Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

The stock market is not well setup to advance strongly over the next six months (the unfavourable period for stocks) and is susceptible to a correction. See my recent report *Stocks are in for a Rough Summer,* on my website www.alphamountain.com or visit http://bit.ly/1oSL0En.

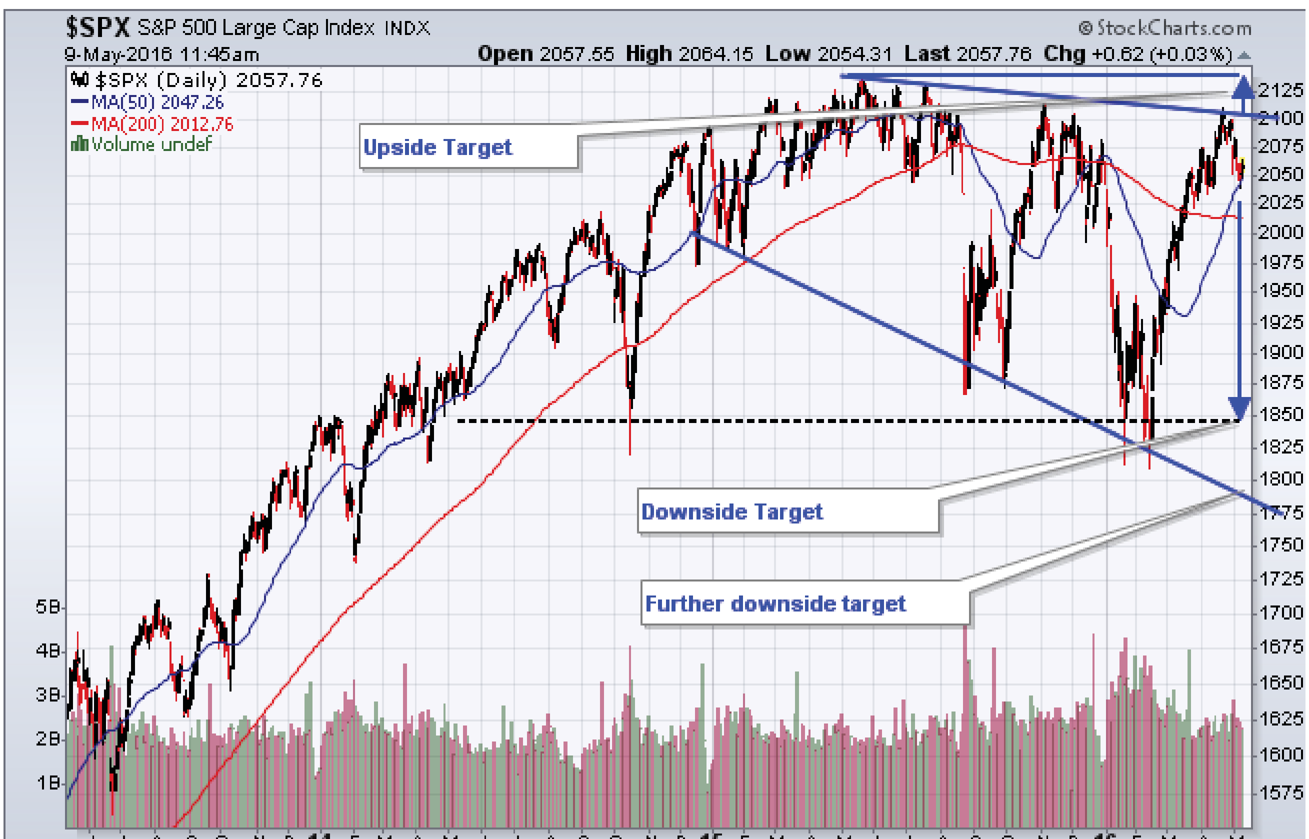
Starting the unfavorable period for stocks does not mean that the stock market will immediately plunge. In fact, there are no assurances that the stock market will be negative when the next six months comes to a finish. Since 1950, the unfavorable period for stocks has been a volatile time period that has produced an average geometric loss of 0.5%. A lot of pundits point to the fact that the S&P 500® has been positive 63% of the time in its unfavorable period as a reason to stay fully invested at this time. They are clearly missing the point and are not considering risk adjusted returns. It is not possible to determine in any one year, if a loss or gain will occur, but on a long-term risk adjusted basis it is best to adjust a stock portfolio to be more conservative. Why take large risks in a time period that has on average lost money?

