Thackray Market Letter

— Know Your Buy & Sells a Month in Advance —

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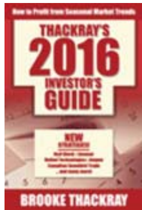

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Market Update

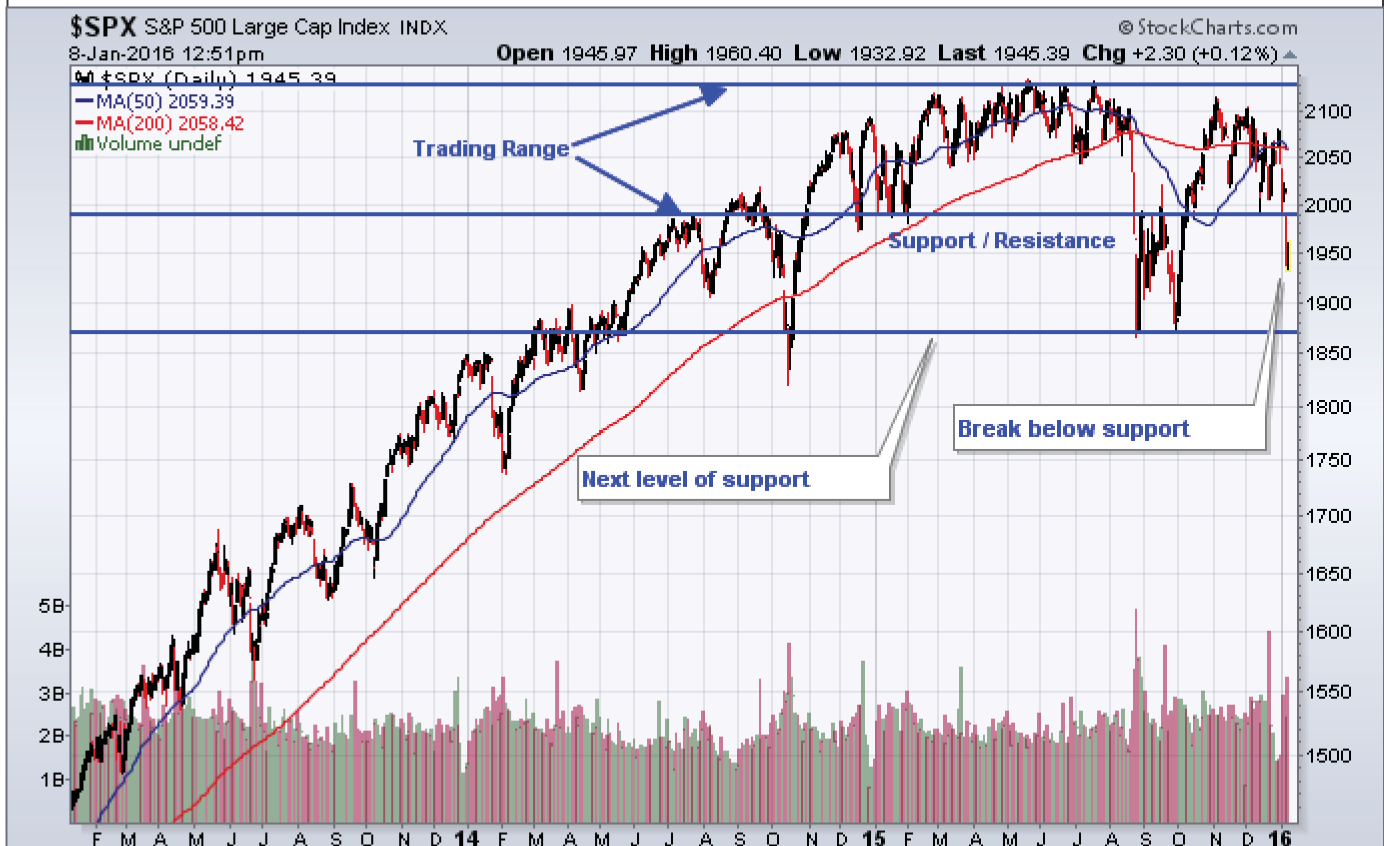
Ouch, the recent drop in the stock market was unexpected....as it often is. The stock market was rallying into year-end looking to make a strong close for the year and with two days left in the year, the S&P 500 collapsed.

