Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

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Market Update

Buying Opportunity – OXI (No) !

The Greek shenanigans and the Chinese correction have had an ephemeral negative impact on the investor psyche. The Greek situation is going to go on for a long time yet. This is not the closing act. Any way that it turns out, the market will digest the news and move on. Ultimately, the concern is if more countries leave the Eurozone, particularly if a large country leaves. This is not going to happen in the short-term.

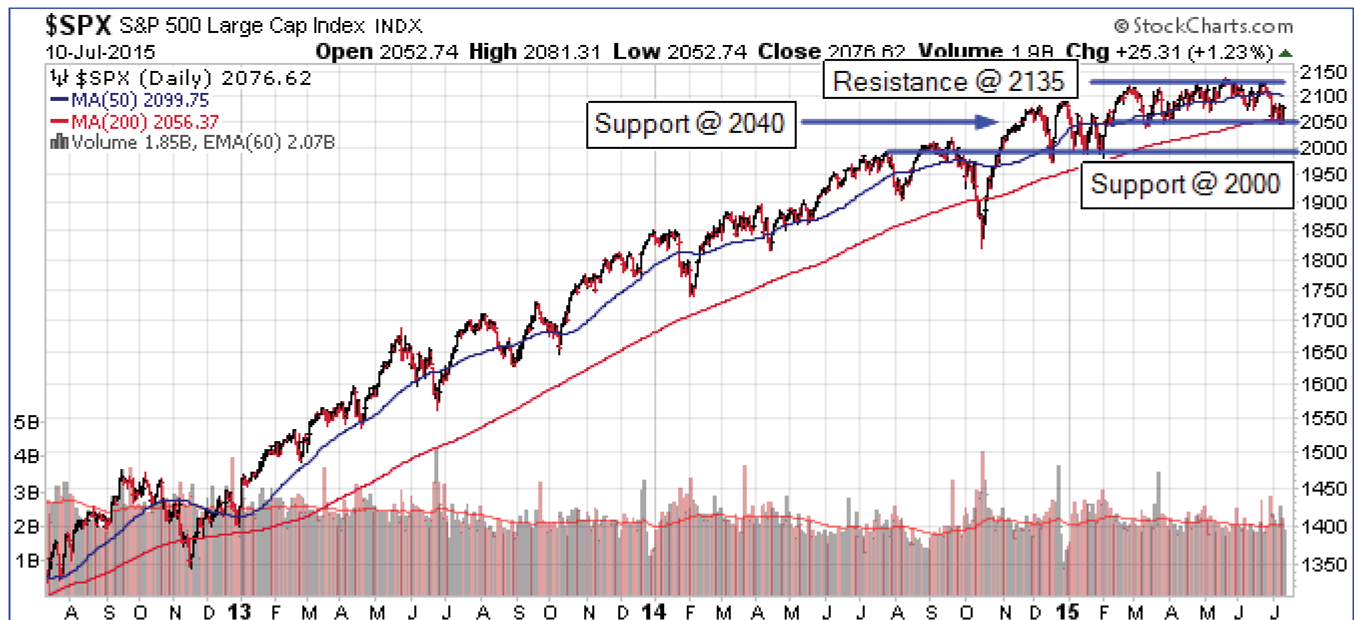
The Chinese have artificially propped up the stock market in the short-term, but at some point things will unravel.

S&P 500 Technical Status

The S&P 500 has pulled back from its highs and is below its high of 2135. The Greek crisis and plunging Chinese stock market have caused the S&P 500 to correct, but the closing prices have held at the 2040 support level.

It is going to be very difficult for the S&P 500 to break above 2135. If investors believe that the Greek crisis is "resolved" and the Chinese stock market stabilizes, it is possible that the S&P 500 can make it back to 2135. Strong Q2 earnings will also help.

The more likely scenario is for the S&P 500 to have limited upside and test its support levels. There is a significant chance that the 2000 level will be tested. If the S&P 500 is able to break below this level, then the market will be in a corrective phase and more likely to probe lower levels.



