Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

Corporate Earnings Recession

Corporate earnings have decreased for the last three quarters in a row. This is a rarity and the last time it happened was in the first three quarters of 2009. I call the current trend an earnings recession based upon the definition of a

S&P 500 Technical Status

The S&P 500 has broken above 1950, a key resistance level which should now provide support. The next level of resistance is 2000. If the S&P 500 is able to get above this level it will then have a good chance of moving higher to trade in the 2040 to 2135 range that dominated most of 2015. Given the weak fundamental backdrop, it is going to be hard for the S&P 500 to break above its all time highs set last year at 2135. Nevertheless, in the next month and a half, up until the beginning of May, the S&P 500 should be able to move higher in the short-term.

We are fast approaching the unfavorable six month period for stocks, which starts on May 6th. At this point in time, it is difficult to determine if the S&P 500 will finish its seasonal run early, or if will continue with strong momentum into May. The strength of the earnings and the stock markets reaction should provide some clues. Currently, it is better to give the S&P 500 the benefit of the doubt to move higher, especially if it is able to move and stay above 2000.

Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **February 29th** 2016

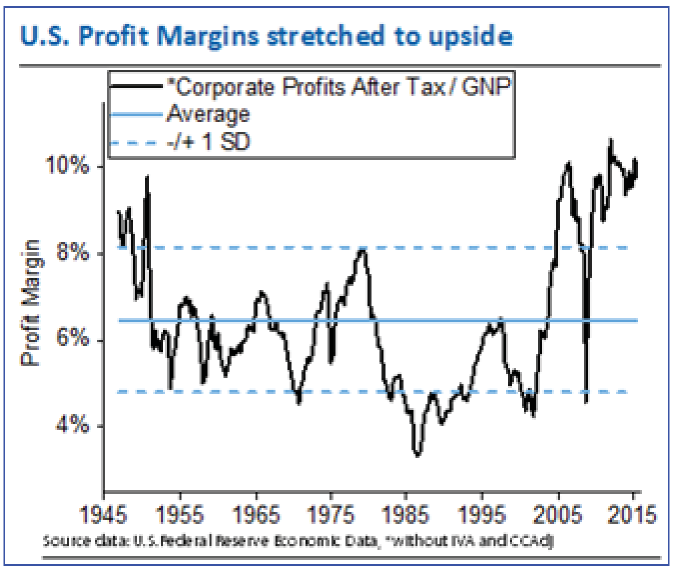
Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	40.4%
HSU	Horizons BetaPro S&P 500® Bull Plus ETF	10.0%
HXE	Horizons S&P/TSX Capped Energy Index ETF	5.8%
	United States Dollar Exposed Assets	
	Equities	
HXS	Horizons S&P 500® Index ETF	35.3%
XRT	SPDR S&P Retail ETF	5.4%
	US Dollar Forwards (March 2016) - Currency Hedge **	-0.1%
	Cash, Cash Equivalents, Margin & Other	3.1%
	Total (NAV $141,953,360)	100.0%

*** Reflects gain / loss on currency hedge (Notional exposure equals 49.5% 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.

GDP recession, which is defined as two negative quarters of economic growth. Although the energy sector has had a large negative impact on earnings, the performance of other sectors has not been stellar. As of February 26th, the energy sector of the S&P 500® saw its earnings decline by 74% on a year-over-year basis (Thomson Reuters). Overall, S&P 500® earnings are down 3.4% for the quarter.

Yes, a negative trend in earnings is a concern, but there are other troubling elements in the mix. Corporate profit margins are very stretched to the upside. Although this sounds good, the problem is that corporate profit margins tend to regress to the mean. If they are too high, competition increases driving down profit margins and if corporate profit margins are too low, then competition decreases as firms exit. With corporate profit margins at extremely high levels, the most likely direction for corporate profit margins is down.



If corporate profit margins decrease, the impact on the P/E ratio will be negative. The P/E backdrop is not particularly attractive. The current S&P 500® forward 12 month P/E ratio 16.6 (March 4th, Birinyi Associates). The trailing 12 month P/E ratio is 23.1 (March 4th, Birinyi Associates). We could spend reams of paper discussing the best method of measuring the P/E ratio and trying to establish relative value, but most analysts would agree that the current values are not particularly cheap.

The question that begs to be answered is if profit margins are high, the P/E ratio for the S&P 500® is moderate or high and U.S. economic growth is anemic at best, where is the P/E expansion going to come from? In other words how is the S&P 500® going to be propelled substantially higher from the current level?

