Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 9, Number 8, August 2015

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Market Update

Who is Driving Now?

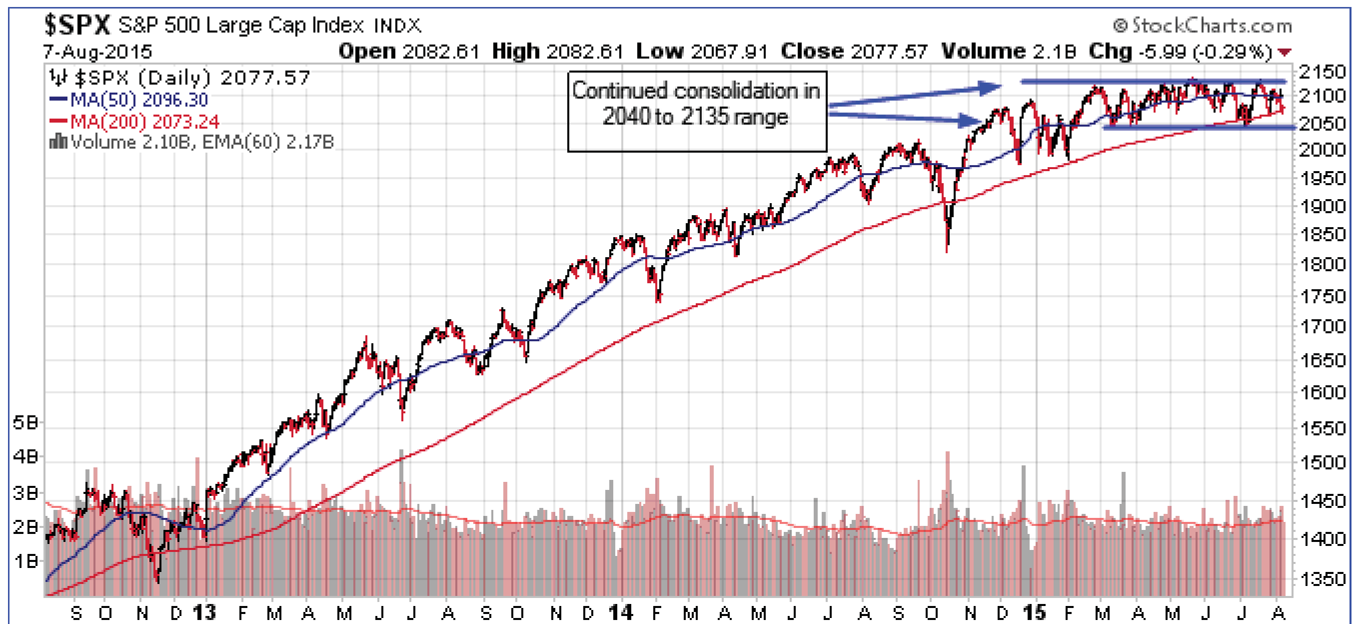
At some point in our lives, most of us have woken up from a deep sleep as a passenger in a car and wondered who is driving the car and where we are going. At the time, it takes a few seconds to get your bearings and figure everything out. In the last eight months, investors have been in a deep sleep as the S&P 500 has traded in a very tight range, from 2040 to 2135. Investors are starting to wake up and look around and try and figure out what is driving this market and where it is going.

The economic numbers are not particularly strong, as global growth is slowing and U.S. economic numbers are

S&P 500 Technical Status

Back to where we were...last month and many months previous. As we are stuck in this historically tight range with the S&P 500, it seems that nothing changes from month to month.....except things have changed.

As the S&P 500 consolidation has extended, it has started to round over and is only slightly above the 200 day moving average, which has provided effective support. Since last October, every time the S&P 500 has come back down to approximately the 200 day moving average, traders have stepped into the market and driven the S&P 500 back up to its resistance level of approximately 2135. It is just mathematics that with the passage of time, the 200 day moving average will move higher after a market rally starts to flatten out. This creates an interesting situation. If the S&P 500 is capped at 2135 with its resistance level and has support with its 200 day moving average at 2075 (and rising), the market is going to break one way or the other. The most likely scenario at this time of the year, is a possible test to the upside and then a break to the downside. Investors beware.