The six month unfavorable period for stocks does not mean that you go fishing and come back in six months….

S&P 500 Technical Status

Is It Worth It?

The S&P 500 is close to its all-time high, and has a low probability of moving substantially above this point, especially given that the stock market has entered its six month unfavorable period for stocks. The downside potential for the S&P 500 is greater than the upside potential, making this a time to be conservative in the stock market. There will be times in the next six months where increased beta may make sense... just not now.



Horizons Seasonal Rotation ETF (HAC :TSX)
Portfolio Exposure as of **April 30th** 2016

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HFR	Horizons Active Floating Rate Bond ETF	9.4%
	United States Dollar Exposed Assets	
	Equities	
HXS	Horizons S&P 500® Index ETF	71.5%
	Commodities	
HUN	Horizons NYMEX® Natural Gas ETF	4.9%
	US Dollar Forwards (May 2016) - Currency Hedge **	2.2%
	Cash, Cash Equivalents, Margin & Other	12.1%
	Total (NAV $174,150,727)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 62.5% 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.

although if you enjoy fishing this strategy can make sense. There are ample seasonal opportunities in the stock, bond and currency markets to help ride through the unfavorable period.

What can push the stock market higher above its previous all-time highs? I keep asking myself this question but I do not see a strong catalyst that can drive the stock market substantially higher. The three drivers over the past seven years have been:

♦ ***earnings,***

♦ ***strong economic reports,***

♦ ***central bank loose monetary policies***

These three drivers are not set to provide the necessary muscle to power the market higher. We are just finishing up the earnings season and for the fourth quarter in a row they have been negative on a year-over-year basis. Hardly the jet fuel needed to move the market higher. In addition, the earnings season is largely over and the next earnings season will not have an impact until late June and early July.

It is possible that in the next earnings season companies will surprise to the upside and just being positive for the first time in more than a year, investors will view this as an inflection point and a sign of better times ahead. Nevertheless, the earnings would have to be strongly positive to have a meaningful impact.

The recent economic reports have been less than stellar. The last week ended with a dismal 160,000 increase in the Non-Farm Payroll report, 40,000 less than expected. This has not been the only disappointing economic report recently. It is possible for economic reports to reverse direction, but large improvements would be needed to have a meaningful impact on the stock market. Large scale reversals usually take place off the bottom of recessions or through aggressive monetary action. The U.S. is not bouncing off a recession and the Federal Reserve is not set to introduce another quantitative easing program in the near future.

Central bank policy is becoming ineffective. On this side of the ocean, the U.S. has very few monetary policies left with which to experiment. At the beginning of 2016, the stock market went into a free fall as the Federal Reserve was initially pushing out the dialogue to expect four interest rate increases in the year. When they backed off this position, the stock market responded with a strong rally in February. Now that investors do not expect the Federal Reserve to increase interest rates at a fast pace, does it really matter if they delay yet another few months for the next successive rate increases. It doesn't. Watch for the Federal Reserve to keep the conversation alive by putting forward the possibility of increasing rates. Investors do not really believe the Federal Reserve's expectations for future increasing rates.

Can the stock market climb the Wall of Worry?