Now is not the time to exit the stock market!!

S&P 500 Technical Status

After putting in a series of lower lows and lower highs since October, the S&P 500 collapsed starting in the last two days of December. It dropped below its 1994 support and has stayed below this level. The next level of support is the August 25th low of 1868.

The new trading range for the S&P 500 is 1868 to 1994. If the S&P 500 is able to get above 2000, this would be a good development and put it back into its old trading range of approximately 2000 to 2135. Earnings season is just around the corner. In the short-term, look for the earnings season to possibly drive the S&P 500 back into its old trading range. If it is not able drive above the 2000 level, look for the S&P 500 to make repeated attempts before moving higher. Seasonality is positive for the stock market at this time and should provide some support with the stock market resolving higher, close to its old highs over the next few months.



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

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	9.8%
HSU	Horizons BetaPro S&P 500® Bull Plus ETF	9.7%
HQU	Horizons BetaPro NASDAQ 100® Bull Plus ETF	9.7%
COW	iShares Global Agriculture Index ETF	4.6%
HSX	Horizons S&P 500® Index ETF	1.2%
	United States Dollar Exposed Assets	
	Equities	
IWM	iShares Russell 2000 ETF	19.8%
XLI	Industrial Select Sector SPDR Fund	14.5%
XLF	Financial Select Sector SPDR Fund	10.1%
QQQ	Powershares QQQ Trust Series 1	9.8%
ITB	iShares U.S. Home Construction ETF	4.9%
SLV	iShares Silver Trust	4.8%
	*US Dollar Forwards (February 2016) - Currency Hedge ***	*-1.0%*
	Cash, Cash Equivalents, Margin & Other	*2.0%*
	Total (NAV $157,259,706)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 24.02% 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.

First, a lot of the damage has already been done. It is true that the stock market can fall further, but from the peak of the S&P 500® in May 2015, to the August 1868 low, we are more than halfway down. Exiting the market at this time exposes investors to the risk that the market could have a snap back rally on positive earnings or positive economic news. Although this is true at any time, it is more likely after a major correction.

Second, we are still currently in the favorable six month period for the stock market (October 28th to May 5th), where stocks tend to perform well and the seasonal risk reward profile makes sense for investors to stay in the stock market. Aside from the stronger average performance of stocks during this period, historically there have been more large gains and fewer big losses compared to the unfavorable six month period of the year for stocks (May 6th to October 27th).

In the favorable six month time period for stocks, from 1950 to 2015, the S&P 500® has produced gains greater than 10%, twenty-six times and losses greater than 10% two times. In comparison, in the unfavorable six month period for stocks, the S&P 500® has produced gains and losses greater than 10%, eight times in both cases.

In other words, the period that we are in right now, the favorable six month period for stocks, tends to have more large gains and fewer large losses compared to the unfavorable period for stocks. Yes, a large loss can occur at this time, but based upon seasonal trends, it is less likely to occur during the favorable period for stocks.

The bear market of 2008/2009 was a trying time for investors. The S&P 500® corrected sharply in the favourable six month period for stocks. If an investor had exited in the early part of 2009 it would have been very difficult for them to get back into the market. Ironically, the S&P 500 was positive in the favourable period for stocks in 2008/2009, despite the large drop in the stock market.

To be clear, from a seasonal perspective it is best not to exit the stock market in an attempt to avoid downdrafts during the favourable six month period for stocks. On the other hand, such a strategy can be prudent in the unfavourable six month period for stocks. The rationale for this is that the stock market is more likely to decline in its unfavorable six month period.

China Syndrome….In Reverse

Once again it has been China's economy and its volatile stock market that has been roiling the world wide stock markets. In the end, the Dow Jones and S&P 500 both had their worst first week start to the year.....ever. This is not a good way to start the year.

