Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

Published the 10th Calendar Day of Every Month

Volume 13, Number 2, February 2019

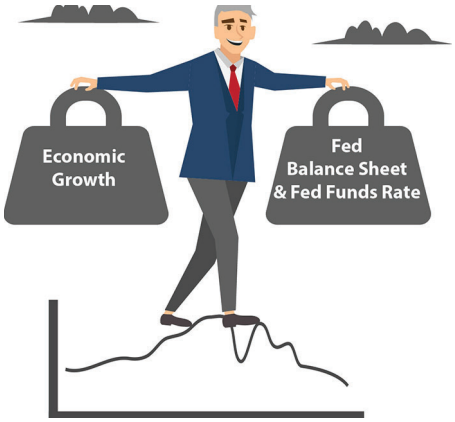
Written by Brooke Thackray

Thackray's 2019 Investor's Guide

Available in all fine bookstores, Amazon and Barnes & Noble

Lot's of new strategies....

Powell's Balancing Act
Will it be successful?



Market Update

We live in a world of instant gratification, with tweets and instant messages and updates. Investors react to every major economic announcement as soon as it is released,

S&P 500 - Technical Status

The much followed market signal, the 200 day moving average, broke to the upside three times in late 2018 (red arrows in Oct/Nov/Dec), only to have the S&P 500 move lower. The S&P 500 has just recently broken above its 200 day moving average (again). This upside break does not necessarily ensure a strong rally at this point. In fact, the S&P 500 is just below major resistance at 2800. It failed this level numerous times in 2018 (red arrows). A strong break above 2800 would be positive for the S&P 500 and would probably mean that old highs could be tested. A concern is that the rally has been accompanied by low volume. Investors do not have conviction in this rally. The S&P 500 is still in its strong seasonal period which could help support a rally over the next 2 to 3 months.

Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **January 31st,** 2019

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	47.8%
HEWB	Horizons Equal Weight Canada Banks Index ETF	9.9%
HXF	Horizons S&P Capped Financials ETF	5.1%
HXE	Horizons S&P Capped Energy ETF	5.0%
	United States Dollar Exposed Assets	
	Equities	
IWD	iShares Russell 1000 Value ETF	10.5%
IWM	iShares Russell 2000 Value ETF	9.8%
IJH	iShares Core S&P Mid-Cap ETF	9.1%
	US Dollar Forwards (January 2019) - Currency Hedge **	0.1%
	Cash, Cash Equivalents, Margin & Other	2.7%
	Total (NAV $224,934,205)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 34.3% 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.

pushing the stock markets up or down. It is how we expect the world to operate.

Monetary and fiscal policy do not fit into our "instant" world. Any policy changes take time to effect the economy, particularly fiscal policy. There is typically a lag of a year or two before the effects are felt. When the Federal Reserve says that it is data dependent, it is, but it is using the trend of the current data to make decisions for the future. Whatever they do today, will affect the economy tomorrow. It is a difficult process.

Overall, the Federal Reserve has done poor job enacting policy (including Bernanke and Yellen). After the initial round of quantitative easing in the Great Recession of 2008 and 2009, the Federal Reserve has been consistently behind the ball in getting the federal funds rate up to a neutral level. The stock market responded positively to the Federal Reserve's consistent stimulus of low interest rates, which caused a misallocation of capital.

Powell, to his credit tried to get the federal funds rate back to neutral where the rate is neither stimulative nor restrictive and reduce the Federal Reserve balance sheet. Unfortunately, economic conditions around the world have continued to deteriorate and Powell was forced to shift the Federal Reserve's policy stance abruptly. He should never have overstated the rising rate case, but that is another issue.

Despite the Federal Reserve's recent strong dovish stance, it will take any opportunity it can to raise rates and decrease its balance sheet. Powell's dovish statements in December and January did not erase its previous hawkish October stance, it only put it on "pause."

At the last FOMC meeting, Powell hinted that the Federal Reserve may take a look at adjusting the current rate of its balance sheet reduction. Balance sheet adjustments are typically not made very often. Such an act would help solidify the Federal Reserve's dovish shift.

Has the damage already been done?

Powell is playing a balance act adjusting monetary policy to economic conditions. If the economy shows signs of strong growth, increase rates or become more hawkish. If the economy shows signs of slowing, hold rates. In effect, the Federal Reserve has indirectly "capped" the potential returns in the stock market. Economic growth is the background for increasing corporate profits which helps push the stock market higher.

