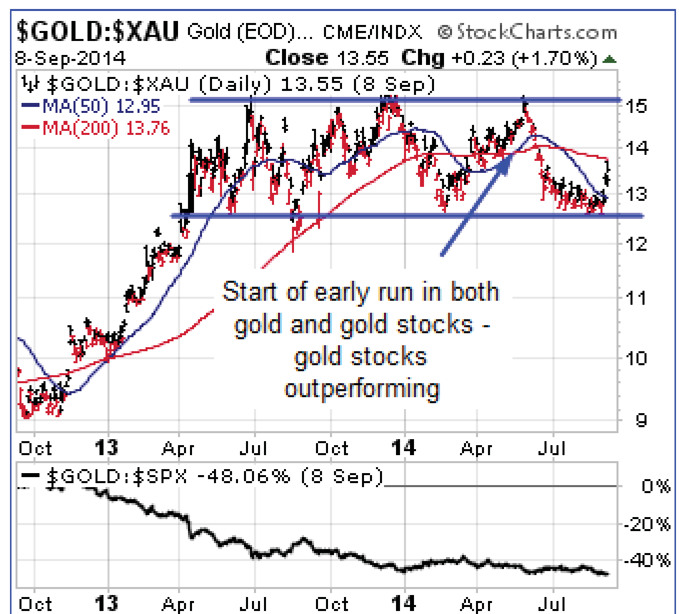
At the end of August, HAC held a position in SPDR® Gold Shares (GLD)

Gold stocks - time is running out

The seasonal period for gold stocks starts later than gold bullion and ends earlier. When investors are entering the gold sector, they typically wait to see gold strengthening before taking on gold equity positions. When investors are exiting the gold sector, they typically exit their riskier positions first, mainly their gold equities. As a result, gold stocks finish their seasonal period on September 25th.

Gold stocks, like gold bullion, started their seasonal run early in June. Technically, at the start of the seasonal period, gold stocks were set up to perform well. As the U.S. dollar has strengthened, the performance of gold stocks have deteriorated. Currently, the Market Vectors Gold Miners ETF (GDX) is oversold, and is at the mid-point in its trading range.

Relative to gold bullion, gold stocks have recently been underperforming. Using the gold to PHLX Gold and Silver Index ratio, in June at the start of the gold run, gold stocks were undervalued compared to gold bullion. As a result, gold stocks outperformed gold bullion in June. At the start of the seasonal period for gold stocks, the ratio was favouring gold bullion. Recently, gold bullion has been outperforming gold stocks and this pattern looks set to continue.



Currently, gold stocks have turned down and are underperforming the S&P 500. Investors should consider exiting this position on further weakness.

At the end of August, HAC held a position in GDX.

Warning! - Holding Gold and Gold Stocks in October can be detrimental to the health of you portfolio

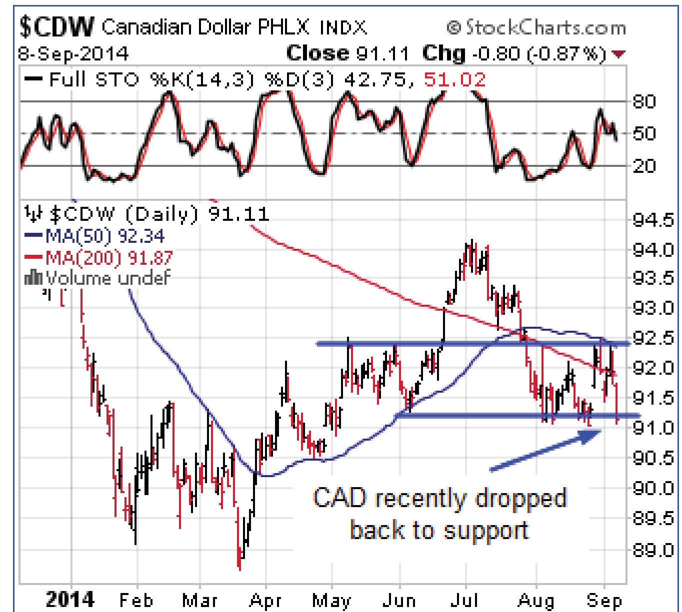
It is always tempting to hold a weak position and wait for it to recover. Depending on the circumstance, sometimes this can make sense. Most times, it does not. From a seasonal perspective, it is not a good idea to hold gold stocks in October (in strong bull markets, gold bullion can perform positively for the first part of October). Overall, the month of October has not been kind to gold bullion and gold stocks, particularly gold stocks. In October, from 1990 to 2013, gold bullion (London PM) and the PHLX Gold and Silver Index, have produced average losses of 1.0% and 3.9% and have only been positive 42% and 46% of the time respectively. October is not a kind month to gold.