The good news is that investors have one more kick at the can. The next earnings season starts in April, which is typically a strong month. From 1990 to 2014, in April, the S&P 500® has produced an average gain of 1.5% and has been positive 68% of the time. On average, most of the gains in April have been made in the first half of the month leading into the earnings season. Generally, investors try to get into the stock market ahead of earnings announcements in order to take advantage of any positive news. Investors tend to have a good feel for the earnings season by the 18th of the month (see *Thackray's 2016 Investor's Guide*, page 43).

If the earnings recession continues once again, this will not bode well for the stock market. It is possible for most companies to beat expectations and earnings to still be negative. Analysts generally set earnings expectations low, including the possibility of losses, making it easy for companies to beat their expectations. The six month unfavorable period for stocks starts on May 6th. It is possible that this time around, if earnings come in weaker than expected, the S&P 500® could start to fade mid-month. If earnings come in higher than expected, the momentum could help the S&P 500® move higher into May. Either way, the six month unfavorable period for stocks is less than two months away and investors should start to prepare to shift gears with their investment strategy.

What the HAC is Going On?

In February, HAC profited by taking a position in the energy sector. At the time, oil was trading in the $30 area and a lot of gurus were calling for it to go into the mid-to-low twenties. The period of seasonal strength starts on February 25th. Based upon improving seasonal strength, HAC stepped into an initial position in mid-February.... ahead of the start of the seasonal period. HAC increased its position in the energy sector towards the end of the month.

HAC did well in holding a position in silver up until mid-February. At the time, silver was trading inversely to the S&P 500, which was starting to show some strength. As a result, silver started to underperform and HAC exited the position.

Another shift that HAC has made over the last two months is decreasing its assets in the U.S. stock market versus the Canadian stock market. With the S&P/TSX Composite outperforming the S&P 500 this has helped HAC's performance.

In mid-January, HAC moved from a position of being long the U.S. dollar to being fully hedged. In February, HAC became slightly over-hedged and has benefited from a rising Canadian dollar. Investors should note that the strongest month of the year for the Canadian dollar is April.

Although HAC has been performing well, there is always room for improvement. In autumn, HAC performed well by holding U.S. investments. Since the new year, HAC has been moving assets from the U.S. to Canada and now has most of its investments in Canada. Still, there is a portion of the holdings in the U.S. broad stock market, which has been holding back HAC's performance relative to the Canadian stock market.

On a go forward basis, it is prudent to consider increasing the Canadian exposure. Of course, a lot of the decision rests on the inter sector performance of the Canadian stock market. Up until now, the major sectors of the Canadian stock market have been working well: energy, financials, gold miners and metals. Nevertheless, increasing exposure to Canada is worthy of consideration.

Seasonal Opportunities

Energy– Still room to pump higher

In my last month's newsletter, I stated that a good entry point could be developing into the energy sector. Shortly after this point, the energy sector started to outperform the S&P 500. The energy sector has been on a strong run recently and at this point it would not be surprising to see the sector to consolidate at this point. The seasonal period for the energy sector lasts until May 9th. Given that April has typically been a strong month for the energy sector, from a seasonal perspective, it still makes sense to hold a position in the sector. HAC initiated an energy position in mid-February and then increased this position late in the month.

At the end of February, HAC held a position in the energy sector (HXE).

> *My Call: The energy sector will suffer some volatility, but will probably move higher in March and April and outperform the broad stock market.*

Silver – Lost its shine

Silver and gold both performed extremely well in January and into February. In my last month's newsletter, I stated that "Silver will likely underperform if the stock market starts to rally in earnest. Consider selling if market starts to rally."

The stock market started to rally and silver started to underperform. Given that the sweet spot for the seasonal trade is from January 1st to mid-February, HAC exited its position.

> *My Call: Silver will continue to underperform over the next few months. The trade worked well, but it is probably finished*

Materials– Chemically charged

The materials trade started on time with a bang and then performed at market for the next few weeks. Recently it has been showing signs of outperformance. The trade has benefited from two of its sub sectors performing well: chemicals and gold miners. The chemicals sub sector tends to continue to perform well up until the beginning of May. Although gold has been providing a positive benefit, gold does not have strong seasonal support at this time.

My Call: The materials sector will probably outperform the S&P 500 over the next few weeks. The risk to this trade is that it will finish before the end of its seasonal period at the beginning of May. Position should be monitored for early exit.

Industrials– Building a base for last move

Similarly to the materials sector, the industrials sector started its seasonal period with a bang and then flattened out. Recently, the sector has been showing signs of strength. If the industrials sector ETF - XLI is able to rally above $55 this should bode well for the industrials sector.

