Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Thackray's 2019 Investor's Guide

Available in all fine bookstores, Amazon and Barnes & Noble

Lot's of new strategies....

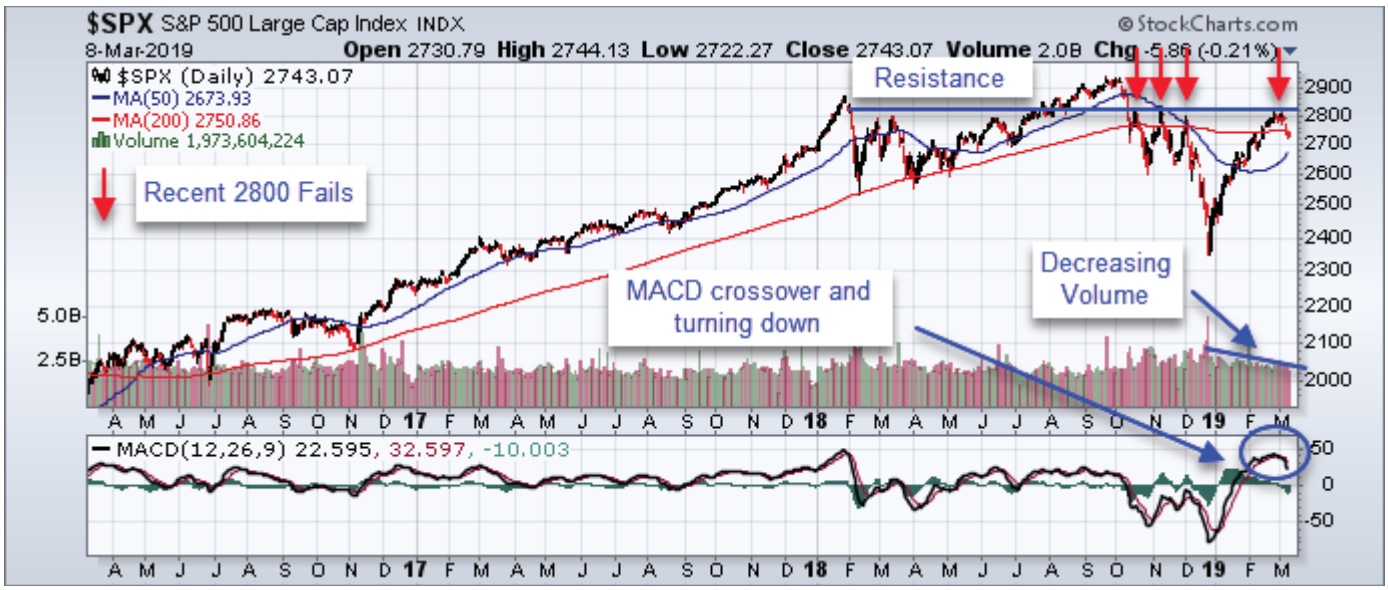
Market Update

There may still be time, but the global economic slowdown does not bode well for the stock market

Most North American investors have not really appreciated the deteriorating global economy until very recently.

S&P 500 - Technical Status

The S&P 500 has once again found great difficulty in crossing and staying above its 2800 level of resistance. The S&P 500 managed to close above 2800 for one day, March 1st, and has since pulled back. Of course, it still could push through 2800. If it managed to stay above this level for more than a few days, this would be bullish and support a move higher. The rally since late 2018 lacks conviction as volume has been decreasing. The MACD has had a negative crossover and is trending down, which is considered by some investors to be the start of a bearish trend. In addition, the S&P 500 has crossed below its 200 day moving average which is also considered a bearish signal by many investors. Although the overall technical picture is bearish, investors should not necessarily give up on the stock market as March and April tend to be strong months of the year.



Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **February 28th,** 2019

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	45.4%
HEWB	Horizons Equal Weight Canada Banks Index ETF	9.3%
HXE	Horizons S&P Capped Energy ETF	7.0%
HXF	Horizons S&P Capped Financials ETF	4.9%
	United States Dollar Exposed Assets	
	Commodities	
UNG	US Natural Gas Fund LP	1.0%
	Equities	
IWM	iShares Russell 2000 Value ETF	9.5%
IJH	iShares Core S&P Mid-Cap ETF	8.8%
IWD	iShares Russell 1000 Value ETF	6.0%
XRT	SPDR S&P Retail ETF	2.9%
FHM	First Trust AlphaDex US Materials Sector Index ETF	2.8%
	US Dollar Forwards (February 2019) - Currency Hedge **	0.2%
	Cash, Cash Equivalents, Margin & Other	2.2%
	Total (NAV $243,298,404)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 26.35% 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.