An ETF for all seasons

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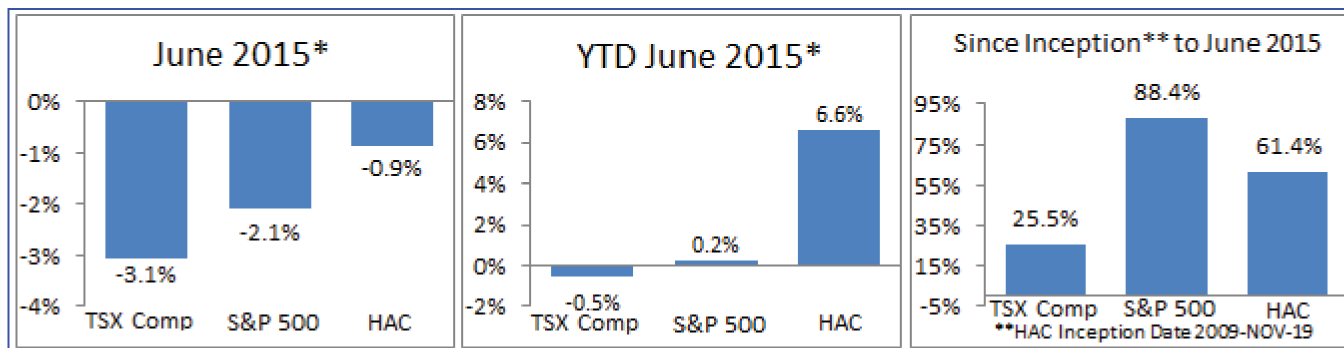
Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **June 30th**, 2015

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Fixed Income	
HFR	Horizons Floating Rate Bond ETF	18.8%
HBB	Horizons Cdn Select Universe Bond ETF	12.9%
HTB	Horizons US 7-10 Year Treasury Bond ETF	6.8%
	United States Dollar Exposed Assets	
	Equities	
IBB	iShares Nasdaq Biotechnology ETF	9.7%
XLP	Consumer Staples Select Sector SPDR Fund	9.6%
	US Dollar Forwards (June 2015) - Currency Hedge **	-0.6%
	Cash, Cash Equivalents, Margin & Other	42.7%
	Total (NAV $124,529,354)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 39.9% 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.

Right now it can be argued that the Chinese stock market is not really a market, given the level of government support and regulations. Their actions include halting a large percentage of the Chinese stocks from trading, institutional investors not being allowed to sell, a short-selling ban, IPO's not being allowed to come to the market and the Chinese government buying a huge amount of stocks to try and support prices.

This is not the first bubble in the Chinese stock market. Most recently, the Shanghai went on a tear in 2005 and then collapsed in 2007. It is interesting to note that the stock market corrected back to support at the 2000 level established in 2001 (the first support level). Although the current correction in the Chinese stock market has been swift and deep, the stock market has barely corrected compared to the start of the bubble in 2014. Without government intervention, the Shanghai would probably correct to at least the last support level of 3000, where it was only a few months ago, at the beginning of this year. And possibly to correct to the previous support level of 2000 that was last seen in the year 2014.

The Chinese stock market has been rising rapidly at the same time that the Chinese economy has been sputtering. This divergence could not last forever as it is the economy that allows for profit growth and hence higher stock prices. One of the main reasons the stock market has been rising is the incredible number of newbie investors opening up trading accounts, fearful that they were going to miss out on the large returns everyone seemed to be making. Typically, in a significant correction, these types of accounts get flushed out in some sort of capitulation. So far the government has been able to stop this from happening, but it is difficult for the government to support the market over the long-term.

In the current six year bull market, buying the dips has paid off – it usually does. As a result, investors have been conditioned over the years to buy the dips. A lot of S&P 500 investors are looking at the current pullback as a buying opportunity.

If the S&P 500 does rally at this point, it will probably not last long and investors should be cautious and not over commit. From a technical standpoint, the S&P 500 has a major resistance level at 2135. It is going to be difficult for the S&P 500 to break above this level. According to Thomson Reuters (July 2), S&P 500 companies are expected to report a decrease in earnings of 3% in Q2. It is possible that the current earnings season produces results that are substantially above expectations and the S&P 500 is able break above its resistance level, but unlikely.

We will find out shortly how companies are stacking up against their expected earnings. Key earnings out this week include: Bank of America, Citigroup, CSX, eBay, General Electric, Goldman Sachs, Google, Honeywell, Intel, Johnson & Johnson, JPMorgan, Netflix, UnitedHealth and Wells Fargo.