It is possible that despite the Federal Reserve's recent dovish shift, the tightening that occurred last year may be set to cause its damage this year. The effect of rising rates and decreasing the balance sheet does not occur right away and can take over a year or more to really have an impact. This is what makes the Federal Reserve's job so tough. The momentum of the previous year's data is not known until next year. Even then, it is not really known.

The damage from the previous Federal Reserve's tightening action could already have been done. The economy could roll over into a recession despite any policy action implemented by the Federal Reserve.

Is the stock market doomed?

Not necessarily. If the Federal Reserve is successful in continuing to "kick the can down the road" the stock market can continue to make gains. Probably not huge gains, but gains nevertheless.

We are in a totally different world today compared to a couple of years ago. It was not long ago that the Federal Reserve was making a decision on whether to pause or apply the brakes to quantitative easing programs. Today they are trying to decide whether to pause or apply the gas pedal on quantitative tightening. Sure, some investors think that the next move will be for the Federal Reserve to cut rates, or reverse its quantitative tightening program. It will be difficult for the Federal Reserve to take such action, without significant erosion to the economy and/or the stock market.

At this stage in the market cycle, investors would be wise not to expect a strong multi-year stock market rally. Any signs of a sustained market rally will probably be capped by the Federal Reserve becoming more hawkish and ramping up its runway of increasing rates. Investors would be wise to temper their expectations.

Bullish or Bearish?

Neither. I am neither bullish nor bearish. At the current time there is a lack of a catalyst to move the stock market higher. Of course Trump could sign a deal with China addressing some of the trade issues, which would probably push the stock market higher. It is doubtful that it would create a multi-month stock market rally.

The stock market could "climb a wall of worry." In this circumstance the market continues to move higher despite investor bearishness. This tends to be a frustrating experience for "bearish investors" as the stock market seems to defy logic.

The bottom line is that in the short-term it is difficult to predict short-term market movement, despite the lower expectations for stock market gains over the next few years.

Seasonal value added

Investing based upon seasonal trends, helps reduce the anxiety of a bull-or-bear market perspective. Seasonal investing helps make investment decisions over a multi-month time period, in which it is often difficult to determine the direction of the stock market. Based upon seasonal probabilities, it helps to increase the odds of success investing in sectors of the stock market, or the broad stock market itself.

Where do we stand right now? Currently, we are in the second half of the six-month favorable period for stocks which runs from October 28th to May 5th. March and April tend to be two of the stronger months of the year. From a seasonal perspective, it is prudent to be invested in the stock market at this time as there is a higher likelihood of gains compared to any two month contiguous period over the following six months.

What the HAC is going on?

In the month of January, HAC was fully invested in equities. In December, HAC changed its allocations by decreasing its sector based holdings and increased positions in the broad market indices. Often, the cyclical sectors suffer in the first part of January and it is best to take a broad market position until the sectors "sort themselves out." During January, HAC increased its Canadian stock market holdings relative to the US. HAC also decreased its exposure to the US dollar as the strong seasonal period for the Canadian dollar, the month of April, is approaching.

Seasonal Opportunities

Small Caps – Ending seasonal period soon

After breaking its downtrend in late December, the small cap sector has recently been consolidating relative to the S&P 500. Currently, the sector is within one month of end date for its seasonal period. At this time, a move higher or lower relative to the S&P 500 would probably establish a new trend. If the sector starts to underperform the S&P 500, consideration should be given to exiting the sector. On the other hand if the sector starts to outperform the S&P 500 it could outperform the S&P 500 past its seasonal period.

My Call: The small cap sector will probably mildly out perform over the next two to three weeks before ending its seasonal period.

US Financials – Not showing strong leadership

The US financials underperformed the S&P 500 for most of 2018. The sector started to improve relative to the S&P 500 in late December as the stock market turned positive. It has failed to continue its strong momentum and in mid-January started to underperform the S&P 500. At the same time, on an absolute basis, it failed to break above its trend line.

The financial sector's poor performance is not a good sign for a sustained stock market rally. As I mentioned in my January newsletter, a stock market rally with the financial sector being one of the top performing sectors, tends to have "legs." It tends to have sustainability. A strong financial sector is a sign of a strong economy. So far, the performance of the financial sector does not bode well for the sustainability of the current rally.