The US has provided enough economic reports that were not "bad," placating investors. You had to look closely to see any signs of a slowdown. On Friday March 8th, an extremely weak Nonfarm payroll number of 20,000 jobs was a bit of a wake up call for US investors.

The US experience has been different compared to most other countries around the world. Europe has been slowing dramatically over the last few quarters. Italy is in a recession, Germany produced 0% growth in the last quarter on a quarter over quarter basis. It is not just Europe, Japan has been slowing, producing a 48.9% Manufacturing PMI.

Recently at the beginning of March, the OECD lowered its global growth forecast dramatically affecting almost every major nation in its purview. In addition, the ECB in its latest meeting revived its Targeted Longer-Term Refinancing Operations (TLTRO) in order to encourage banks to provide credit to businesses and customers. It also gave strong indications that is probably not going to consider any further interest rate increases until 2020.

How is the changing economic reality playing in the stock market?

At the beginning of 2018, the stock market was rallying as investors expected Trump's tax reform to improve the economy and corporate earnings. The stock market corrected and then rallied strongly into late September. The underlying premise to the rally was that a stronger US economy, largely based upon tax cuts, was going to continue into the future.

Investors were somewhat soothed by the Federal Reserve raising its federal funds rate because this action confirmed that the economy was in good shape. Personally, I have never figured this one out. How can you use the reactor (the Federal Reserve's monetary decisions) to predict what it is reacting to? It was only when the Federal Reserve started to get too far ahead of itself with an aggressive rate hike schedule that investors became spooked.

When the Federal Reserve turned dovish and put its aggressive rate hike schedule on hold, suddenly the media was flooded with articles about the possibility of a recession. What did the Federal Reserve see? Did they see a recession on the horizon? If they did, they did not say.

The reality of the global economic slowdown is slowly catching up to the US. The US cannot stand as lone island in the world of an economic slowdown. It is not possible. Eventually, slowing global growth will have an impact on the US.

There is a false sense of belief that the central banks can / will save the day.

The Federal Reserve "saved the day" with its multiple quantitative easing programs starting in 2008. Each quantitative easing program helped to propel the stock market higher, but with diminishing benefits. In 2017, the Federal Reserve reversed its monetary policy and introduced a quantitative tightening program that was supposed to balance out the growth of the economy with the negative effects of the Federal Reserve's actions.

Officially, the Federal Reserve is still on a quantitative tightening program and in fact it is still shrinking its balance sheet. Even if the Federal Reserve were to revert to a quantitative easing program, it may not have the effect that everyone thinks should happen.

Further reductions to interest rates that are already so low and an increase in the money supply may not be enough to stop the economy's decline. As I wrote in the February newsletter, monetary policy can take a year or two before it has a major effect. What the Federal Reserve did last year will not have most of its effect until this year. What it is doing now, will not have most of its effect until next year. The economy can roll into a recession despite the Federal Reserve instituting easier monetary policy.

Of course, the Federal Reserve can throw the kitchen sink at a slowing economy: use rates negative, buy bonds, buy ETF's, buy stocks and drop money from a helicopter. This would probably have a positive influence on the stock market and create a sustainable rally. In all likelihood, Powell is not going to go "nuclear" just because the economy is starting to slow down. If the economy were to stumble, Powell would probably move slowly back to quantitative easing and gradually increase its loose monetary policies. The economy/stock market will have to show very weak results before Powell starts the quantitative program with any dramatic action. In other words, good luck in expecting a quantitative easing program to rally the stock market higher on a sustainable basis.