In the 1979 movie, *China Syndrome* starring Jack Lemmon, Jane Fonda and Michael Douglas, a threat exists that a poorly maintained nuclear reactor will have a meltdown with the reaction eating right through the earth's core to the other side of the world and ending up in China. The threat today is the opposite where a meltdown in China threatens the stability in the U.S.

Last summer the Chinese economy was showing signs of slowing down and the Chinese stock market was correcting severely. These actions along with the Chinese devaluing their yuan had a large negative impact on worldwide stock markets. It was only after the Chinese market stabilized and Western investors focused on U.S. earnings that the U.S. stock market started to rally at the end of September and into October.

Today, a similar situation exists as the Chinese economy is once again showing signs of slowing down and the stock market is having significant losses on a daily basis. The Chinese government is "once again" trying to prop up the stock market and stimulate the economy by devaluing the yuan. The effect on the western stock markets is similar the reaction to the Chinese "situation" last summer, which was a large correction.

It used to be said that when the US catches a cold the rest of the world sneezes. It seems that today the statement is also true for China. In the summertime a lot of analysts were down playing the impact of the Chinese slowdown on the world by stating the small percentage of revenues earned by S&P 500® companies in China. This analysis is a bit of a misnomer, as slowing Chinese growth based upon exports is a reflection of the world wide economy. If global growth is slowing there is less demand for Chinese products. A lot of analysts talk about how the Chinese economy is moving to an internal consumption model and being less dependent upon exports. Although this may be the case, the effect of this transition is negligible today and will take many years to have a meaningful impact.

The big question is how long can this China induced correction go on? Looking back at the summertime correction we can see that investors overreacted and pushed U.S. stock market too low for the circumstances to warrant. When investors started to focus on U.S. earnings, the stock market responded positively. Earnings are upon us once again as we are in an earnings month. Although the expectation is for a year-over-year earnings decline, this was also true back in October. Up until the end of September, investors had a myopic focus on the volatile China stock market. Once investors shifted their focus to the expectation of positive earnings surprises the stock market rallied strongly.

It is possible that the same phenomenon could occur once again in this earnings season. According to Thomson Reuters (January 8, 2015), fourth quarter earnings are expected to produce a 4.6% decline on a year-over-year comparison basis. It is possible to manipulate the earnings expectations by removing energy companies etc. The fact remains that we are still in an earnings recession.

The good news is that analysts focus more on the expectations rather than the actual results. The idea is that the expectation of weak results is already baked into the stock market. Setting the bar low with a decrease in earnings growth makes it easier for companies to beat their expectations.

In the short-term, beating expectations tends to provide a boost to the stock market. You have to wonder, at some point negative absolute growth has to have an effect on stock prices: let's hope that it is not for a while yet.

What does the recent correction indicate?

The recent correction stock market was largely unanticipated and caught many investors off guard, including myself. In late December the stock market was rallying as it often does at this time of the year. The S&P 500 was approximately at the midpoint in its trading range and seemed to lack a catalyst to drive it either higher or lower. The U.S. stock market started to correct on its own volition and Chinese weak economic numbers and plunging stock market threw fuel on the fire.

There is no question that the recent decline in the stock market is of concern. This is particularly true as the S&P 500 broke a key support level at 1994. This price action means that it is going to be more difficult for the S&P 500 to break above its previous highs of 2015. At this time investors should look for the S&P 500 to enter its old trading range of approximately 2000 to 2135. For the S&P 500 to break above the previous 2015 highs, a strong catalyst is going to be needed, such as strong earnings or a string of strong economic reports.

Unless China continues to have a severe meltdown, the most likely scenario is for the market to stabilize and move higher over the next few months but not significantly. The danger zone will be later, in the unfavourable six month period for stocks, particularly if the stock market moves sideways from this point and reported earnings and economic reports do not improve.

Monitoring the health of the market

Typically it is the cyclical sectors of the market that outperform in the springtime. If the market continues to go sideways or even improve a bit and the defensive sectors outperform, this will be a sign of a fragile market.