An ETF for all seasons

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

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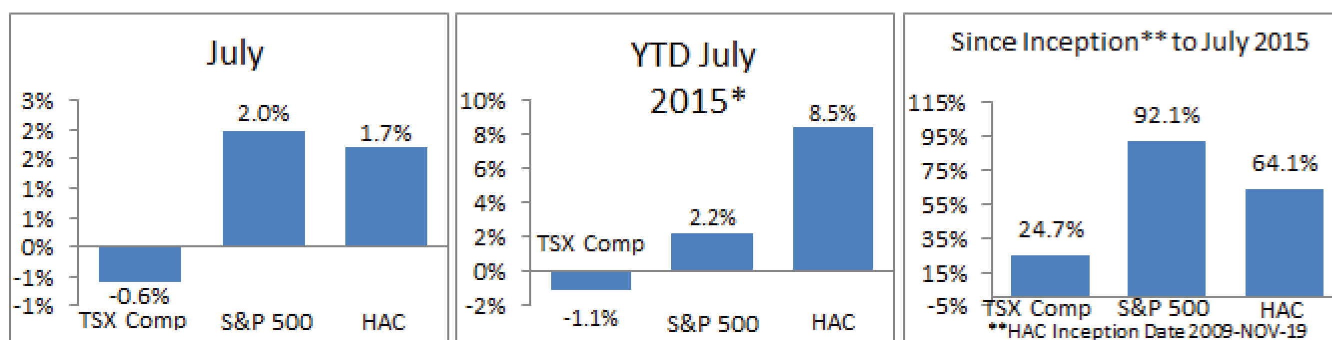
Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **July 31st**, 2015

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Fixed Income	
HFR	Horizons Active Floating Rate Bond ETF	21.3%
HTB	Horizons US 7-10 Year Treasury Bond ETF	17.0%
HBB	Horizons Cdn Select Universe Bond ETF	16.8%
	Equities	
HUG	Horizons COMEX Gold ETF	9.0%
AGU	Agrium Inc.	1.2%
	United States Dollar Exposed Assets	
	Equities	
IBB	iShares Nasdaq Biotechnology ETF	9.9%
XLP	Consumer Staples Select Sector SPDR Fund	9.9%
CF	CF Industries Holdings Inc.	1.2%
MOS	The Mosaic Company	1.2%
	US Dollar Forwards (July 2015) - Currency Hedge **	-0.3%
	Cash, Cash Equivalents, Margin & Other	12.7%
	Total (NAV $132,378,078)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 24.9% 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.

tepid. In addition, Q2 earnings are expected to come in with 1.6% growth (Thomson Reuters, 2015 August 7), hardly something to get excited about. So far, 71% of the companies reporting have beaten expectations, but only 49% have beaten on the revenue side.

With the major portion of the earnings season out of the way and less than stellar earnings....investors are starting to wonder....what is driving the market?

In recent years, the Federal Reserve actions or expectations of their actions has been a major driver of stock prices. Without a strong push from earnings or economic data, investors are once again turning their focus back to the Federal Reserve. The problem is that the possibility of a rate hike in September or December has been bantered back and forth in the media for an extended period of time, wearing down investor's sensitivity to the issue. As a result, any action by the Federal Reserve will probably have a muted investor response, unless of course the action taken is totally unexpected.

Maybe Federal Reserve raises rates in September or maybe it is December, or maybe it is even next year. At some point they will raise. The big question is the path after the initial raise. Up until now, investors have been very complacent, fully expecting the dovish Federal reserve to engineer a situation that is friendly to the stock market. Generally speaking, so far they have been able to achieve this goal which has helped to propel a six year bull market.

Believing that the Fed will manage to control the macroeconomic environment will not work at some point. As investors in the past have found out in the past, blind faith can have major repercussions. Chinese investors are starting to become aware of this reality.

The danger occurs when investor psyche shifts and they start to view the stock market differently. The stock market can remain very overbought in a fragile state for an extended period of time. A catalyst, usually unexpected, often starts the correction process going.

Although the S&P 500 has been trading in a very tight range, there are signs that investors are starting to look out the "window" and they don't like what they see.

What the HAC is going on?

