Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 9, Number 10, October 2015

Written by Brooke Thackray

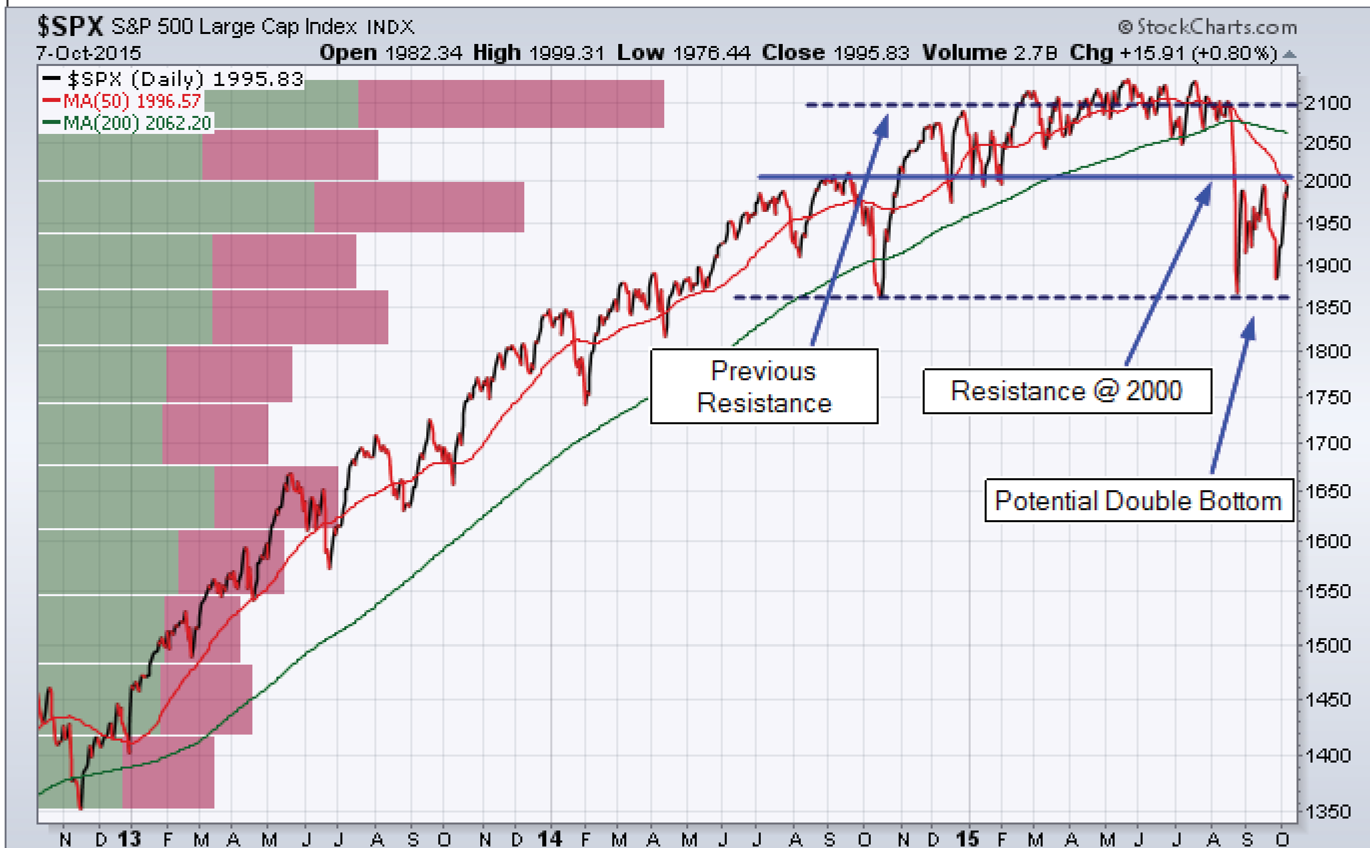
Market Update

In my report in late April, titled *Stock Markets are in for a Cold Summer* (available at www.alphamountain.com), the conditions that I described pointing to the stock market being stretched to the upside, largely exist today. Sure, some of the metrics used to show that the stock market was overvalued at the time, might have receded, but they are still high. So, am I still a bear? Actually, I was never a bear, the case that I laid out was that the market was susceptible to a correction with the most likely time being in the six month unfavorable period for stocks from May 5th (S&P 500 peaked on May 21 on a daily close basis) to October 27th. The correction has occurred and officially