My Call: The financial sector will probably continue to underperform the S&P 500, which is not supportive of a multi-month stock market rally.

Canadian Banks – Look for break out of consolidation box

Canadian banks have been performing at market, equal to the S&P/TSX Composite Index since September. The sector is currently below resistance.

There is a lot of talk in the media regarding the Canadian banks susceptibility to underperforming the stock market if a recession were to occur. Although this is a reasonable argument, on a seasonal basis, Canadian banks tend to perform well in the month of February and into mid-April. At this point, if relative performance of the sector compared to the S&P/TSX Composite were to improve and break upwards out of its consolidation box, this would be an indication that banks could run to the end of their seasonal period in mid-April, or further. On the other hand, if the Canadian banking sector were to break downwards out of its relative performance consolidation box, it could be an indication that Canadian banks are finishing their seasonal period early.

My Call: The Canadian banking sector will probably outperform the Canadian stock market over the next two months, but trouble could loom for the sector after this time.

Industrials – banking on improving trade negotiations

The industrial sector has been performing well since its low in late December and has managed to outperform the S&P 500. The industrials sector has managed to break above its resistance level on an absolute basis, but has still not broken above its trend line relative to the S&P 500.

The positive performance of the sector is largely based upon increasing expectations that progress will be made on a trade deal between the US and China.

My Call: The industrial sector will probably slow its outperformance relative to the S&P 500, but manage to outperform in its seasonal period that ends May 5th.

US Materials – Good relative value?

The US materials sector has performed at market since its December low. This is in contrast to the industrials sector, which has managed to outperform the S&P 500. Both sectors were previously hurt by trade war negotiations between the US and China. As the climate appears to have improved in the trade negotiations, the materials sector has not benefited, compared to the industrials sector.

Given, that the materials sector is at the bottom of its relative trading channel compared to the S&P 500, the materials sector could provide an attractive opportunity that has a seasonal period that finishes on May 5th.

My Call: The materials sector will probably outperform the S&P 500 over the next two months and represent a better seasonal opportunity than the industrial sector.

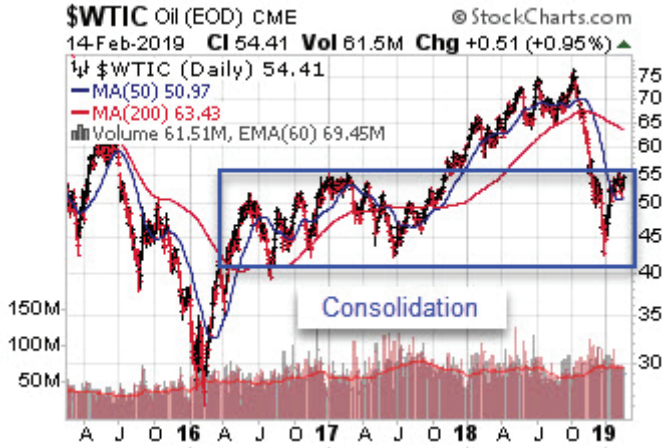
WTIC – break above $55/56 is positive for the sector

Oil has formed a trading range between $42 and $55. In 2017, oil made a bullish move out of the box climbing to $75 on bullish forecasts. In late 2018, the price of oil tumbled as increasing supply and a shift to a risk-off mode by investors pushed the price lower. To make matters worse for oil, Trump had convinced Saudi Arabia to increase production to offset the effects of the Iranian sanctions. Overall, oil supply increased as Trump handed out waivers for countries to buy Iranian oil. In addition, US producers cranked up the pumps and produced record amounts of oil.

As the stock market bottomed in late December, the price of oil bottomed at the lower end of its consolidation box. The price of oil has since moved just above the top end of its consolidation box, just over $55. Overall, this is a positive development.

There will be a lot of discussion in the media about how an oil price above $55 is going to "turn on the oil pumps" with the shale producers and bring the price of oil lower. There is no question that a higher price of oil will provide an incentive for producers to increase production. Nevertheless, oil prices can still move higher. The US is already producing record amounts of oil. They can still increase production, but because they are have already cranked up production, it is hard for them to dramatically increase production in the short-term. It is not as if they have a large amount of capped wells that are ready to be turned on. In addition, OPEC's recent commitment to cut production, will help support higher prices.