In July, HAC strongly outperformed the TSX Composite and slightly underperformed the S&P 500. HAC's positive performance was largely driven by positions in the:

♦ ***U.S. dollar– Although this trade was successful, investors should note that the Canadian dollar can perform well for a month starting in late August.***

♦ ***Consumer staples sector (XLP)– which has been strongly outperforming the S&P 500***

♦ ***Biotech sector (IBB)– which in the month of July outperformed the S&P 500.***

♦ ***U.S. and Canadian bonds– which provided a positive return in July***

Positions with negative influences:

♦ ***Gold– which performed poorly despite the start of its seasonal period***

♦ ***Fertilizer stocks– which have started their seasonal period negatively***

Sector Updates and Opportunities

U.S. Dollar– the key to commodity prices

Over the last year, the strong U.S. dollar has driven commodity prices down and as a result, a weak U.S. dollar will drive commodity prices upwards.

The U.S. dollar is not the only driver, but it is definitely one of the major drivers of weak commodity prices. As a result, if the U.S. dollar starts to falter at this level the probability of commodities rising in price is high.

The U.S. dollar has risen based upon its status as a safe-haven currency, stronger U.S. growth, other countries initiating monetary stimulus and the expectation that the Federal Reserve will raise rates "soon."

But how far is too far? Does the U.S. dollar deserve its rich value?

In the short-term, the USD has probably gone too far.

♦ ***Geopolitical tensions have eased significantly, reducing the attractiveness of the U.S. dollar***

♦ ***Other than the last quarter, the U.S. has had a declining GDP profile. Relieving upward pressure on the USD.***

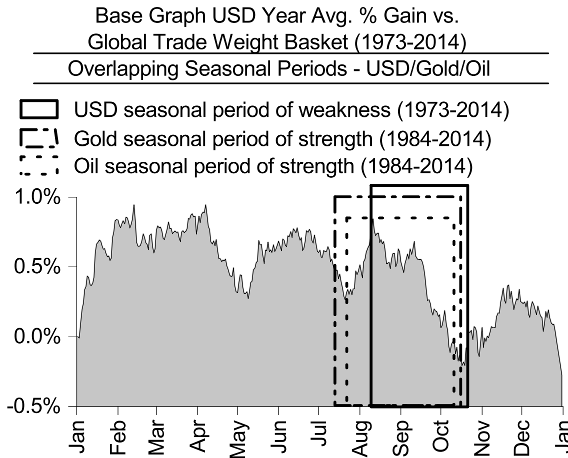
♦ ***Although the Eurozone and Japan went through a spat of monetary stimulus earlier this year, they have not launched significant new stimulus initiatives recently.***

♦ ***Almost everyone in the world (slight exaggeration) believes that the Federal Reserve will raise rates soon. The Fed rate hike is largely "baked" into the value of the USD.***

The U.S. dollar in entering a period of weak seasonality versus a trade weighted basket of currencies. From August 11th to October 17th, during the period of 1973 to 2014, the U.S. dollar produced an average loss of 1.0%

and has lost ground to world currencies 62% of the time. There is no guarantee that the U.S. dollar will decline once again, but it is susceptible after such a strong rally.

The strong seasonal periods for oil and gold overlap with the weaker period for the U.S. dollar, making these commodities more likely to rally if the USD falters.



Although the commodities complex could have a bounce on a weakening U.S. dollar, investors have to be mindful that if the S&P 500 starts to have a major correction, commodities and commodity stocks will likely follow suit.

Gold– negative start to seasonal period, but give it a chance

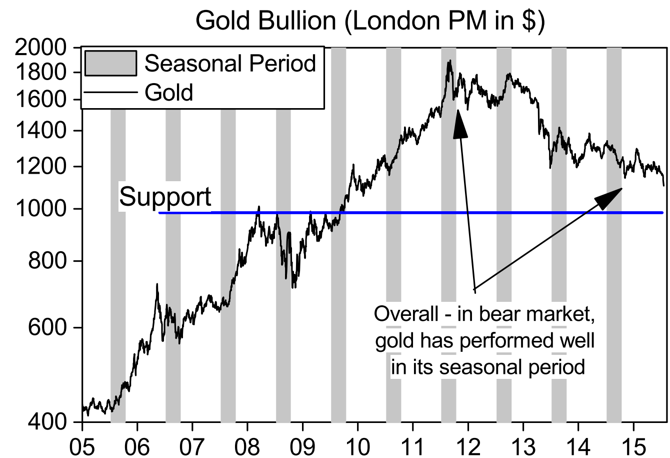
Gold has suffered a multi-year bear market and has recently broken support. In my last month's newsletter I wrote that it is typically acceptable to buy a sector at support if it is sitting at support at the beginning of a major seasonal period. So far, that has not been the case for gold. The strong U.S. dollar has continued to push gold down.