S&P 500 Technical Status

Let's hope that it is not.... "meet the new boss, same as the old boss" (The Who). The old boss that I am referring to is the resistance level of 2100 for the S&P 500, and the new boss, 2000 for the S&P 500. Although we are currently trading around 2000, this level could provide some difficulty. If the S&P 500 is able to rise above this level and stay above it for more than a few days, the most likely scenario is a consolidation pattern between 2000 and 2100. The 2100 level (to be precise 2135) is considered major resistance as the S&P 500 spent such a long time at this level.

The graph below shows volume by price bars on the y-axis. The bars show the total amount of securities traded at the corresponding price levels. The green sub-bar is upside volume and the red sub-bar is downside volume. Note that over the last three years the greatest volume was at the 2100 level. It is going to be very hard for the S&P 500 to get past the 2100 level. Slightly positive news isn't going to do it. Extraordinarily good news of some sort is needed. My call: since we are entering the six month favorable period for stocks, the S&P 500 will be higher by yearend. How high? The old May high of 2135, or slightly higher.



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

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Fixed Income	
HFR	Horizons Active Floating Rate Bond ETF	20.0%
	Commodities	
HUG	Horizons COMEX® Gold ETF	8.7%
HUN	Horizons NYMEX® Natural Gas ETF	4.5%
HOD	Horizons BetaPro NYMEX®Crude Oil Bear+ ETF	2.5%
	United States Dollar Exposed Assets	
	Equities	
XLP	Consumer Staples Select Sector SPDR Fund	10.0%
IWM	iShares Russell 2000 ETF	-10.0%
	US Dollar Forwards (October 2015) - Currency Hedge **	-0.1%
	Cash, Cash Equivalents, Margin & Other	64.5%
	Total (NAV $139,540,751)	100.0%

*** Reflects gain / loss on currency hedge (Notional exposure equals 22.8% of current 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.

we are still in the correction. Staying out of the stock market, or at least reducing equities over the last few months has saved investors a lot of angst.

After a sharp correction in the third quarter, the S&P 500 started the fourth quarter on a strong footing. Investment managers "window dressed" their portfolios on the second last day of September, in order to have the better performing investments for the next quarter. As a result they helped to push stocks sharply higher.

The rally at the start of the October is a good thing, but it does not mean that the volatility that we have experienced recently is over. Historically, October has been one of the most volatile months of the year.

The big question on the table remains....are we in for a warm autumn for stocks? In other words, is the correction over? Also, what is the prognosis for the last quarter of the year?

Although it is great to see the stock market pick up a bit at the beginning of October, it is going to be difficult for the S&P 500 to get back to the point where it all started (May 21st high of 2131). Sure, if companies have strong earnings and great forecasts, the stock market can drive higher, but this is going to be hard to accomplish. Currently, the forecast is for a 4.2% decline in earnings (Thomson Reuters, Earnings Aggregates, Oct 2, 2015). Yes, a negative number makes it seem easy to beat, but beating a negative number with a negative number, probably is not going to propel the stock markets to all time highs.

In my April report, titled *Stock Markets are in for a Cold Summer* report, I illustrated how current corporate profit margins were at historically high levels. They are still at very high levels, which makes it difficult for the "E" part of the Price/Earnings ratio to expand. The combination of year-over-year earnings declines and high profit margins with very little room to expand, are going to make it difficult going forward. The Price/Earnings ratio is going to have to rely on an increase in the "P" part of the equation for expansion. The current forward Price/Earnings ratio is at 15.1 (Factset, Oct 2). Although this estimate is in the normal range, it is not at a bargain basement level that is easily driven upwards.