In 2017, the price of oil broke above $55, when it seemed that everyone was saying that increased production would cap any upside movement. The price of oil continued to rise to over $75 in 2018.



My Call: The price of oil will probably continue to rise until the May/June time frame.

Energy Sector – One of the stronger seasonal trades at this time

Last year, the energy sector was profitable in its seasonal period from February 25th to May 9th. Most investors lost money in the energy sector last year, but that is what seasonal investing is all about: Investing in a sector of the stock market when it tends to perform well based upon a seasonal trend.

The energy sector corrected sharply in the last quarter of 2018. As the energy sector is on the doorstep of its seasonal period, it is off its 2018 peak and has substantially underperformed the S&P 500.

Given the energy sector's depressed relative value compared to the broad market, as it starts its seasonal period the energy sector looks like one of the more attractive trades in the stock market.

When commodities and commodity stocks rally, their move can be substantial and last longer than expected. Even though the energy sector has been positive recently, its move in its seasonal period could be substantial in its seasonal period.

Energy US –

The energy sector has broken out of its downtrend on an absolute basis, which is positive. It is just starting to show signs of consolidating relative to the S&P 500, which is often a precursor of strong performance as the seasonal period starts.

My Call: The US energy sector will probably start to outperform the S&P 500 and continue to outperform into May.

Energy Canada –

The Canadian energy sector has a similar seasonal trend to the US energy sector and also represents a good seasonal opportunity at this time.

There are some differences between the US and Canadian energy sectors at this time. The current Liberal federal government has hung a big sign across Canada that says, foreign investors do not invest in Canada, particularly the energy sector. Although this affects Canada and the energy sector over the long-term in a negative way, in the short-term, if the price of oil increases sharply the Canadian energy sector would be expected to perform well. In the past, I have stated that investors would be wise to consider the Canadian energy sector as a small cap sector compared to the US market.

My Call: The Canadian energy sector will probably perform well and outperform the US energy sector until early May.

Transportation – rolling higher

The transportation sector has been rolling higher since the end of last year. It is currently in its seasonal period that lasts until April 16th. It is currently at the top end of relative trading channel compared to the S&P 500.

My Call: Given the current valuation of the transportation sector relative to the S&P 500, investors should be cautious with this sector. It will probably perform at market over the next two months.

Consumer Discretionary – Boxed in

The consumer discretionary sector substantially outperformed the S&P 500 in the second half of 2017 and the first half of 2018. In recent months, the sector has been performing at market.

A lot of the sectors previous growth was driven by it large weighting of Amazon in the Consumer Discretionary Select Sector SPDR ETF (XLY), at almost 25% of the portfolio.

The sector is currently at resistance and a break above this level would bode well for future strong performance. Nevertheless, given its consolidation relative to the S&P 500 after a strong run, investors should watch for possible underperformance.

My Call: The consumer discretionary sector will probably continue to perform at market over the next two months.

Retail – Relative value?

The retail sector is attempting to breakout on an absolute basis. On the other hand, the sector has still not managed to breakout on a relative basis.

The retail sector has started its seasonal period. It typically performs well from January 21st to April 12th. On a fundamental basis, the sector is struggling. The January sales numbers were the worst in nine years. This number should be taken with a "grain of salt," as the government shutdown clearly affected purchases. On a positive note, the retail sector held up relatively well on a weaker report which could indicate strength ahead. In addition, the sector is substantially off its high relative to the S&P 500 since September, which presents a good relative value proposition at the start of retail's seasonal period.

Nevertheless, this sector should be monitored for continued technical weakness. If the sector is not able to break out on a relative basis compared to the S&P 500, consideration should be given to exiting the seasonal trade.

My Call: The retail sector will manage to slightly outperform the S&P 500 over the next two months.

Gold – losing its lustre - for now

Gold has managed to perform well since October on an absolute basis. On a relative basis compared to the S&P 500, it has pulled back to its trendline. It is possible that it could bounce off this line, but given that gold tends to start underperforming at this time of the year, the more conservative play is look elsewhere for an investment opportunity and re-visit a gold investment before its next seasonal period in July.

My Call: Gold will probably underperform over the next few months.