How many times have we heard the saying that the stock market is climbing a wall of worry. This expression is used to describe a condition when the stock market continues to advance when the majority of investors are negative on the stock market's outlook. Stock markets climb a wall of worry after they have been advancing for an extended period of time and the supporting conditions have turned negative. This is currently not the case. The S&P 500® has been in a consolidation range around the 2100 level since late 2014. A strong rally above 2131, the all-time high in the S&P 500® set last May, is going to require a lot more support than the market sneaking higher without a strong catalyst. It could happen…but not likely.

What the HAC is Going On?

In April, HAC outperformed the S&P 500®, but lost ground to the S&P/TSX 60™ Composite Index. HAC's "calls" on the stock market, the sectors of the market and currency were effective. HAC fell short because of its emphasis on the U.S. stock market versus the Canadian stock market.

In the first quarter and April, the S&P/TSX 60™ Composite Index finally outperformed the S&P 500® in a meaningful way. This is really the first time that this has happened in over seven years. The deflationary trade (expecting disinflation) has persisted for an extended period of time, which has favored the U.S. stock market. The current outperformance of the S&P/TSX 60™ Composite Index has largely been based on, not only a falling U.S. dollar, but also an investor sentiment shift to accepting the possibility of reflation.

I am not going to make a call and say that the deflationary trade is over, but I will say that investors are more accepting of the possibility of the reflation trade that benefits commodities and the subsequent companies.

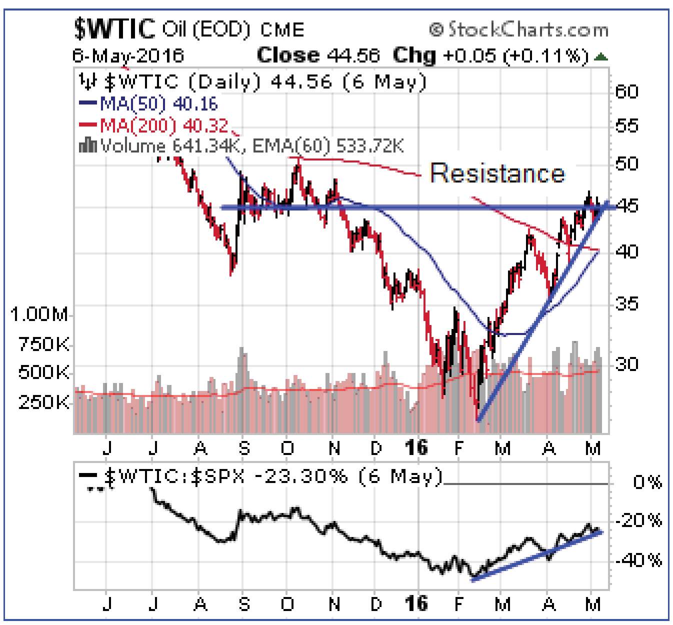
What does this mean for future investments? Up until this particular cycle, the cyclical seasonal trades have lagged. The success of the current reflation trade increases the possibility of success in future similar trades, particularly in their seasonal period. Investors have shown their willingness to enter into cyclical sectors that have been forlorn for years. In the past, HAC has invested in the cyclical sectors of the stock market in their seasonal period, but on a fairly tentative basis using smaller positions and tight stops. In the future, HAC will endeavor to give the sectors of the market that benefit from the reflation trade increased emphasis

Seasonal Opportunities

Energy

Oil has performed well in its seasonal period…once again. As a result, energy stocks have also performed well. Although the seasonal period for energy stocks has just finished, the sector is getting a push from unfortunate supply constraints. Fort McMurray Alberta has been evacuated as parts of the town have been destroyed by wildfires and the rest of the town is being threatened. It is estimated that the shuttering of the oil facilities in area surrounding Fort McMurray has resulted in a production reduction of 1 million barrels of oil per day. All of the different levels of government and private citizens have been helping deal with a terrible tragedy, but it going to take some time for the town to deal with the situation. Supply has also been reduced in Libya because of regional disputes once again.

The current supply constraints can help provide support for the energy sector, but the seasonal period for the energy sector has come to an end. Seasonal investors should be looking to exit the sector on weakness.