The risk/reward relationship does not point to the current situation as a buying opportunity. The upside is too limited, relative to the downside. The stock market is arguably overvalued at a time of the year when it is more prone to corrections and has difficulty producing large rallies. In the late summer months and early autumn (the bulk of the unfavorable period for stocks), the market needs a strong reason to have a substantial rally, such as quantitative easing, very strong earnings etc. "Solving" the current Greek situation and locking up the Chinese market are not strong enough reasons for a major stock market rally at this time. Yes, the "resolution" of these situations will have a short-term benefit but the damage that they caused has not been substantial to the S&P 500, and as such, neither will any resulting rally.

What the HAC is Going On

HAC lost a bit of ground in June, but outperformed the S&P 500 and the TSX Composite. HAC mainly held a large cash position, Canadian and U.S. bonds, and positions in the biotech and consumer staples sectors. Overall, HAC's conservative position helped to mitigate losses.

Sector Updates and Opportunities

Gold–

Beaten down, but starting its seasonal period: Equals a good opportunity

The seasonal period for gold bullion starts July 12th and lasts until October 9th. In last month's newsletter, I said... "If gold does make it back down to support, given that it is starting its seasonally strong period soon, this would be a good entry level into the sector."

Gold bullion has pulled back close to support and currently represents a good entry point. Since the beginning of the year, gold has been tracing out a bearish descending triangle pattern. Classic technical analysis, requires that an investor waits for confirmation on the upside before entering the position. Seasonal analysis has a different approach. Since there are more success than failures in the seasonal period for a security, it makes sense to enter the position before confirmation. In other words, since gold has a higher probability of increasing, based upon historical trends, a confirmation is more likely. In addition, if gold does break down, the position can always be exited.

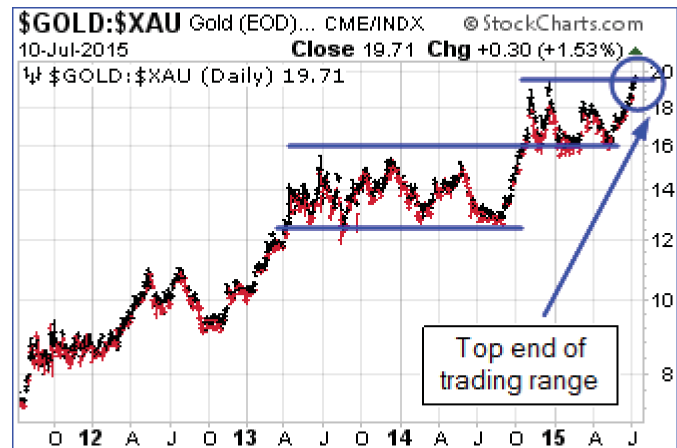
The current price action is very similar to the pattern that was traced out in 2012. At that time, gold had consolidated in a bearish descending triangle pattern at the start of its seasonal period. It was not long until gold responded with a positive breakout.

Gold has pulled back in its multi-year bear market and has recently been weak. Investors have not been attracted to gold for geopolitical reasons, or its safe haven status. Investors are also concerned about the possibility of the Fed raising rates. These concerns are largely "baked" into the price of gold. Given that we are technically just above support and we are starting the seasonal period for gold, entering into a gold position makes sense.

Gold Stocks–

Substantially undervalued relative to gold bullion

In my last month's newsletter I discussed the relationship between gold and XAU. As an update, the ratio has moved to a more extreme level, where gold stocks are even more underpriced relative to gold bullion. The period for gold stocks starts on July 27th. Investors should be monitoring the strength of gold in order to help determine an entry point into gold stocks. If gold bullion starts to show signs of strength, investors should consider entering into a gold stock position early.



Matrix of Expectations - Gold stocks

Below is a table of expectations for gold stocks during their period of seasonal strength. As a disclaimer, the table was not mathematically constructed and is only meant as visual representation.

The seasonal period for gold stocks is from July 27th to September 25th. In this time period, gold stocks have track record of outperforming gold bullion on average.

The table below illustrates the possible outcomes for gold stocks based upon the performance of gold bullion and the S&P 500. At the two extremes: if gold bullion and the S&P 500 perform very well, it would be expected that gold stocks would outperform both gold bullion and the S&P 500; and at the other extreme, if gold bullion and the S&P 500 both perform very poorly, then it would be expected that gold stocks would have losses greater than both gold bullion and the S&P 500.

The benefit of investing in gold stocks during their seasonal period, is that historically the probability of gold stocks performing well at this time of the year provides a net positive value of expected positive returns over most possible scenarios.