So what is the good news? It is likely that the stock market will end up at the end of the year higher than where it is today. The last few days of October and the months of November and December tend to be a good time to be in the stock market. On average, the S&P 500, from 1950 to 2014, in November and December has produced average gains of 1.5% and 1.7% respectively. In addition, over the same time period, both months have been positive 66% and 75% of the time respectively.

Let's not get greedy. If the S&P 500 ends up at the old highs by the end of the year, from current levels, that would be an approximate gain of 7%...that would be a good thing.

What the HAC is going on?

In September, most sectors of the market and asset classes retreated.

Positions with negative influences on HAC:

♦ ***After a positive August, gold bullion and gold miners pulled back in September***

♦ ***Natural gas sputtered a long in September and fell sharply at the end of the month***

♦ ***Canadian bonds did not manage to perform as well as U.S. government bonds and suffered a decline***

Positions with positive influences on HAC:

♦ ***U.S. government bonds were able to produce a positive return for the month***

Sector Updates and Opportunities

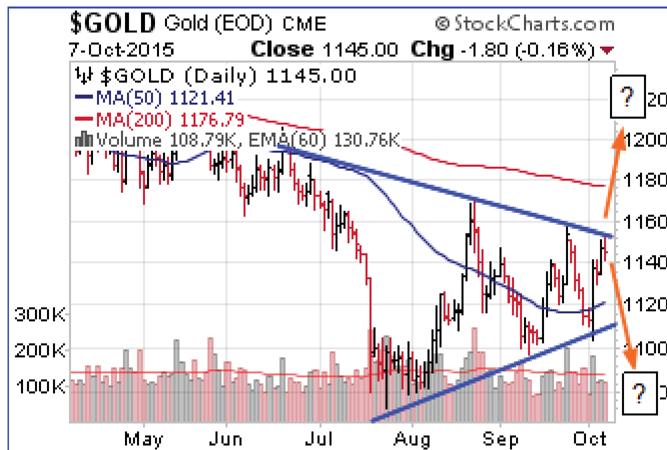
September was not kind to the stock market. Most sectors of the stock market were caught up in the downdraft, but opportunity is ahead.

Gold bullion– Losing its shine

Gold performed well for most of September, but corrected sharply, along with the stock market close to the end of the month. Gold has still not broken above its downward

trendline, so it is difficult to say gold is on a new leg upwards. Gold needs to move above $1160 before its recent strength is confirmed.

A closer look at gold bullion shows that it has been in a consolidation pattern since July. It is currently at the top of the consolidation symmetrical triangle pattern. This type of pattern is neither bullish, nor bearish. When gold finally does break out of the pattern, the direction of the breakout is likely to be the direction of the new trend.



> *My Call:*
>
> *Gold bullion is just entering a weak seasonal period that occurs for the last few weeks in October. November and December tend to be positive, but on average gold bullion tends to underperform the S&P 500. Look for gold bullion to break out of its consolidation symmetrical triangle to the downside and underperform for the rest of October. The caveat to this is the U.S. dollar. If USD continues to weaken, then gold bullion will get a boost.*

HAC exited its gold bullion position in early October.

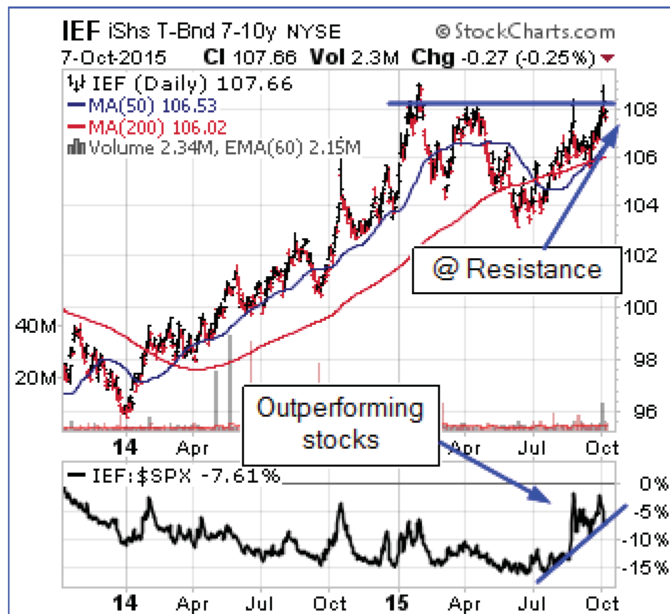
Gold miners– Not the best place to dig anymore