Historically, September has been the strongest month for gold. Since 1984, in September, gold (London PM) has been produced an average gain of 2.2% and has been positive 68% of the time and has outperformed the S&P 500 72% of the time. August is also one of the better months of the year.

Gold fell in mid-July as speculators placed large short-side bets in the gold paper market, causing the price of bullion to fall. More recently, gold has been consolidating below what is now its resistance level of $1180.

Given that gold is approaching its seasonal sweet spot (September), at this time, investors should give gold a bit of time to prove itself. If gold continues to show weakness, seasonal investors will be forced to consider trimming/exiting positions.

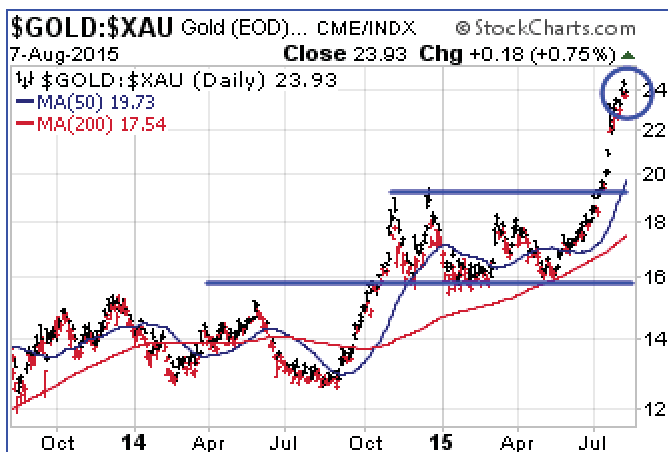
Over the mid-term, gold appears to be working its way back to $1,000, which is the next level of major support. The good news is that even in the bear market from 2011 to date, gold bullion has overall performed positively in its seasonal period (from July 12th to October 9th). The exception occurred in 2014 when gold was dragged down by the skyrocketing U.S. dollar (for more details on rates of return, please see Thackray's 2015 Investor's Guide, page 83).



Gold stocks– down with gold, but extremely cheap relative to gold bullion and could have a strong positive bounce

Gold stocks have suffered with the falling price of gold. Most of the decline for gold stocks took place before the start of the seasonal period for the sector. Gold stocks have a seasonal period that lasts from July 27th to September 25th. The seasonal sweet spot for gold stocks is in September.

The exit date for gold stocks is just over a month away. It is possible that gold stocks will finish their seasonal period early. Investors should be prepared to exit the sector earlier in September if gold stocks continue to perform poorly.



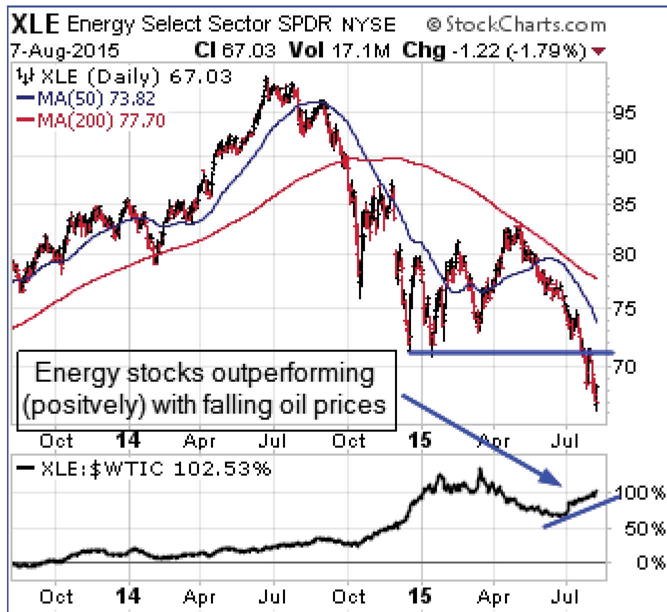
As I mentioned in my newsletter last month, gold stocks relative to gold bullion, are extremely cheap. With the gold/gold stocks ratio at historic levels, if gold does start to perform well, gold stocks are expected to perform strongly (see July newsletter).