Gold Stocks Outcome in Seasonal Period

S&P 500 \ Gold Bullion	↑↑	↑	--	↓	↓↓
↑↑	↑↑↑	↑↑	↑↑	--	↓
↑	↑↑↑	↑↑	↑↑	↓	↓↓
--	↑↑	↑↑	↑	↓	↓↓
↓	↑↑	↑	--	↓↓	↓↓↓
↓↓	↑	↑	↓	↓↓↓	↓↓↓

[shaded] *Positive gold stocks outcome*

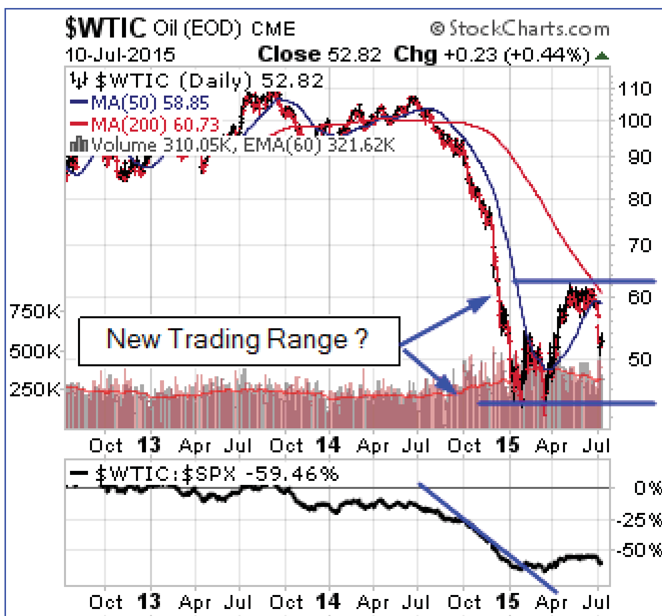
↑/↓ *Arrows represent pos./neg. magnitude*

Energy–

Second seasonal trade of the year could provide an opportunity

The primary seasonal trade for oil and oil stocks is from February 25th to May 9th. This year the trade worked well. Oil has a secondary seasonal period from July 24th to October 3rd. This trade is not as strong as the primary seasonal trade; nevertheless, it is a trade that should be considered (see *Thackray's 2015 Investor's Guide*, p87).

It appears that under the current economic climate and the Saudi output/price regime, oil has found a new range from \$45 to \$60. If oil is close to support at the start of its seasonal period, this would represent a good buying opportunity for the seasonal trade.

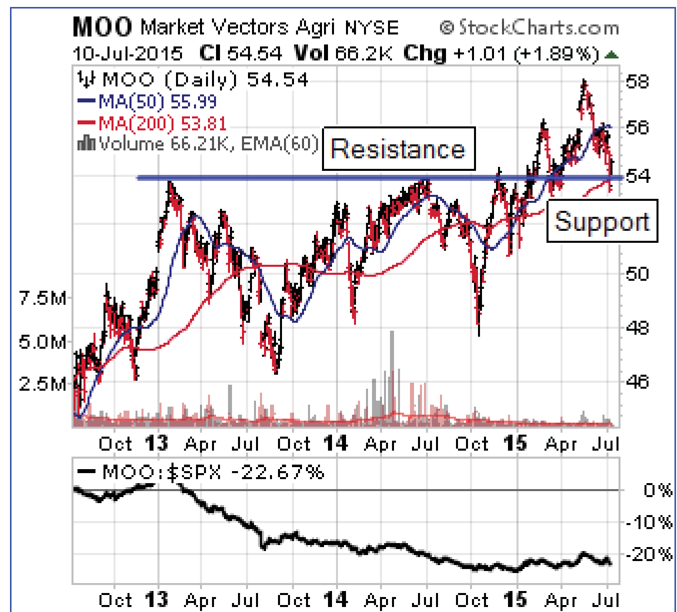


Oil stocks are close to support and investors should be monitoring their strength to determine if an early entry is suitable.

Agriculture–

Looking good, but the sweet spot of the trade occurs in late August/early September

The agriculture sector starts its seasonal period in August, but the real sweet spot for the trade is in late August or early September. The sector is currently at support and if the stock market starts to rally, this would be positive for the sector. Given that the seasonal period has not started for the agriculture sector, it is best to wait for the sector to start to show signs of outperformance.