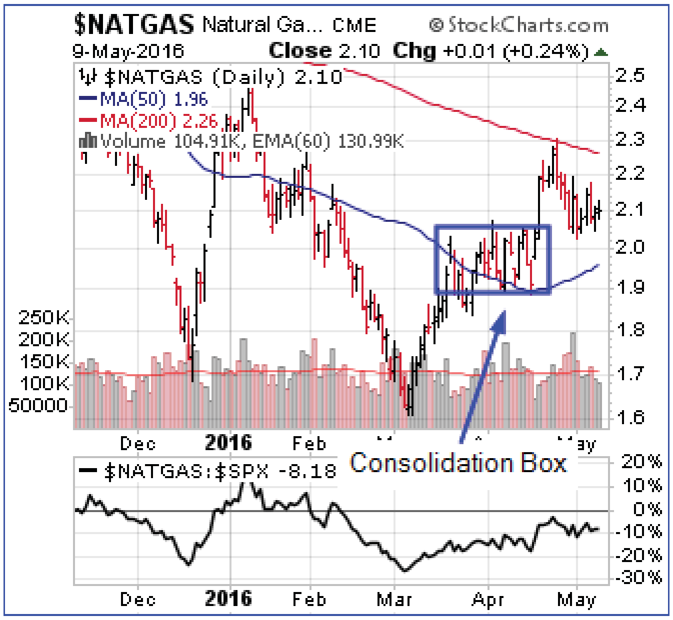
HAC exited the energy sector in late April, as the sector was starting to show signs of weakness at the time. HAC's goal is to capture the benefit of sector outperformance during a seasonal period. Although HAC can hold a position in a sector past its seasonal period if it has strong momentum, once HAC leaves a sector at the end of its seasonal period, HAC would typically not reenter the sector. HAC does not have an objective to invest where there is a lack of seasonal justification.

Oil, the commodity, has not quite broken down yet, but energy stocks have broken their downtrend line, showing more relative weakness.

My Call: The energy sector has finished its seasonal period. It is possible for the sector to tick higher, but the big gains have been made. The more likely path for the sector is down.

Natural Gas

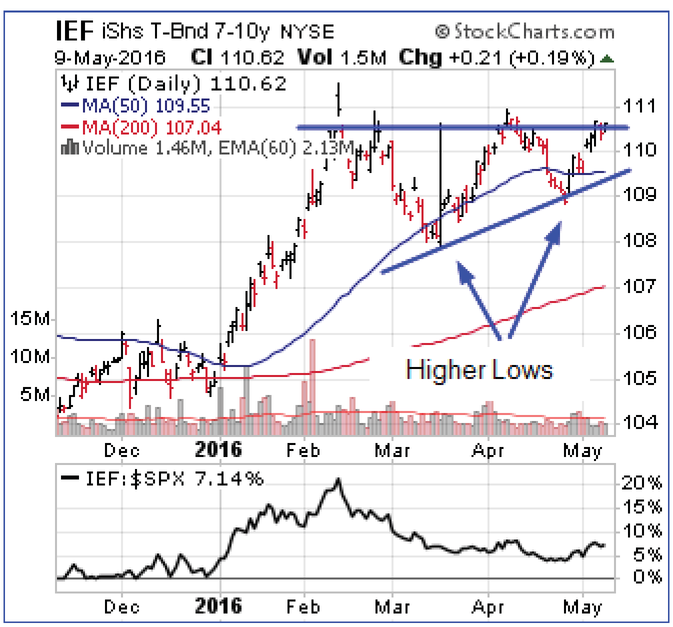
Natural gas has provided a volatile ride but overall is still positive. Natural gas typically trades around its inventory report that is released every Thursday. Generally, if the natural gas inventory is higher than expected, then natural gas prices decline and vice versa. From a seasonal perspective, the magnitude of the gains from a lower than expected inventory number tend to be greater than the losses on a higher inventory number– hence, the positive seasonal benefit. The seasonal trade finishes on June 19th (see Thackray's 2016 Investor's Guide, page 47). If the price of natural gas starts to underperform, with the spot CME price dropping well into its consolidation box, investors should consider exiting the trade.