Oil– How low can it go?

After a strong bounce in March and April, oil has corrected sharply back down to just above support. A confluence of events has been keeping the downward pressure on oil, including a strong U.S. dollar, weak global growth, China faltering, excess supply from Saudi Arabia, frackers and the potential increase in supply from Iran.

Longer term, it is possible that we see prices oscillate between a low where production starts to get shut in, and a high where the taps get turned on again. Currently it looks like the low and high levels are in the $40's and $60's, respectively. In the last cycle, the low was reached in the $40's as more and more production was shut in with lower prices. The reduced supply helped to drive up the price into the $60's, but the higher the price went, the more interested the frackers were in restarting their shuttered operations. Fracking is a relatively costly operation, but a lot of frackers are willing to expand their operation when oil is in the $60 range. As a result, when the price of oil reached $60, it faltered and started to turn down. Compounded with weak global growth, the price of oil has come back down to the low $40's. The price could easily go lower at this point, but it is looking interesting at the support level at approximately $43.

Energy stocks– look for a seasonal bounce



Energy stocks have dropped along with the price of oil

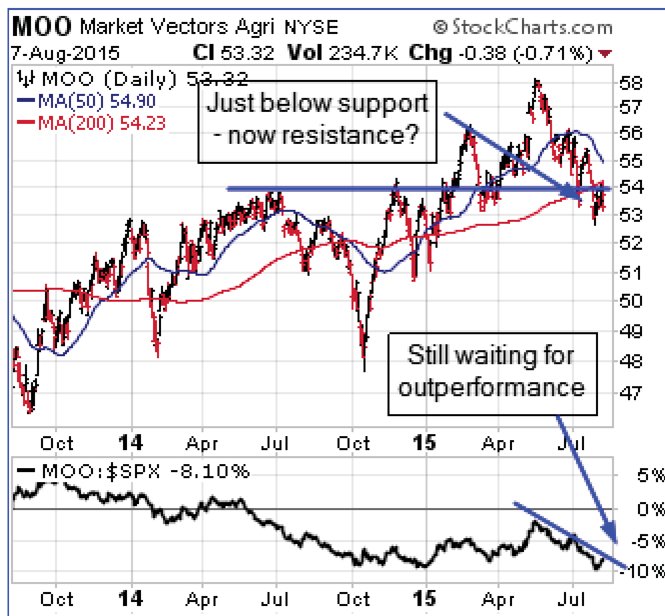
and have broken through their support level. The seasonal period from July 24th to October 3rd is a minor seasonal period and as such positive confirmation is preferable before entering the sector.

The good news is that energy stocks, even though they have been heading south have been outperforming oil on a relative basis. If oil is able to get some traction, energy stocks would be expected to perform well.

Given that we are in the seasonal period for energy stocks, there is a fairly strong possibility that we could see a bounce at this point.

Agriculture– trying to prove itself

The agriculture sector typically performs well from August until yearend. The real sweet spot for the trade is in October. The sector can start its uptick in August, especially under favorable conditions, such as a strong economy and strong commodity prices. Currently, neither of these conditions exists. Investors should be looking for signals that the sector is about to start outperforming, such as a weakening U.S. dollar.



Technically, MOO has bounced off the top channel line (and its 200 day moving average) and has turned down. Although MOO has started its seasonal period on a positive note, investors should be looking for MOO to breakout above its trading channel before making further commitments.