My Call: The industrials sector will probably outperform the S&P 500 over the next few weeks. Monitor for weaker performance once the stock market starts to enter into earnings season in April and consider exiting if the sector starts to underperform the S&P 500.

Retail– Do not return yet

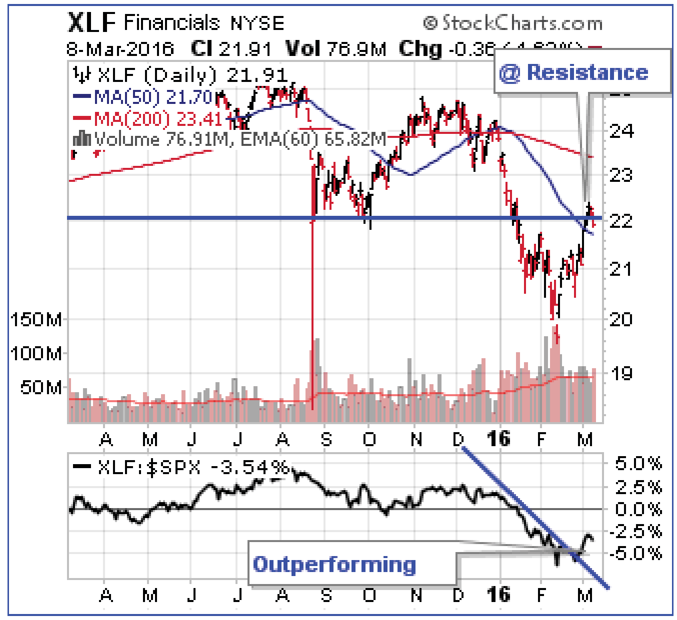
The retail sector has been on fire recently. After underperforming since September of last year, the sector was poised to perform well in its seasonal period once again. This retail trade at this time of the year has a high frequency of outperforming the S&P 500 at this time of the year (see *Thackray's 2016 Investor's Guide*, page 9).

My Call: The retail sector should continue to outperform the S&P 500, but the pace of outperformance will probably slow. Investors should be looking to exit this sector in mid-April, or earlier if it starts to underperform.

At the end of February, HAC held a position in the retail sector (XRT).

Consumer Discretionary– Starting to fade

The consumer discretionary sector had a strong surge of outperformance in January. In March, it has started to show signs of weakening performance relative to the S&P 500. At this point, the consumer discretionary sector is not a preferred sector and would have to show better performance before being considered a top seasonal sector.



My Call: The consumer discretionary sector will probably perform at market for the next month. If this sector were to outperform the S&P 500, this would be bullish for the overall market.

My Call: The financials sector will probably perform at market, despite a recent spurt of outperformance. The sector should be monitored for continued outperformance.

Financials– Trying to overcome headwinds

The U.S. financial sector has been underperforming the S&P 500 since the beginning of the year. HAC was previously invested in the sector, but exited in January due to its weak performance. The financial sector has some strong headwinds as any positive economic data that is released is viewed as pushing the U.S. Federal Reserve's interest rate rise schedule forward and thus hurting the net interest benefit of the banks and therefore diminishing the potential of the sector to perform well.

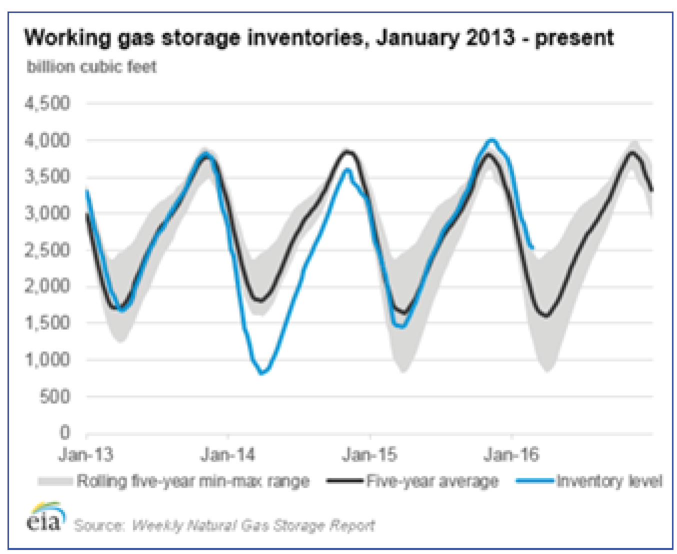
In addition, all the worldwide talk of negative deposit interest rates is having an effect on global banks. Although the U.S. is probably not going to use negative deposit interest rates anytime soon, the "echo" effect is having a negative psychological effect on the U.S. banks.