When sectors of the market that should be positive from a seasonal perspective are underperforming, this tells us that there is something wrong. In the springtime, if there is a rotation into the defensive sectors, it is a sign that investors are becoming more cautious and that the market internals are getting weaker. The end result is that the stock market is susceptible to a correction.

In my newsletters I will be monitoring the relative performance of the defensive sectors compared to the cyclical sectors over the next few months in order to establish the health of the market.

What the HAC is going on

HAC is fully invested in the stock market and has been suffering alongside the stock market. As the stock market has been declining into the new year, HAC has been cutting back on some of its higher beta sector investments.

Sector Updates and Opportunities

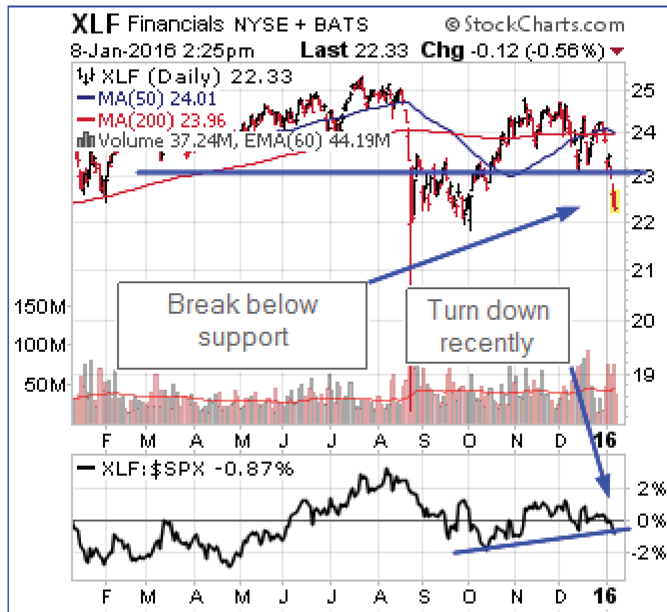
Silver– performing well because of geopolitical concerns

Silver is one of the few investments that have been performing well at this time. Silver's price is largely determined by its value as an industrial metal and a precious metal. Typically, silver performs well from the beginning of January into March. The price increase at this time of the year is mainly driven by an increase in economic activity increasing the demand for silver as an industrial metal. This year, silver's price is being driven by its precious metals quality and due to its attractiveness as a safe haven asset. As China gyrates in turmoil and Saudi Ara-

bia and Iran produce increasing tensions in the middle-east, both gold and silver have increased in value. The danger is that as geopolitical tensions fade, the attractiveness of silver can also fade. This is something that needs to be monitored.

My Call: The Chinese turmoil should subside, and as a result, silver's precious metal lustre will probably fade. Silver's industrial demand should remain stable despite recent downward pressure on global GDP growth. It is highly probable that this sector will finish its seasonal run early this year.

Financials– faltering on global growth concerns



The U.S. financial sector appreciated in late autumn as investors were anticipating the U.S. Federal Reserve rate hike and the potential net margin benefit that would be provided to the banks. Recently, the sector has been faltering as global growth has been slowing and China stumbles. Not only do U.S. banks not perform well when global growth is an issue, there is an increasing belief that the U.S. Federal Reserve will have to hold off on more interest rate increases due to slowing global growth. It is difficult for the U.S. to raise rates when the rest of the world is slowing and increasing their monetary stimulus. U.S. banks report their earnings in mid-January. Investor reaction will help determine the forward momentum of the financial sector.

My Call: U.S financials will outperform the S&P 500 over the next two months, but will finish their seasonal period early. Investors should be prepared to exit this sector upon further weakness, especially after U.S. bank earnings.

Industrials– pause or correction

Despite its oscillations, the industrial sector outperformed the S&P 500 from late July to the end of 2015. Recently, the sector has pulled back relative to the S&P 500. From a seasonal basis, the industrial sector has a tendency to underperform from the beginning of January to later in the month as investors typically try to figure out sector leadership in the new year. HAC sold its position in the industrial sector in early January, but will possibly revisit the sector later in the month or in early February, depending on market conditions.