Silver – At resistance and could turn down

Silver outperformed the S&P 500 starting in late September. Although it has been positive in 2019, it has underperformed the S&P 500. After a strong run that started before its seasonal period, silver has essentially exhausted itself. Of course, it can move higher with a strong catalyst, but at this time it looks like it has finished its seasonal trade.

On an absolute basis, it is at the top of its trading channel as its seasonal period finishes.

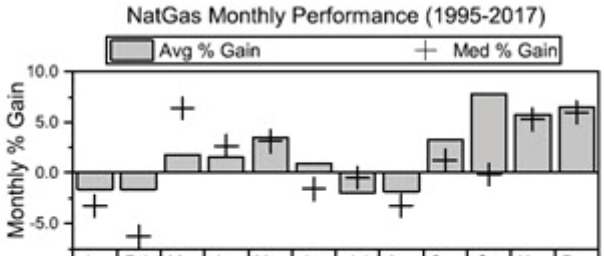
My Call: Silver will probably underperform over the next few months.

Natural Gas – Getting ready to fire up again

Natural gas performed very well in its September 6th to December 21st seasonal period. It peaked in late November, but still performed well.

The setup for the seasonal trade was strong in September, with inventories well below 5 year average levels. Hurricanes and cold weather helped move the price higher.

Natural gas has fallen back to its support level set back in 2016. Natural gas has another seasonal period from March 22nd to June 19th. We are currently just on the doorstep of the seasonal trade. The problem is that February tends to be a weak month for natural gas and it is often better to wait until March before considering an entry position. On the other hand, natural gas can put in a bottom in February. It is interesting to note that since 1995, the worst month for natural gas on a median basis has been February, which is juxtaposed with March which has been the best month of the year.



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Avg. % Gain	-1.6	-1.6	1.8	1.5	3.5	0.9	-2.0	-1.8	3.3	7.8	5.8	6.5
Med. % Gain	-3.2	-6.3	6.4	2.7	3.1	-1.6	-0.5	-3.2	1.2	-0.2	5.3	6.0
Fq %>0	39	39	70	65	65	43	39	43	52	48	65	57
Fq %>S&P 500	43	30	65	48	61	39	39	57	43	48	65	52

My Call: Natural gas will probably put in a bottom sometime in late February or early March and perform well in its next seasonal period.

Stocks

Chevron – Breaking out at start of its seasonal period

Chevron is a diversified energy company and is a relatively conservative investment compared to many smaller energy producers.

Chevron is an attractive investment on a technical basis as it is at the mid-point of its consolidation box relative to the S&P 500, and breaking out on an absolute basis. A confirmation would take place if Chevron were able to break out of its relative consolidation box to the upside.

My Call: Chevron will probably outperform the S&P 500 into May.

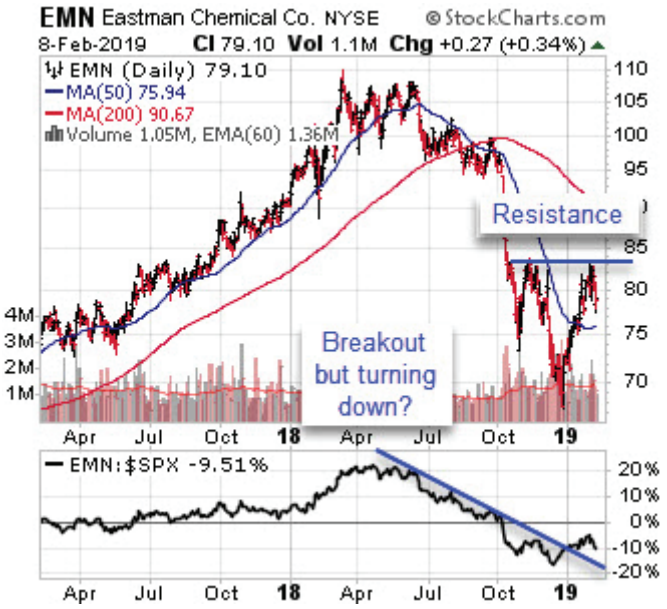
TJX Companies – Consolidation, waiting for confirmation

TJX broke down relative to the S&P 500 in November after weaker than expected earnings. It recovered at the beginning of the year and is consolidating at approximately the same level that it consolidated in the summer months of 2018. Breaking out of this consolidation range to the upside would be positive for TJX and vice versa.