Fertilizer Stocks–

Seasonal period starts in late June, beaten up and providing a relative opportunity

The fertilizer sector starts its seasonal period in late June. PotashCorp has pulled back substantially since January. Given that PotashCorp is close to support, it currently represents an interesting opportunity.

Agrium has a better technical chart as it recently had a breakout and has since pulled back.

Biotech–

In the sweet spot of the trade - still performing

As the stock market has gone through its gyrations up and down, the biotech sector has risen more than the S&P 500 on strong up days for the S&P 500 and fallen more on down days. Overall, the sector has recently been performing at market. At the end of June, HAC held a position in IBB, as the sector is still maintaining its longer term uptrend in its strong seasonal period.

The risk to this trade is if the stock market suffers a major correction, the sector would be expected to underperform the S&P 500. Although the sector is expected to outperform, investors should still be monitoring for signs of underperformance.

Health Care–

Continues to outperform the S&P 500- seasonal period coming up

The health care technical chart is similar to the biotech sector chart. Both sectors have performed very well, mainly as the result of mergers and acquisitions.

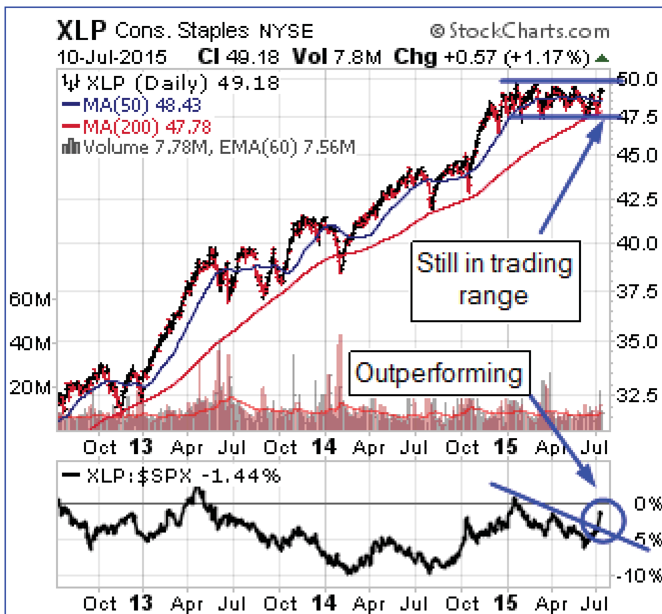
The health care sector seasonal period starts on August 15th, which is later than the biotech sector. The reason for the late start is that the health care sector is more defensive than the biotech sector and August and September tend to be weaker months of the year for the overall stock market and as a result health care sector gets more investor attention at this time.

If the biotech sector starts to weaken, one option for investors wanting to have exposure to the health care sector is to flip the biotech investment over to the health care sector. The returns would not be expected to be as strong, but it is a more defensive option.

Consumer Staples–

Outperforming

The consumer staples sector tends to be one of the better performing sectors in the summer months as investors favor companies with stable earnings. After underperforming since the beginning of the year, the consumer staples sector has started to outperform the S&P 500 as the Greek and China concerns have heated up. As the sector is still in its trading range, it is still considered a hold.



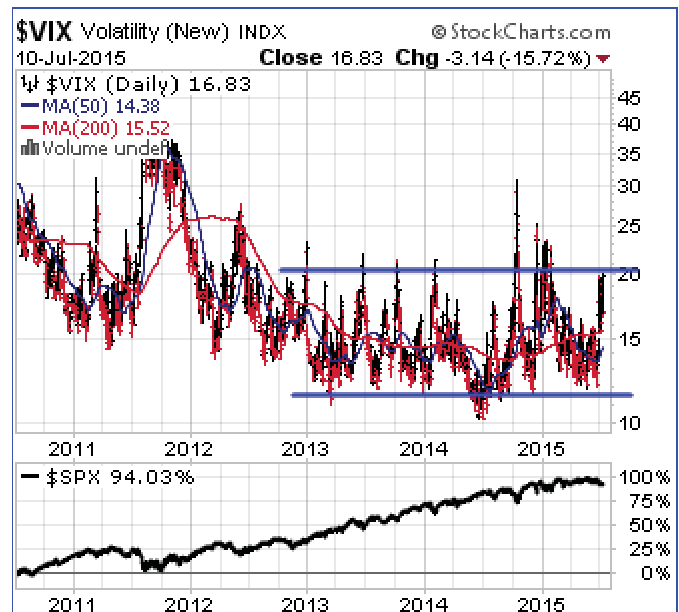
Government Bonds–

Sweet spot approaching, but more talk of Fed raising rates

Up, down and up we go. Bonds have pulled back since the beginning of the year and have had a bumpy ride since the start of their seasonal period in May. IEF has managed to hold at support and is now entering the sweet spot of its seasonal period (starting in late July/ early August).