If the U.S. banks were to outperform, this would be very bullish for the S&P 500. If the financials are one of the top sectors in the market, it very often supports an extended rally.

Natural Gas– Low price at start of seasonal period

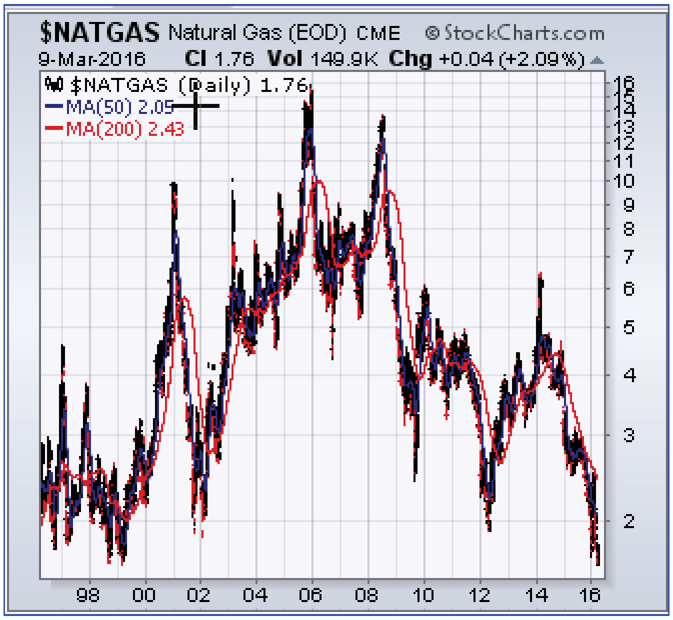
The seasonal period for natural gas is from March 22nd to June 19th (see *Thackray's 2016 Investor's Guide*, page 47).

Okay...the fundamentals for natural gas are not necessarily strong. The inventory levels of working gas are extremely high. If you are interested in the fundamental statistics, one of the best sources of information on oil and natural gas is the U.S. Energy Information Association website. For natural gas, inventory report go to http://ir.eia.gov/ngs/ngs.html.



The graph above from EIA, does a good job of summarizing the current working inventory situation. We are currently well above the five year average storage levels and above the highest level for this time of the year.

Below is the graph of natural gas prices for the last twenty years, putting the current low prices in historical context.



The point is that the weak fundamentals are built into the price. We are currently trading at 20 year lows. Yes, natural gas could trade much lower, but the sensitivity to the upside resulting from less negative news than expected is strong. We are currently moving into the injection season where inventories increase. As we approach the summer, hotter than expected forecasts tend to drive up the price of natural gas as it is required to produce electricity to run air conditioners.

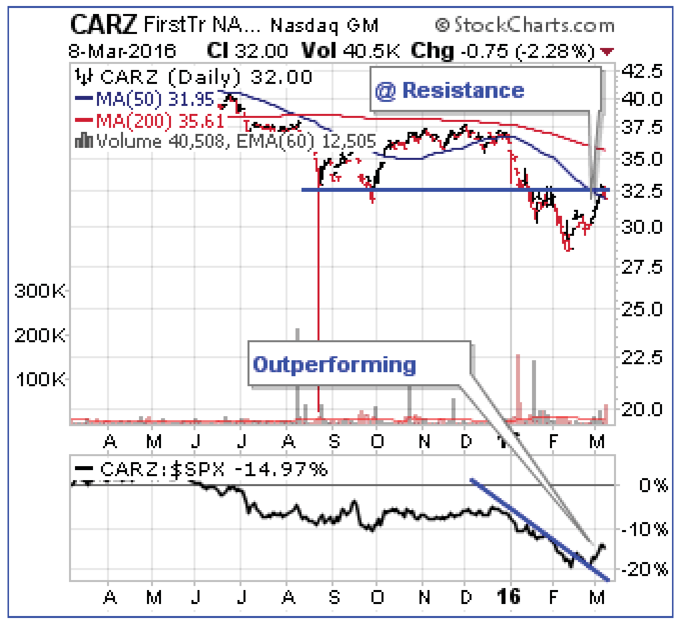
Currently, natural gas has bounced off a bottom at the beginning of March, and has triggered a full stochastic oscillator buy signal.

My Call: Natural Gas will probably bounce higher and perform well in its seasonal period

Automotive Sector– Driving higher

The automotive sector tends to perform well from February 24th to April 24th (see *Thackray's 2016 Investor's Guide,* page 23).