Gold miners end their seasonal period on September 25th. Gold miners have outperformed the S&P 500 since the start of their seasonal period in late July and have had a nice bounce at the beginning of October. Gold miners are now at resistance. If the sector is able to break through resistance, then this will be bullish for the sector, as it will have broken above a double bottom formation. The sector may garner support from the Federal Reserve, as it procrastinates on raising interest rates, helping to push up gold bullion prices and gold miners. Nevertheless, the seasonally weaker period remaining in October should be respected.

> *My Call:*
>
> *The gold miners sector tends to underperform in October. Given the strength of the negative seasonal trend, gold is likely to get rebuffed at resistance and decline, ending up lower at the end of the month.*

HAC exited its position in gold miners in late September.

U.S. Government bonds– Brought to you by Yellen



U.S. government bonds are at resistance, just as their seasonal period ends in the first week of October. Government bonds tend to underperform in October and then return to positive performance, but underperforming equities, in November and December.

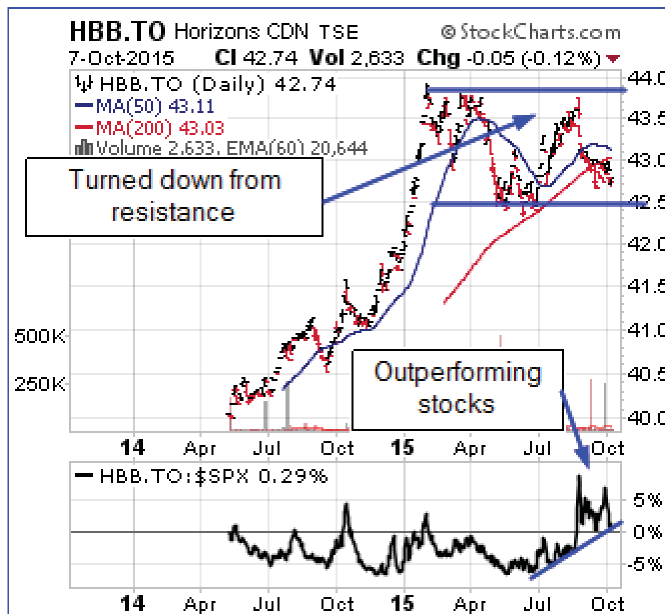
Recently, Yellen and the Federal Reserve have been sending out mixed messages of whether a rise in the Federal Reserve Funds rate is in the cards. Despite this confusion, U.S. government bonds have risen as generally investors believe that the Federal Reserve will delay once again.

> *My Call:*
>
> *U.S. government bonds will likely to turn back from resistance and have slight negative performance in October, despite the possibility of investors once again pushing out the expected date that the Federal Reserve starts to raise interest rates.*

HAC exited its position in U.S. government bonds in late September.

Canadian bonds– Down when the stock market was down

Canadian bonds got hit hard in August, declining when the stock market was declining. The seasonal period for Canadian bonds ends on October 3rd. Canadian bonds can still perform positively in November and December, but on average at this time, have underperformed the equity market. Currently, Canadian bonds have turned down from resistance and are in the lower portion of a trading range.