Canadian Dollar - Helped by the Whopper, Hurt by Scotland

The USD has performed extremely well in recent months against a basket of world wide currencies, of which the Euro has the greatest weight. On a relative basis, compared to other currencies, the Canadian dollar has held up well. The Canadian dollar received a boost when Burger King bought out Tim Hortons with plans to move the Burger King head office to Canada. U.S. companies have been executing tax inversion deals for a while in order to avoid the high corporate U.S. tax (disclaimer: Burger King has stated that the deal was not to reduce taxes, but the general perception by the public has been otherwise). The deal helped bring Canada to the worldwide stage as a favorable country to locate a business and helped support the Canadian currency. The "halo effect" only lasted so long, as a weak jobs number for Canada brought negative attention to Canada's growth prospects. Interestingly, the July number was stated incorrectly and some economists are wondering if the August number was also incorrect.

To make matters worse for the Canadian dollar, the Scottish Independence Vote has recently swayed to favor independence. Although Scotland is a long way from Canada, Quebec and secessionist movements around the world are watching intently to see the results. Many fear that if Scotland does vote to separate and they are successful in the implementation, secessionist groups, including the Quebec independence movement, will have a renewed interest in the independence process. This would obviously be a negative for the Canadian dollar.

Currently, the Canadian dollar is at the bottom of its trading range relative to the U.S. dollar. If it breaks through this trading range in the short-term, it makes sense to exit the position. The Canadian dollar has a strong seasonal trend relative to the U.S. dollar starting August 20th to September 27th. From the end of September to the beginning of November, the seasonal trend is neutral, and then the U.S. dollar tends to have stronger performance. Given the backdrop of a weaker Canadian dollar, investors that are long Canadian dollars should consider exiting the position upon any further weakness.



At the end of August, HAC held a position in Canadian dollars

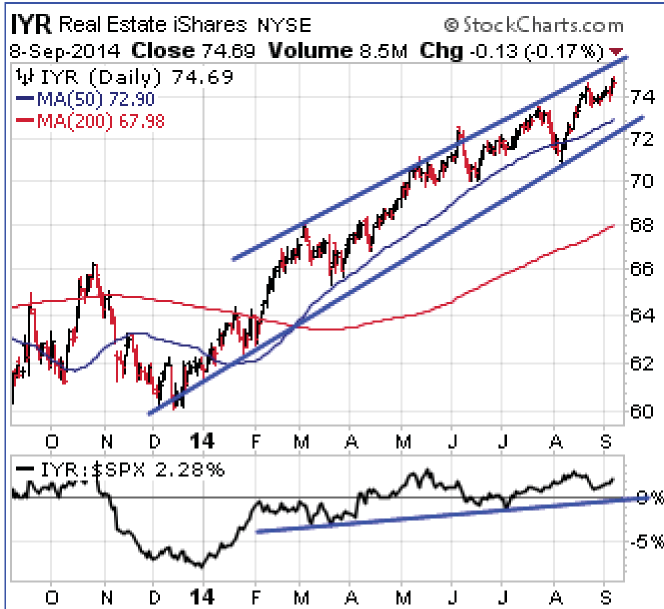
Consumer Staples - A core part of a portfolio in October

Consumer staple stocks tend to have strong relative performance compared to the S&P 500 in late September and in October. In fact, since 1990, it has been one of the top performing sectors in the market during the month of October. The consumer staples sector tends to perform well at this time of the year as it is one of the more volatile periods and investors are attracted to the consumer staples sector due to the stability of earnings.

From a technical basis, the sector is still in its upward channel and has started to outperform the S&P 500.

At the end of August, HAC held a position in XLP.

REITS iShares U.S. Real Estate ETF (IYR)- Hard exit coming up



The REIT sector has been performing positively in its seasonal period (which lasts from mid-May to September 19th) and outperforming the S&P 500. Given that September 19th is just around the corner, this position should be exited upon any weakness. Investors should also note that IYR has a very poor track record from September 20th into November and seasonal investors would be better off having a hard exit out of the position if it is still held on September 19th.

At the end of August, HAC held a position in IYR.

Health Care - Relatively Healthy

The health care sector has been performing well as investors have been attracted to this sector because of its defensive nature. The seasonal period does not end until mid-October

At the end of August, HAC held a position in XLV.

Government Bonds - Becoming "Unbonded" - time to exit soon

Government bonds have performed positively in their seasonal period from the beginning of May and which lasts up until October 3rd. As economic growth has not be as robust as expected and investors have picked up on Janet Yellen's dovish tendencies, bonds have responded positively.

There is event risk for this sector with the FMOC meeting next week if the results are more hawkish than expected. In addition, the Fed is expected to finish its bond purchasing program in October. Although this is anticipated, an increase in media attention surrounding this event may increase investor aversion to this sector. Investors should be looking to exit the sector on or before October 3rd, when the seasonal period for government bonds ends. It is not that government bonds cannot perform well until the

end of the year, it is just that the seasonal sweet spot for government bonds ends.

At the end of August, HAC held a position in IEF and Horizons CDN Select Universe Bond ETF (HBB).