There are concerns that the Fed will raise rates in September, although a lot more investors are moving to the December date. The possibility of a rate rise will crimp the returns of bonds, but the expectation of a rate rise is already built into the price. Overall, bonds are still an attractive seasonal investment. Concern for IEF will increase if it falls below its support level of $104.

Volatility has arrived early–



This year, volatility has arrived early. On average, volatility does not pick up until mid-July and lasts into October

(see *Thackray's 2015 Investor's Guide*, page 81).

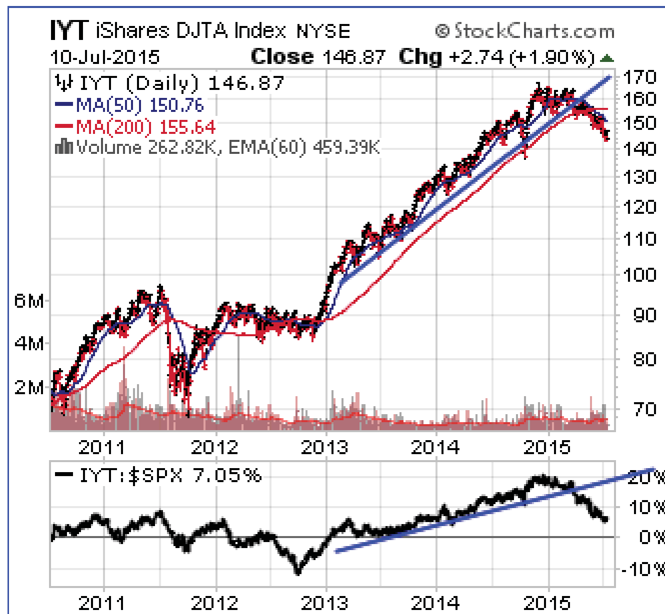
The VIX is currently just below 20. In the past, sustained moves above 20 have been associated with stock market corrections.

Short SELL Opportunities

Transportation– Still going lower

How much lower can it go?

In the springtime, HAC successfully shorted the transportation sector as part of a seasonal pair trade. HAC exited the short position at the end of the seasonal short period and the transportation sector continued to underperform the S&P 500. The next seasonal short period for the sector starts on August 1st. Given the extent of the decline for the sector, investors should be careful entering into a short position in August. If the stock market were to rally, the transportation sector could possibly have a bounce and outperform the S&P 500, at least on a temporary basis.



Nikkei–

Underperformance coming up?

In my *Thackray's 2015 Investor's Guide*, I included a brief analysis on the seasonal performance of the Nikkei 225 Index, illustrating how the index tended to lose value from May 6th to November 13th (see page 75).

As a caveat, the Nikkei225 has fallen dramatically since 1989 and is still well short of its high level. On an absolute basis, the numbers will be skewed because of the Nikkei225's poor performance. Nevertheless, the historical trend has value in showing the relative trend to the S&P 500. Although the magnitude may not be representative, the trend direction is still of value.

In the last few years Japan has embarked on an unprecedented program of quantitative easing. This has helped the Japanese stock market to perform well, but it has also hurt the Japanese yen.

In the future Japan will probably come out with another round of quantitative easing as they try and push the economy to 2% inflation rate. At the current time, it has not been that long since the latest bout of stimulus was announced. This means that in the short-term, Japan will probably not announce another stimulus package unless their economy produces numbers that are dramatically below expectations. If more stimulus were to be initiated, stock prices would probably rise once again and at the same time the Japanese yen would fall against the dollar. An unhedged U.S. investor on their Japanese short sell position would lose on the stock side, but gain on the currency side. The degree of magnitude between the two investments would determine if a net gain or loss was realized.