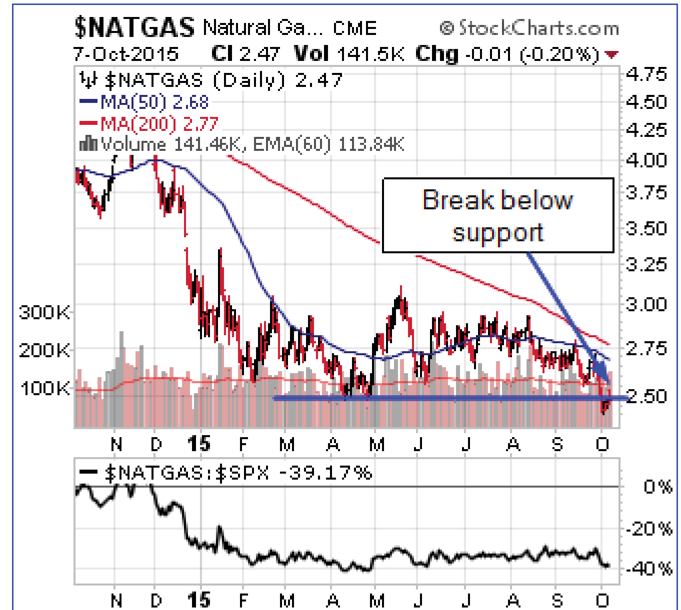


> *My Call:*
>
> *Canadian bonds are likely to have slight negative performance in October and end the year slightly higher than where they are today.*

HAC exited its position in Canadian bonds in late September.

Natural Gas– Flame is burning out

Too much natural gas with inventory levels persistently above the five year average have put a damper on natural gas prices. Natural gas has broken below its support level @ 2.50.

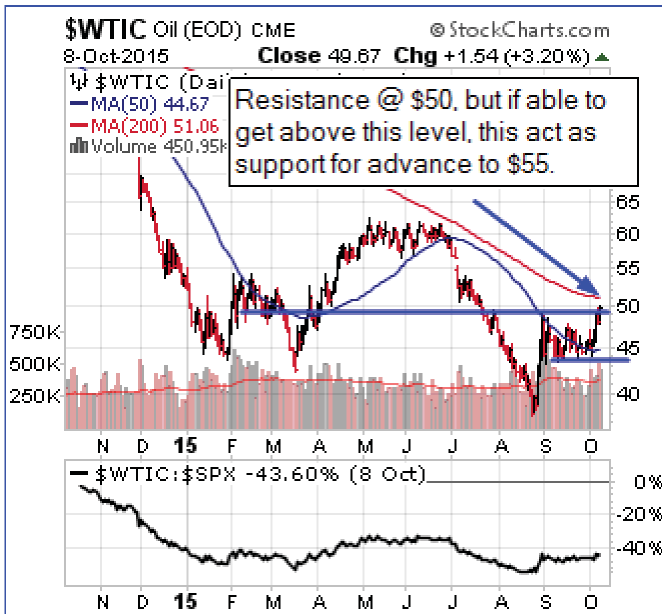


> *My Call:*
>
> *Natural gas is likely to meander around the $2.50 area and end up higher by December 21st.*

HAC exited its position in natural gas in early October, based upon a STOP being triggered.

Oil (Short)– Too many things working against the negative seasonal trade

Oil is typically weak in October and November. After a sharp rise in August, oil started to consolidate, with $45 as a base. At the end of September/beginning of October, oil shot up in price as the rig count dropped, oil inventories dropped more than expected, OPEC started to show signs that it was at least willing to consider working with other countries to manage the oil price and Russia started a military campaign in Syria. All of these events helped to counter the seasonal trend of weakness at this time.

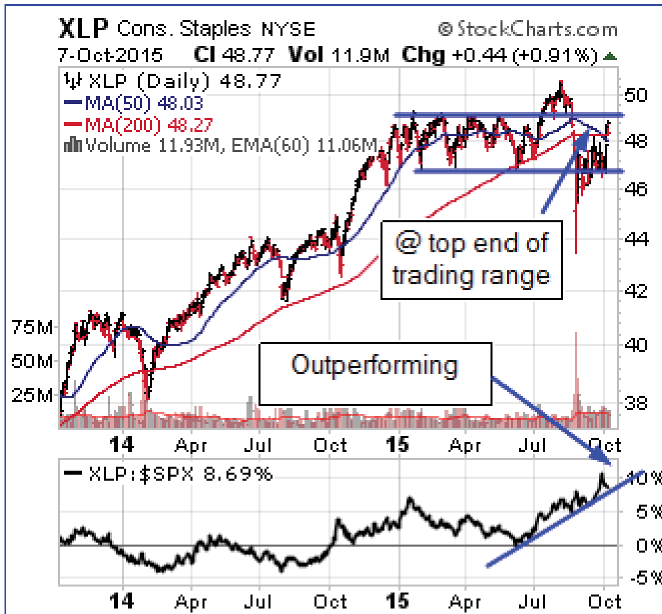


My Call:

Oil is likely to move higher before the end of the year, with WTIC touching on $55.