My Call: The industrial sector will probably underperform for most of January until the stock markets stabilize. Once this occurs, the industrial sector will probably produce mild outperformance relative to the S&P 500 in its seasonal period up until the end of April or the beginning of May.

Consumer Discretionary– comeback sector?

HAC exited its position in the consumer discretionary sector in December as the sector was underperforming the S&P 500. The good news is that the sector can increase its relative performance compared to the S&P 500 later in January with the assistance of the retail sector that tends to start a seasonally strong period in late January. HAC intends to possibly re-enter this sector later in the month.

> *My Call: The consumer discretionary sector will likely outperform the S&P 500 over the next few months as investors focus on the consumer part of the economy. Investors should look for this sector to outperform up until late April.*

Retail– starting to show signs of life

After underperforming the S&P 500 since September, the retail sector is starting to shows signs of life ahead of its seasonal period which lasts from January 21st to April 12th. In this time period, for the years from 1990 to 2015, the retail sector produced an average gain of 8.5% and was positive 77% of the time. In addition, and more importantly, the retail sector outperformed the S&P 500 more than 80% of the time in the same yearly period. (see *Thackray's 2016 Investor's Guide*, page 9)

> *My Call: After underperforming since July, the retail sector is setting up well to outperform the S&P 500 in its next seasonal period which starts later in January. As investors focus on the consumer, this sector is expected to outperform.*

Homebuilders not building a solid foundation

The homebuilders sector performance has been a disappointment this year, as has been the home construction sector. From 1990 to 2014, the strongest month for the homebuilders sector has been December, which has produced an average gain of 8.0% and has been positive 80% of the time. In the same time period, it has also outperformed the S&P 500 88% of the time. This year, the trade did not work in December. Investors should consider exiting the trade on further weakness.

> *My Call: The sector may have an oversold bounce, but the prognosis for the sector is looking dim. Investors should consider exiting the sector, especially if an oversold bounce does not materialize.*

Nasdaq 100– not much to drive it higher

Recently, the Nasdaq 100 started to underperform the S&P 500 as the technology sector started to slip. The start of the technology sector's underperformance hinged on Apple's underperformance. There have been strong rumors that Apple has been dramatically cutting its production on its latest phones which has rippled through to its suppliers. Given that the strong seasonal period ends for the technology sector, the outlook for the Nasdaq 100 is dimming. The biotech sector can sometimes give the Nasdaq a boost at the end of the year, but its relative perfor-

mance is also fading.

My Call: *The Nasdaq-100 Index could outperform over the next few weeks on an oversold bounce, but given its recent underperformance and the fact that the seasonal period for the technology sector ends soon, the multi-month prognosis for the sector is not strong and consideration should be given to exit the sector on further weakness.*

Small Caps– still showing investor risk off perspective

A stronger U.S. dollar can often influence the small cap sector to have stronger performance than the S&P 500 because a large part of the small cap sector's revenue is generated domestically. Also, when the U.S. economy is outperforming most other countries, investors tend to favor the small cap sector. On the other hand, when investors are risk averse, they favor large cap names. Recently, as the S&P 500 has been making lower highs and lower lows, investors have become more risk averse and have been favoring large cap names. Not only have they been favoring large cap names, but they have been favoring relatively few stocks leading to overall "bad breadth" in the marketplace.

My Call: The small cap sector will probably start to perform at market and will outperform if the S&P 500 starts to show strength. Regardless, investors should be prepared to leave the sector if it continues to underperform.

Brooke's Rant–

I have never met an IMF forecast that I believed.

The IMF is notorious for overestimating world growth. It seems that every year they develop a Pollyanna forecast at the beginning of the year and then have to ratchet that forecast down towards the end of the year. Earlier in 2015, the IMF expected world GDP growth to be 3.3% in 2015. In October, they lowered their forecasts to 3.1%. Just recently they indicated that it will be difficult for the forecast to be met and they were expecting slower growth once again.

It seems that the IMF feels that they control world growth and if they forecast world growth to be high this will somehow help to boost production. This is the only explanation I can find for their constant over estimation. Optimism is good, but the IMF is ridiculous.

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