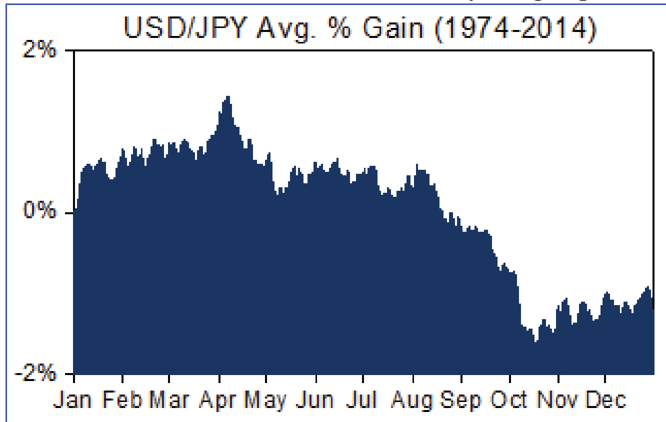
Recently, the S&P 500 has been correcting, and the Nikkei225 has been outperforming the U.S. market. From a seasonal basis, the divergence should resolve itself with the Nikkei225 weakening.

U.S. investors have the option of investing (short selling) in an unhedged ETF to invest in Japan, such as iShares MSCI Japan ETF (EWJ), or a hedged ETF, such as iShares Currency Hedged MSCI Japan ETF (HEWJ).

Although generally, it is desirable to invest in hedged international ETF's, if a seasonal currency trend exists to support investing in an unhedged product, then this is also an option.

In the case of USD vs. JPY, USD tends to underperform from early August into mid-October. From 1974 to 2014, during the period of August 5th to October 19th, the USD has underperformed the JPY by an average of 2.2% and

was negative 61% of the time. Over the long-term, these numbers slightly favor the trend of a weakening USD in the core part of the negative seasonal trend for the Nikkei225. As a result, if an investor is going to take advantage of the seasonal opportunity to short sell the Japanese stock market, it is better to use a currency hedged product.



Brooke's Rant

I tip my hat to Hans Albrecht, a colleague of mine at Horizons Investment (Canada) Management Inc. who wrote a piece earlier this week on how the Greek Euro Farewell Tour was akin to the farewell tour of *The Who*, which started in 1982 and is still going on today. I had a good chuckle. As a side note, *The Who's* farewell 1982 performance was one of the only rock concerts that I have ever attended.

To extend the rock band analogy between Greece and *The Who*; one of *The Who's* most popular songs is titled "Won't Get Fooled Again." The title is somewhat a propos as the song describes the cynicism of a revolutionary ruling party. The ending lines say it all.

"Meet the new boss
Same as the old boss"

At the time of writing this newsletter, the Troika and Greece are in last minute negotiations and rumors are swirling about Greece taking a five year "leave" from the eurozone in order to demonstrate that they are serious about implementing their reforms. It looks like I am not the only one that does not trust the Greeks to take the necessary steps of reform.

On a different note, Chinese investors are starting to realize that the stock market can correct, even when the government tries to prop it up. U.S. Federal Reserve Chairpersons, Greenspan and Bernanke have been accredited with creating a moral hazard of introducing too much risk into the market by encouraging the belief the Federal Reserve would support the stock market if it got into trouble. The "put" is aptly named as investors believed that the stock market had a floor price which if the stock market dropped below, the Federal Reserve would step with support. In essence, creating a put option. A similar situation has "frothed up" in China with too many newbie investors rushing into the market, believing that the Beijing government will do anything to successfully support the stock market.

Chinese investors have proven to be partly right, as the government has done almost everything it can to artificially support the market, including (as mentioned earlier in the newsletter) halting a large percentage of the Chinese stocks from trading, not allowing institutional investors to sell, implementing a short-selling ban, sanctioning IPO's and the Chinese government buying a huge amount of stocks to try and support prices.

The big question remains....what happens when the restrictions are removed. If the Chinese stock market is able to hold at these levels, and I am not sure it will be able to, then watch for the Chinese government to roll off the restrictions one-by-one later in the future. If they are able to get to that point, the cascade could happen all over again.

One Last Rant– Just Call Me Madame Frexit

Marine Le Pen, the President of the right-wing National Front, the frontrunner for France's presidential election has publicly declared herself as Madame Frexit (http://www.bloomberg.com/news/articles/2015-06-23/call-me-mrs-frexit-le-pen-sees-france-euro-exit-next). She is openly supporting the idea of France leaving the euro if she gets elected. You know the name game has gone on too long when politicians ascribe their own "...exit" name.

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