HAC entered into a short position for oil towards the end of September and then exited the position in early October due the positive move for oil.

Consumer Staples– Comfort in Stability



The consumer staples sector is one of the better performing sectors in October. It tends to outperform at this time as investors are attracted to the stability of the earnings in the sector when the stock market tends to be volatile.

Currently, consumer staples is at the top end of its trading range. This is a good thing when it is in its seasonal period. It is also outperforming the S&P 500. Also a good thing.

My Call:

The consumer staples sector is likely to continue to outperform the S&P 500 up until October 27th.

In late September, HAC entered into a position in the consumer staples sector, against a short sell position in the small cap sector.

Small Caps (SHORT SELL)– Pair against consumer staples

The small cap sector tends to underperform in the month of October for exactly the opposite reasons that the consumer staples sector tends to outperform. The small cap sector has a higher beta than the S&P 500 and the consumer staples sector, and generally entails more risk. In a typically volatile month such as October, investors tend to shy away from the small cap sector.

Up until the last few days of October, it is expected that the small cap sector will underperform the consumer staples sector when the S&P 500 has negative days or slightly positive days. On the other hand, it is expected that on large up days for the S&P 500, the small cap sector will outperform. The net combination of the up and down days is expected to favour the consumer staples sector outperforming.

My Call:

Based upon seasonal trends, the small cap sector is likely to underperform up until October 27th. Investors should look to take a long position in the small cap sector in December, when the sector has a track record of outperforming the S&P 500.

In late September, HAC entered into a short sell position in the small cap sector, against a long position in the consumer staples sector.

Technology– All charged up

The technology sector has been outperforming the S&P 500 since July. It has recently had a breakout of a short-term double bottom.

The technology sector tends to outperform starting on October 9th. It can underperform in December, before once again outperforming for most of January.

My Call:

The technology sector is likely to continue its outperformance up until December, and then surpass its April 2015 highs in January.

Canadian banks– Showing signs of strength

Canadian banks have recently broken above its downward trendline. A positive development. Canadian banks have been outperforming since the summer. Canadian banks start their period of seasonal strength on October 10th. The sector has been badly beaten up partly because of the energy sector's demise over the last year and a half. The sector represents good value from a fundamental basis and if the energy sector does have a rally at this point, this should provide further support to the banking sector.

My Call:

The Canadian banking sector is likely to continue to outperform. If the sector significantly outperforms in November, look for the sector to weaken late in the month as banks start to release their earnings. If the sector only has moderate outperformance, look for the sector to continue on this trend until the end of the year.

Agriculture– Getting ready to grow

The agriculture sector can start outperforming in the late summer, but the real sweet spot to the seasonal trade starts in October. This year, the sector started to underperform the S&P 500 in May and has continued its negative trend.

With the agriculture sector being tied somewhat to the overall growth trend of the world, there is a risk that the sector will continue to underperform if more economic reports show slowing global growth. However, given the magnitude of the decline of the sector, and the strength of the seasonal run at this time, the sector is attractive.

> *My Call:*
>
> *The agriculture sector is likely to outperform the S&P 500 until yearend. If published economic reports show strong global growth, look for the sector to continue its outperformance into January, as it has done in the past.*

In October, HAC entered into a position in the agriculture sector.

Canadian dollar–

The Canadian dollar has been on a run recently, as it was previously oversold. In the last two weeks, it has also gathered strength from a rising energy sector. The Canadian dollar is still largely a petro-currency and is affected by the price of oil.

> *My Call:*
>
> *Look for CAD/USD to have trouble making it past $0.78 as this level provides major resistance. For CAD/USD to make it past this level of resistance, it will probably need help from the energy sector. Given that the energy sector is typically weak in November, look for the Canadian dollar to be slightly lower than today's levels, by yearend.*

Last Minute Thoughts

China is in a slow down and nobody seems to care anymore.