> *My Call: The price of natural gas has performed positively in its seasonal period. It is expected to continue to drift upwards.*

U.S. Government bonds

Government bonds have a seasonal period that lasts from May 9th to October 3rd. The real sweet spot to the trade starts in late July and runs into the beginning of October. The major reason that government bonds increase at this time is that when the market suffers a downturn and increased volatility in the summer months, the marginal investor exiting the stock market is looking for a viable investment alternative.



U.S. Government bonds performed well in the first quarter as investors bid up their price in reaction to the U.S. Federal Reserve pushing out its "planned" interest rate increases. The previous positive performance does not negate a seasonal trade, but the setup is not as strong, but still worth the investment.

> *My Call: U.S. government bonds are expected to perform positively. The returns may not be large at this point but the trade is still a good hedge to the market. The trade may come under pressure towards the end of May as we get closer to the next June FOMC meeting. It might be worthwhile to exit the trade at this point and re-enter in late July. TBD later this month.*

Canadian bonds

The Canadian bond sector has the same seasonal period as its American counterpart. Global growth concerns affect the Canadian economy much more than the U.S. economy, helping to drive bond prices higher when weak economic reports roll in.

Canadian bonds have performed well and have currently broken above resistance.

> *My Call: Canadian bonds have had a positive breakout. The prospect for Canadian bonds is greater than U.S. bonds as the economy is slowing and the Canadian bond market does not suffer from the Federal Reserve Guessing Game.*

Consumer Staples

The consumer sector has started its seasonal period. Investing in the consumer staples sector in the unfavorable six month period for stocks does not necessarily guarantee positive performance. On average, the consumer staples sector has outperformed the S&P 500 at this time, but if the stock market suffers a big drop, the consumer staples sector is not immune.

Over the long-term, the consumer staples sector provides greater value than the broad market in the summer months. At the current time, the sector is richly valued and investors should look for ideal entry opportunities. The sector could provide tradeable opportunities this summer.

My Call: *The consumer staples sector has started to show some strength relative to the S&P 500 in May. We are currently in period of seasonal strength for the sector. Expectations are that the sector will be mildly positive over the next few months. Look to trade the sector.*

Gold - Stay Away for Now

Gold is not in its seasonal period, nor are gold stocks. Both sectors have performed well since the beginning of the year.

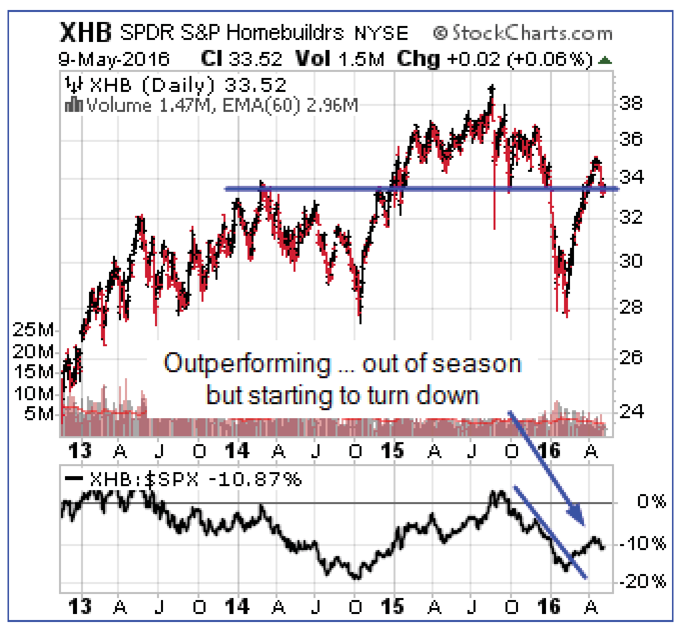
Gold can perform well at the beginning of the year, but typically silver is the better play. HAC entered into a silver bullion position in late December and sold it in mid-February.