Seasonal implications - time may be running out

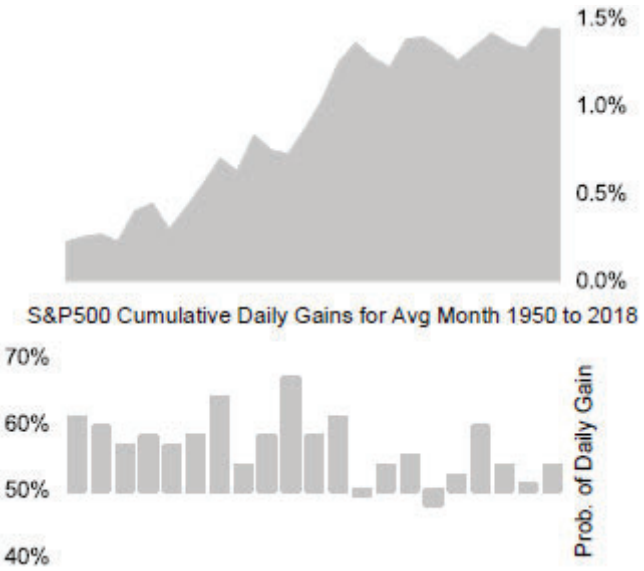
The stock market typically performs well in the six month period from October 28th to May 5th (favorable six month period for stocks), compared to the other six months of the year. Of course the S&P 500 can have its bumps and bruises in its favorable period. On the other hand, sometimes the stock market can continue on past the end of its seasonally strong period (early May) with strong momentum. Given that the world is waking up to the reality that global growth is slowing, a more likely scenario is for positive momentum to fade in early May or even in April. It is possible that the US-China trade

deal could save the day and help with stock market rally. But don't count on it. First, investors should not believe anything that Trump or the Chinese say about the trade negotiations as most of it is posturing. Second, some sort of trade deal is probably already priced into the market.

An economic slowdown is probably not the end of the world. On Friday March 8th, the US published a disastrous Nonfarm payroll number of 20,000 new jobs. By the end of the day, the S&P 500 was only down 0.2%. Investors did not know what to make of the weak number and many tried to explain it away. It looks like that it is going to take more than a couple of weak economic numbers to convince investors that the market may be in jeopardy.

A big problem will develop if US corporations produce weak Q1 profit numbers in April. If this happens, investors will struggle to parse the affects comparing earnings with the previous year which are skewed higher because of the tax reforms that were implemented in 2018.

On a seasonal basis, April is a strong month, but most of the strength tends to come in the first part of the month as investors typically push up the stock market ahead of Q1 earnings releases.



The graph above, from my T*hackray's 2019 Investor's Guide* (page 41), illustrates the earnings month effect in the month of April. On average from 1950 to 2018, the S&P 500 has performed well in the first part of the month, both on a daily probability basis and a cumulative average gain basis. Although it should not be expected that the stock market will necessarily trace out this pattern in 2019, the graph does demonstrate that over the long-term, the stock market his a higher probability of performing better in the first part of the month.

If the stock market does start to fade in mid-April, it would be wise for investors to consider reducing risk in their portfolio.

What the HAC is going on?

In February, HAC was fully invested in the stock market. Its core holdings were largely skewed to the Canadian stock market. On the Canadian side, HAC held positions in Canadian financials and energy sectors. HAC entered into a small position in the energy sector in late December and increased its position in February.

On the US side, the main investments were in the small and mid cap sectors. The initial position in the small cap sector was established in late 2018. The sector tends to perform well from mid-December to early March and this particular seasonal cycle followed its outperformance cycle. In February, HAC also held small positions in the US materials sector, retail sector.

Seasonal Opportunities

Small Caps – finished seasonal period

Small caps outperformed the S&P 500 in their seasonal period which starts mid-December and lasts until March 7th. After the ECB announced that it was instituting a quantitative easing program and putting its rate increases on hold until 2020, the US dollar gained in strength, which is supportive of small caps. In the days leading up to the ECB announcement, the small cap sector was underperforming the S&P 500. Consideration should be given to exiting the sector.

My Call: The small cap sector will probably start to underperform the broad stock market.

US Financials - good relative seasonal value?

In 2018, US financials frustrated many investors as they steadily underperformed the S&P 500. A lot of the underperformance can be attributed to the flattening of the yield curve which hurts banks profitability. Strong performance from the financials is often a sign of a healthy economy and a sustainable stock market rally. Neither happened in 2018. The US financials have a strong seasonal period that lasts from mid December to mid-April. In its 2018/2019 seasonal period, the financial sector started by outperforming and then underperforming. Overall, performance has been at market. The sector has pulled back to its relative base support line and potentially represents good value on a seasonal basis. Investors should note that the strong seasonal period for the sector ends in a few weeks.

My Call: The financial sector will probably mildly outperform the S&P 500 over the next month.

US Materials - trading in a range

The US materials sector has been performing at market since October. Although it is a cyclical sector, it has not received the same benefit from perceived progress on the trade talks between the US and China. The sector is just below resistance and poised for a breakout on a positive market rally. The sector is currently in a trading range relative to the S&P 500. A breakout above this range would be positive for the sector to perform well for the remainder of its seasonal period that lasts until early May.