In August, weakening economic data out of China brought worldwide markets down. Investors were concerned about the ramifications. The concern did not last long, as the fear was rationalized away.

The main argument that China's situation was not a big deal, was the S&P 500 companies only exported goods worth approximately 10% of revenues to Asia, which is mostly made up of Japan. So in the end, China is not a big deal. Not so fast! That rational is applicable when examining a small country such as Greece, but China is a different story.

It all comes down to the multiplier effect. It is difficult to pinpoint, and many analysts and even politicians use different numbers, but a job lost in the auto industry effects approximately eight other jobs. These jobs are not just the obvious auto parts suppliers, but other companies that provide anything from art work for marketing to counseling services.

The Chinese situation with their economy slowing, is not exactly the same, but the multiplier effect is applicable. With Chinese growth slowing, their demand for goods and materials decreases. Countries hardest hit up front are the commodity countries such as Canada and Australia. The ripple effect slowly works its way through the system. As commodity countries become affected, they reduce their purchases from other countries, and so on.

Other than the direct impact on the demand for commodities, the other effects are slow moving and take a long time to have an impact on economies.

I do not think that China's slowdown will have a huge impact on the global economy, bringing it to its knees, but it is disingenuous to dismiss the second largest economic country in the world and say it is not going to have an impact at all. There used to be a saying, "when the U.S. sneezes, the world catches a cold." Although, China does not have the same impact on the global economy, it is still

something to be respected.

I know that this may seem premature, but I will use the forbidden “R” word...recession. Not now, but possible sometime in late 2016 and into 2017. I know that I am out of step on this one, but world growth is slowing. QE cannot solve problems forever. Although the U.S. is moving towards a tightening bias, I would not be surprised to see a different form of QE if the economy does not pick up....sometime in late 2016 or 2017. It is early, but in the future. I will argue the case for this scenario.

To finish off with a joke...

What is the IMF’s current predicted global growth for 2016?

Answer: 3.6% (IMF Publications Oct 5, 2015)

(*everyone laughs*)

The IMF is notoriously errant in their forecasts, to the high side. It seems that every year the IMF drinks some Polly Anna potion before forecasting and then has to lower their estimates. I might have to eat my words here, but I think they are wrong again (and naturally they will have lots of excuses to justify why they are wrong).

Disclaimer: Comments, charts and opinions offered in this report are produced by www.alphamountain.com and are for information purposes only. They should not be considered as advice to purchase or to sell mentioned securities. Any information offered in this report is believed to be accurate, but is not guaranteed. Brooke Thackray is a Research Analyst with Horizons ETFs Management (Canada) Inc. ("Horizons ETFs"). All of the views expressed herein are the personal views of Brooke Thackray and are not necessarily the views of Horizons ETFs, or AlphaPro Management Inc., although any of the opinions or recommendations found herein may be reflected in positions or transactions in the various client portfolios managed by Horizons ETFs, including the Horizons Seasonal Rotation ETF. Comments, opinions and views expressed are of a general nature and should not be considered as advice to purchase or to sell mentioned securities. Horizons ETFs has a direct interest in the management and performance fees of the Horizons Seasonal Rotation ETF (the "ETF"), and may, at any given time, have a direct or indirect interest in the ETF or its holdings. Commissions, trailing commissions, management fees and expenses all may be associated with an investment in the ETF which is managed by AlphaPro Management Inc. The ETF is not guaranteed, its values change frequently and past performance may not be repeated. The ETF may have exposure to leveraged investment techniques that magnify gains and losses and which may result in greater volatility in value and could be subject to aggressive investment risk and price volatility risk. Such risks are described in the ETFs prospectus. The prospectus contains important detailed information about the ETF. Please read the prospectus before investing.

While the writer of this newsletter has used his best efforts in preparing this publication, no warranty with respect to the accuracy or completeness is given. The information presented is for educational purposes and is not investment advice. Historical results do not guarantee future results

Mailing List Policy: We do not give or rent out subscriber's email addresses.

Subscribe or Unsubscribe to the Thackray Market Letter: Please visit alphamountain.com.