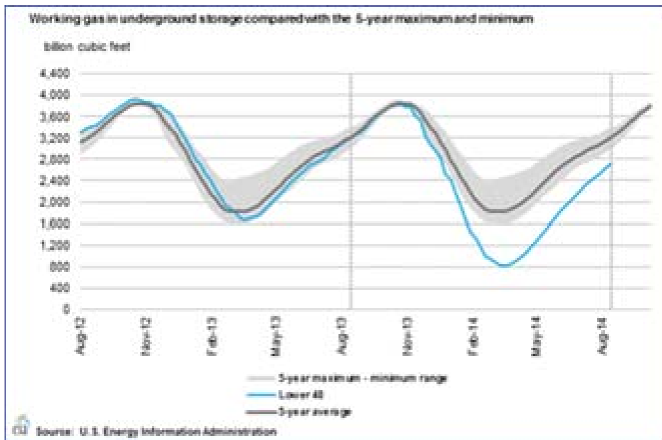
Utilities- Almost time to unplug

Recently the utilities sector has been performing well relative to the S&P 500, but the sector has started to show some downside risk. When the S&P 500 has been negative, the utilities sector has underperformed, particularly when the bond market has been negative. The seasonal period for this sector ends on October 3rd, but investors should be looking to exit early upon weakness.

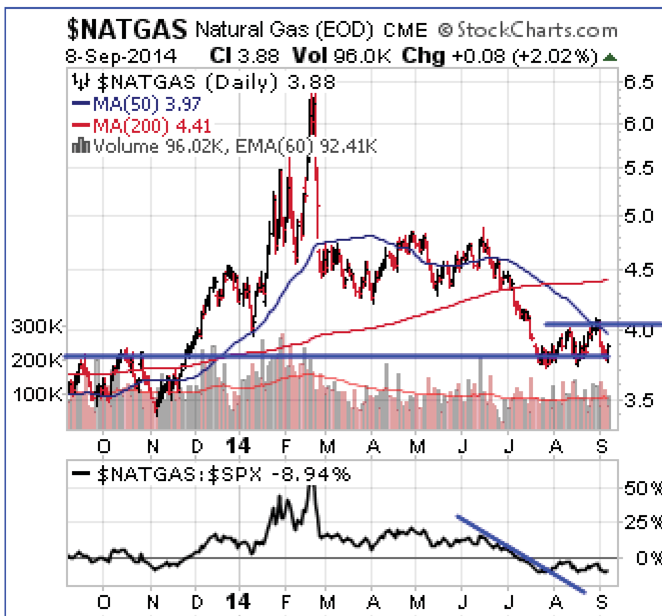
At the end of August HAC held a position in XLU.

Natural Gas- Starting Up

Natural gas tends to perform well two times during the year, from mid-March to mid-June and from September 5th to December 21st. The autumn time period is driven by the anticipation of switching between the injection season when there is an excess of natural gas that has to be stored and the heating season. Recently, we have had a string of record breaking injection numbers, but this is after a very cold winter that drove natural gas inventories to well below average (see EIA graph). In other words, we are playing catch up and it is difficult to say exactly how the inventory level is going to play out in the future as we transition into the heating season. Nevertheless, having below average levels of natural gas in inventory sets up well for the seasonal trade.



After a drop out of its trading range in mid-June, natural gas started to form another trading range in July between $3.75 and $4.00. If natural gas is able to break above $4.00, look for it to work its way to $4.75.



At the end of August, HAC held a position in Horizons NYMEX® Natural Gas ETF (HUN).

Last Minute Thoughts

"We are all connected." Today, more so than ever before, the economies of the world are all connected. It is difficult for a country or the Eurozone to make predictions because a component of the forecasted production/exports is based upon the economic health of other trading blocks and countries. If the U.S. slows down, China inevitably suffers and if China suffers, Canada is affected etc. Meeting forecasts is like hitting a moving target. That being said, countries are not excused for inactivity in meeting their targets. France just announced that it will miss its deficit target until 2017. So far they have not had the political will power to make the necessary cuts. This type of miss on predictions is politically driven. The concern that I have is for predictions that are dependent on the action of others. Specifically, if the U.S. takes action to tighten monetary policy based upon U.S. economic growth and then the rest of the world slows down, the accuracy of the projections is greatly affected. If China stalls and Europe's QE plan fails to gain traction, there is no question that the U.S. will be affected. It is just a matter of how much.

There is a general viewpoint that the economy of America is improving and that it will continue to improve. Some Federal Reserve governors are calling for the Federal Reserve to get ahead of the curve and raise rates before it is too late. A lot of investment pundits are supportive of this position, but acting too fast might do more damage than good at this point. First, if we are seeing a slow down in China and Europe this will put a drag on America's growth and coupled with rising rates, might hinder the economy more than intended. Second, if the U.S. starts to increase its interest rates, the already strong U.S. dollar will get even stronger and put a serious drag on U.S. growth. Which ever way you look at it, the final steps of removing QE and transitioning into an environment of potentially raising interest rates is going to be difficult.

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