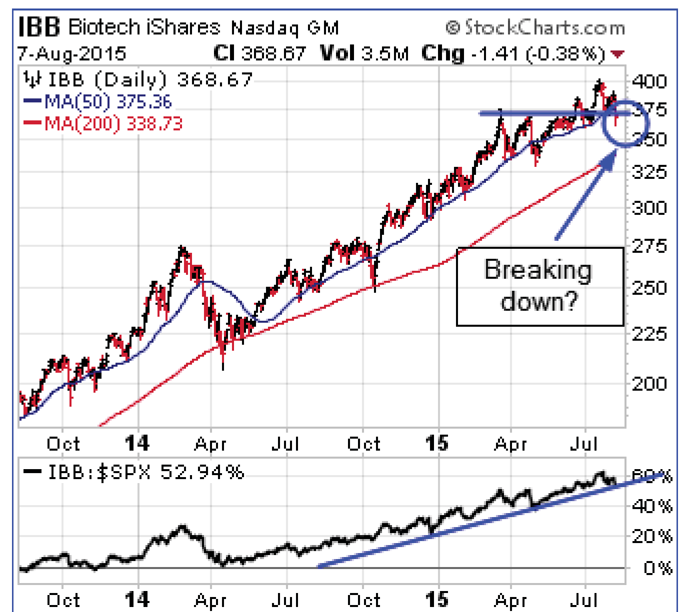
It is difficult for this sector to rally in an environment of a strengthening U.S. dollar. In the summer and autumn of 2014, agriculture stocks underperformed as a strengthening U.S. dollar held commodity prices down. It was not until October and started to show any signs of strength.

At this point seasonal investors should be waiting for the agriculture sector to start to outperform before entering the sector.

Fertilizer stocks– having trouble growing

In a good market, fertilizer stocks can start to outperform the S&P 500 in late June. The real sweet spot for the seasonal trade is October. The sector had a false start in late June and has since been underperforming the S&P 500 mainly as the result of weak grain prices and a strong U.S. dollar. If grain prices start to improve and the U.S. dollar starts to weaken, look for the sector to fall back into its seasonal pattern of outperformance.

Biotech– Outperformed in July, but starting to look vulnerable



Although biotech stocks have managed to outperform the S&P 500, their action is becoming very volatile. Some of the relative moves to the downside compared to the S&P 500 have been quite large. Investors are becoming anxious about this sector, despite some positive reports.

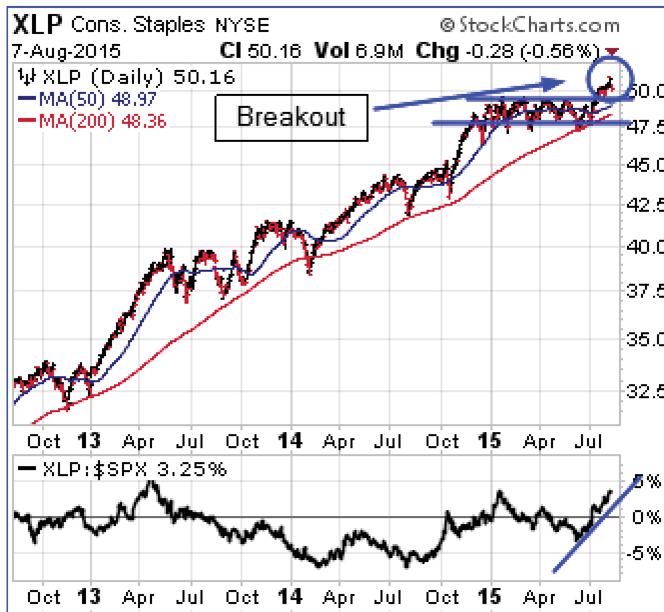
The biotech sector is susceptible to weakness as it finishes its seasonal period, or even earlier, because it has outperformed the S&P 500 so strongly for so long. Such action does not ensure that it will correct, but rather that it is more susceptible to a correction.

The seasonal period for the biotech sector ends on September 13th. With less than one month to go, if the sector continues to weaken, investors should be looking to exit.

Consumer Staples– boring outperformance

The consumer staples sector is a preferred sector in the summer months as investors tend to gravitate to the sector's relative stability of earnings. It is not that the sector produces large returns over the broad stock market in the middle of the summer, but rather the sector's tendency of benefiting from market rallies and not correcting as severely as the broad market which makes it attractive.