The current argument going around against the automotive sector is that car sales were high last year and so therefore they should be softer this year. I don't buy into this argument as car sales remain strong. Let the relative performance of the sector determine if the sector is attractive....so far it is working.



My Call: The automotive sector will continue to perform well in its seasonal period. Look for it to finish its seasonal trade early this year...sometime in mid-April, after the earnings season gets underway.

Linamar– Producing improving returns

Linamar broke above its downward trend line in February. Recently, it has shown a bit of weakness relative to the S&P/TSX Composite. Given the strength of energy in this time period (boosting the S&P/TSX Composite), this is not a major concern.

My Call: *Linamar will be volatile but will probably outperform the S&P/TSX Composite over the next month*

Eastman Chemical– Strong but resistance ahead

Eastman Chemical has a strong track record of outperforming from January 28th to May 5th (see *Thackray's 2016 Investor's Guide*, page 21).

Eastman Chemical started its seasonal run a few days late but has performed extremely well since. The seasonal trade continues until early May. Eastman Chemical may run into some resistance at $72.50, but currently the trend looks positive.

My Call: Eastman Chemical should continue to outperform during its seasonal period. Investors should look for possible fading performance in late April after earnings season gets underway.

Brooke's Rant–

Mario to the rescue....for now !

At the time of writing this rant, the President of the ECB Mario Draghi has just released aggressive monetary policy actions to help stimulate the economy. Mario Draghi:

(1) Decreased the benchmark rate from 0.05 percent to zero

(2) Increased its monthly bond purchases to 80 billion euros ($88 billion) from 60 billion euros

(3) Decreased the commercial bank deposit rate at the central bank to minus 0.40 percent from minus 0.30 percent

In summary, these actions were greater than expected. What did you expect? Last time Mario Draghi's monetary policy announcement in December under whelmed investors and they reacted negatively. As a result, Mario Draghi had to make unexpected dovish statements to the press the next day in order to placate investors. This time the prudent action was to give investors more than they wanted.

Brooke Thackray's – Guide On How To Get the Most out of Monetary Policy Decisions

Sometimes, a large, over the top, decision is needed from monetary policy authorities in order to be effective. This type of approach is best used when there is a real potential of the economy spiralling out of control. A good example of this type of action was the Federal Reserves initial quantitative easing actions after the financial crisis in 2008/2009.

Extreme policy with action beyond expectations is needed to convince the investment world that the central bank is serious about solving the problem. Investor's have to be convinced the central bank will do "whatever it takes" to solve the problem.

Initially, after the financial crisis, the Federal Reserve did all of the heavy lifting with its easing monetary policy. The Eurozone did virtually nothing as it rode the Federal Reserve's tail. There were lots of promises from the ECB, but very little action. Investor's believed that the ECB would follow suit if it had to and that was enough to placate investors for a while. Eventually, the ECB had to show some signs of action and that they would back Mario Dhragi's pledge to do "whatever it takes" to stimulate the Eurozone.

The strategy of executing monetary policy in more stable times requires a completely different approach. Currently, the world believes that the hangover from the financial crisis has largely been solved and that we are only suffering a minor growth problem (I am not so sure.....a discussion for a different time). As a result, central banks do not need to pull out the bazooka. They have an opportunity to "milk" the most of their policies.

Instead of going to zero....or in this case a large negative number, the central bank will typically try to gradually control the flight path. The best strategy to accomplish this objective is to alternate back and forth between doing more or less than the investment community expects. In other words, keep them guessing. If the investment community expectations are always exceeded then monetary "bullets" will be wasted as investors become hungrier for more aggressive action. In other words, if the central bank continually exceeds on the easing side, then investors will expect even greater easing in the future. Why create a bigger problem than already exists.

In December, Mario Draghi released monetary policy that fell short of expectations. This time around, he exceeded expectations. Next time around he will probably fall short of expectations or at least get closer to them. This is not a rock solid pattern of under-over, under-over and so on. A central bank will sometimes exceed expectations several times in a row. The point is that the one thing the central bank does not want to do, is in relatively stable times create a consistent pattern of exceeding expectations or falling short of expectations.

The U.S. Federal Reserve is in a tightening phase, but the same strategy applies to Janet Yellen. If she tightens too much, or the language around the tightening is too hawkish, expect her to back off from this stance. On the other hand, if she does not raise interest rates when investors expect, then expect her to talk tough about the possibility of raising rates.

In the end, it all seems to be a game, investors trying to read what the central bank will do and the central bank guessing how they can best accomplish the task while placating investors.

So investors should take solace in that if the central bank does not do what they want this time around, maybe next time the central bank will be more cooperative.

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