My Call: TJX will probably slightly outperform up until the end of March. Investors should consider exiting the seasonal trade if TJX starts to break down.

Eastman Chemical – Trying to break resistance

Eastman Chemical is trying to break resistance on an absolute basis. Relative to the S&P 500, it is has broken its downtrend. Eastman Chemical has a seasonal period that lasts until May 5th.



My Call: Eastman Chemical will probably slightly outperform the S&P 500 until May 5th.

Currency Corner

Canadian dollar –

The Canadian dollar has been showing signs of stability recently, but it is still in its downward trading channel relative to the US dollar. The good news is that the strongest month of the year for the Canadian dollar is fast approaching - April. Often the Canadian dollar will start to perform well in mid-March.

Do not necessarily "marry" the Canadian dollar in its strong seasonal period in April, as it often starts to underperform in May.

My Call: The Canadian dollar will probably start to perform well in mid-March and end its rally relative to the US dollar in late April.

Brooke's Rant

In October 2018, Jerome Powell, the relatively new chairperson of the Federal Reserve stated that the federal funds rate was far below the neutral rate and the Federal Reserve was on a path to get it to the neutral rate. This was an extremely hawkish statement and many market pundits railed against the Federal Reserve with statements articulating the case that Powell was going to cause the next recession. There was an endless number of graphs that were rolled out illustrating how an increasing federal funds rate could cause a recession and that all or most of the previous recessions were caused by the Federal Reserve raising rates too far, too fast.

In the December FOMC meeting, Powell sprouted his dovish wings and backed down from his extremely hawkish position. And shortly afterwards, in the January FOMC meeting, Powell capitulated and changed his mind about almost everything. His new position became: the federal funds rate was just below the neutral rate and economic conditions justified a reduced expectation of the speed at which the Federal Reserve should increase rates. It is not that he is wrong in his current very dovish position that has investors confused, it is the fact that he has performed a "180 degree turn," without much change in the data.

What happened? There are really only a few choices:

(1) Powell pulled a rookie mistake in his position in October by totally overstating his case to hike rates

(2) Someone spoke to Powell (despite his denials), and pressured the Federal Reserve to maintain rates lower longer

(3) The forecasted economic data is expected to be substantially worse than previously thought and drastic ac-

tion is required

Powell's sharp reversal over a three-month period, is probably a result of options 1 and 3 above. He never should have made his October statement with such conviction. Powell denies that the Federal Reserve is influenced in any way by political influences It is possible that some outside pressure was applied either directly or indirectly, but we will probably never know. The global economic data in October was weak and has continued to be weak. The deterioration of the data is probably responsible for a lot of the Federal Reserve walking back the October statement, but not to the extent of the January statement.

Global economic growth is slowing. Italy recently dipped into a recession. Germany's economy is showing signs of slowing with a recent GDP quarter over quarter (QoQ) loss of 0.2%. Japan has posted a GDP QoQ loss of 0.6%. China's economy is slowing with a recent GDP QoQ of 1.0%.

The US is one of the few countries where the economy is still resilient. How long can this trend continue? Powell is looking forward and predicting that it is inevitable that the US economy faces greater headwinds than expected.

Market implications

Powell with his recent capitulation has essentially "kicked the can down the road." It has been a while since I have seen the "can" phrase, but in this case it applies. The Federal Reserve has probably bought the stock market some time, at a critical point in time. The power of liquidity is huge. It helped drive the stock market higher for a multi-year period after 2009. The opposite of quantitative easing is quantitative tightening. The Federal Reserve is in its quantitative tightening cycle. Just as quantitative easing was a friend to the stock market, quantitative tightening is no-friend to the stock market. Reducing the Federal Reserve balance sheet is a walk the tight-rope activity. Reduce it too slowly and the Federal Reserve reduces its ability to counter weak economic cycles in the future. Reduce it too fast and the Federal Reserve will tip the economy into a recession.

Given the magnitude of Powell's recent reversal, it is going to be difficult for the Federal Reserve to either make a major dovish or hawkish statement. The Federal Reserve is probably on pause. Expect Powell to follow his predecessors to proclaim data dependency when they did not want to commit to possible future moves.

Expect Powell to become Mr. Data Dependent.