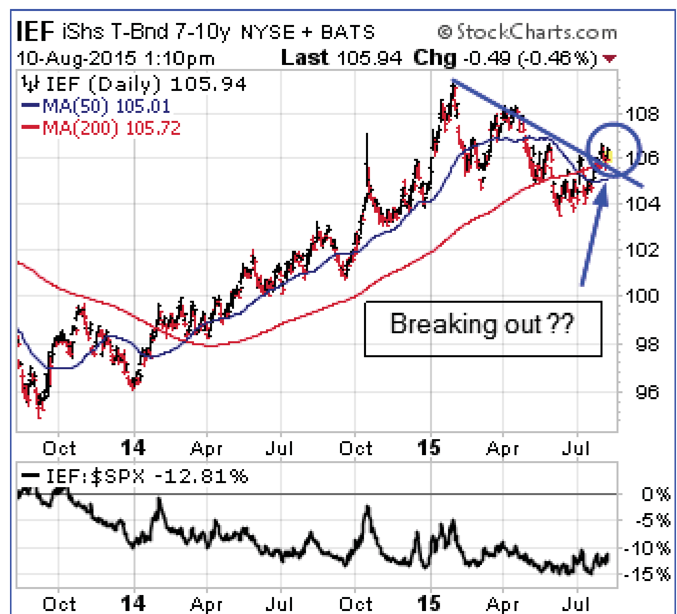
Since the beginning of June, the consumer staples sector has been outperforming the S&P 500. It continues to remain an attractive sector. The real seasonal sweet spot for the sector is in October and investors favoring equities in October should be looking at a position in consumer staples at the time.



Government bonds– Breaking out, but some headwinds ahead

As investors focus on the possibility of a Federal Reserve rate rise in September, government bonds could be negatively affected. At this time, the two factors pushing bonds upwards are a slowing economy and investor's looking for a safe haven in the markets. Government bonds price action will be determined by the relative strength of the drivers.

Bond seasonality lasts until October 3rd. From a technical perspective, IEF has broken out above its downward sloping channel line. Look for IEF to hold above this line. On the other hand, if IEF does pull back into its trading channel, investors should consider reducing/exiting position below $103.80.



CAD/USD– Look for a bounce coming up

The USD has dominated world markets in the last year, including the Canadian dollar which has been hit hard.

The Canadian dollar had a brief period of outperformance in the month of April, which is one of its seasonally strong periods.

The Canadian dollar also has a seasonal period of strength relative to USD, from August 20th to September 25th (see *Thackray's 2015 Investor's Guide*, page 49)

If investors are long the USD, they should consider covering the position, especially as we get closer to the end of August.

The Canadian dollar could perform well as the result of USD weakening against global currencies. It could also get a boost if oil starts to move upward. This scenario is

totally possible as we have just entered the seasonal period for the energy sector.

Investors should note that as the CAD/USD tends to weaken in October, the opportunity to take advantage of the seasonal CAD/USD trade is short.

Last Minute Thoughts

She loves the economy…she loves it not.

Many of us remember sometime in our youth, plucking a daisy's petals one by one and proclaiming that she/he loves me with the first petal and with the next petal proclaiming that she/he loves me not, all the way down to the last petal in an attempt to see if our "love crush" was destined to be with us. As we approached the last petal, it became clearer what the outcome would be.

Investors are plucking the petals of the economy with each data point released, one day proclaiming the Fed is going to raise rates in September and the next day proclaiming that they are not. As we move closer to September, the picture is not becoming any clearer...there always seems to be one more petal that will affect the outcome.

With all of the talk of the Fed raising rates, whether the Fed raises rates in September or December has become somewhat of a moot point. On an absolute basis, a Fed rate of 0.25% is not going to steam roll the economy- what really counts is the action after the first rate increase.

As is so often the case, it is investor psychology that really counts. In 2013, the bond market got hammered when Bernanke started to discuss a potential rate rise. In the end, the bond market became so oversold that it set itself up for a bounce. The big outstanding question over the next month, or four– will a rate rise have a negative impact on investor psyche?

At the risk of sounding disingenuous, this is a difficult question to answer. Sometimes when an anticipated negative Federal Reserve action is implemented a relief rally occurs: other times, the market corrects. It largely depends on other issues that are shaping investor sentiment at the time. If investors are overly bullish and they are starting to become bearish, then typically the market will correct on negative news and vice versa.

At this time, with investors being generally bullish but questioning the valuation of the stock market, if the Federal Reserve were to raise rates in September, the S&P 500 would probably correct. The correction would not necessarily be steep and some other negative data point(s) would be needed for the market to correct severely.

On the other hand, if the Federal Reserve puts off raising rates until December, the market would probably have a bump up, but nothing significant, as December is too close to ignore.

In other words, the Federal Reserve actions will have an impact on market direction, but more data points are going to be needed for the market to move substantially higher or lower.

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