Although gold has performed well, May and the first part of June tend not to be strong for gold bullion. Given that gold is currently overbought, and is in the weaker seasonal period, investors should be cautious with this trade. Gold and gold stocks have seasonal periods that start in July. Under the right circumstances, entry into the gold seasonal trade could take place in late June, but given how overbought the sector is, it is probably best to wait until July. The exception, of course, is if a sizeable correction takes place in the gold sector and sets up the sector for a good entry point in late June.

My Call: Gold will consolidate and be lower towards the end of June and early July. At this point it is probably best to wait for a better entry point.

Short Sells

Homebuilders - Short Sell - Trade ends June 13th



Homebuilders outperformed the S&P 500 during the rally of the February bottom. Recently, the sector has started to turn down. If the market performs poorly, expect this sector to lose more ground than the S&P 500. The trade is currently well setup for this outcome.

My Call: The homebuilders sector will slowly roll over and will underperform the S&P 500 over the next month.

Nikkei - Short Sell

The Japanese stock market has been underperforming the S&P 500 since December 2015. After recent positive performance, the Nikkei dropped when the Bank of Japan (BoJ) did not introduce the stimulus that investors expected. The BoJ currently has a conundrum, as the Yen has been gaining in value even as monetary stimulus has been added. Foregoing the anticipated stimulus did not help as the yen picked up in value once again. The BoJ is contemplating stepping into the currency markets to weaken their own currency.

My Call: The Nikkei will be volatile, but end up lower by autumn. The yen is a difficult call relative to the U.S. dollar as volatility is expected based upon currency intervention and further quantitative easing.

Brooke's Rant

What happened in Japan?

Recently, at a Bank of Japan (BoJ) policy meeting, investors were expecting the Japanese central bank to introduce more monetary stimulus. Investors were surprised when the BoJ did nothing and as a result they sold the Nikkei down sharply.

Make no mistake, the BoJ will continue to use some sort of monetary stimulus as they have no choice, but to keep their monetary experiment going. Like so many other countries, the BoJ really expected that the monetary stimulus would breathe life into their economy and it would gather steam by itself. No such luck. Japan is still sputtering along like every other country.

At this point, the BoJ probably wanted to move investors away from the expectation of constant quantitative easing. It did not work, the stock market went down and the yen went up.

The problem is that Japan is running out of tools. How low can their negative interest rates go? How much more money can they print? Japan will probably be the first country to use helicopter money, which is basically printing money and placing it in the hands of the consumers, instead of investors. The idea is that consumers will stimulate the economy.

Japan is desperately trying to create inflation in their economy. They have been doing this since 1990. Looking back now, it is easy to see that they should have tried to fix their structural problems in their economy. Back then so many companies were owned by each other and Japan was so concerned about increased unemployment that they only tried band-aid solutions. Obviously, their solutions did not work as they are still battling the same demons. Another story for another day.

Japan wants inflation and helicopter money will create it. The problem is that it can get out of hand very fast. I am sure that if the central bankers start to consider using this tool, they will assure the markets that it will only be used in small doses in a controlled manner.....good luck on that one.

As I have said many times before, watching Japan is like watching a slow motion train wreck. It is going to crash and nothing can be done. With a debt to GDP ratio over 200% and an aging population the problem is not fixable. Japan thinks that they can grow their way out of their problems. Not likely.

As I have also said before, there is one sneaky solution to delay the inevitable. In the coming years, watch for Japan to roll out their debt along the yield curve, changing all of their short-term maturities into long-term dated maturities. This will not solve the problem, only delay it. Unfortunately, this game of bond maturity chicken will be exposed before Japan is able to play it out. The markets will demand high interest rates that Japan cannot afford. This is a few years away...but I don't see any other outcome.

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