My Call: The US materials sector will probably slightly outperform the S&P 500 up until the end of its seasonal period at the beginning of May. The sector could potentially finish its period of seasonal strength before the end of its seasonal period.

Retail- struggling

The retail sector has been underperforming the S&P 500 since July. It is at a critical point, where a break upwards relative to the S&P 500 would be positive and a break downwards would point to underperformance for the sector. In either case, investors should be cognizant that the seasonal period for the retail sector finishes in mid-April.

My Call: The retail sector will probably perform slightly better than market over the next few weeks.

Canadian banks - weak earnings, but the banks may still live on

Seasonal period - January 23rd to April 13th

Canadian banks are a core part of most Canadian investor's portfolios. The Canadian banking industry has attracted a number of US investors whom have decided to short sell the sector based upon the higher valuations compared to the US banks and the possibility of an economic slowdown having an adverse affect on the industry. As a percent of the overall economy, the housing industry is much more significant compared to other OECD countries. The Canadian housing industry is approximately double the other countries, coming in at 7 to 8% of GDP being affected either directly or indirectly. Many international investors believe that the Canadian housing market is due for a correction, which would have a negative impact on the mortgage market and Canadian banks.

The banks released their earnings around the last week of February. Overall, the earnings fell short of expectations and the price of the bank stocks took a hit. They have since stabilized relative to the Canadian stock market.

My Call: The Canadian banking sector will probably perform at market over the next month before finishing its seasonal period and then underperform.

Oil - hit by demand and supply issues and the Norwegian sovereign fund

In the first full week of March, the price of West Texas Intermediate suffered as the result of increasing supply, with the US setting a record of 12.1 million barrels per day in February. With global growth slowing, investors are becoming increasingly concerned that demand is waning for oil, putting downward pressure on the price of oil. In addition to the above, the Norwegian Sovereign Wealth Fund stated that they were looking to divest themselves of all their oil and gas assets over the next few years. To exasperate the downturn, the US dollar strengthened relative to world currencies, putting further downward pressure on the price of oil.

My Call: Oil will probably find support at the $55 level, which is the top of the consolidation box that has been established between $42 and $55.

US energy - down but not out

Seasonal period - February 25th to May 9th.

The US energy sector underperformed the S&P 500 starting last summer. It managed to break its downward relative trend line at the beginning of 2019. Currently, the energy sector is consolidating relative to the S&P 500. On an absolute basis, the energy sector has turned down.

My Call: The US energy sector will probably consolidate in the month of March, before outperforming in April.

Canadian energy - down but not out

Seasonal period - February 25th to May 9th.

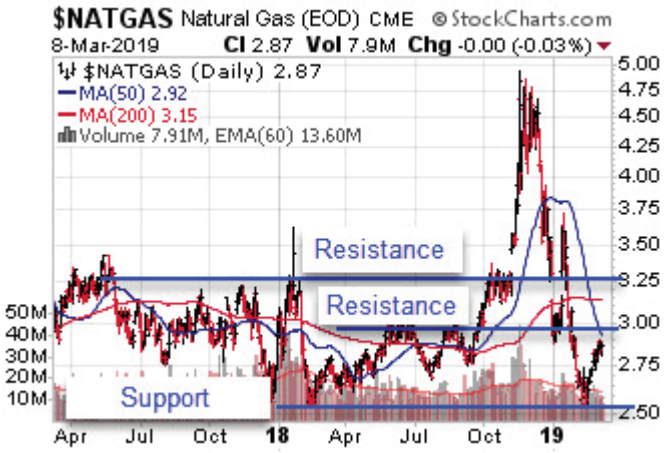
The Canadian energy sector has a similar trend to the US energy sector. The Canadian energy sector generally provides more torque to the price of oil due to its exploration and production profile. Nevertheless, if the price of oil rises in the short-term, it would be beneficial for the sector.

My Call: The Canadian energy sector will probably consolidate in March, before outperforming in April.

Natural gas- strong at the beginning of its seasonal period

Seasonal period - March 22nd to June 19th

Natural gas performed well in its first seasonal period from early September to late December. It is currently set up to perform well in its second seasonal period from mid-March to early June. It has recently bounced off its lows of 2018 and is showing upward momentum.



My Call: Natural gas will probably be extremely volatile, but head higher into late May.

Value- performing okay

The value sector has been performing at market, after initial outperformance in October 2018. The sector is in its seasonal period and provides some relative protection compared to the S&P 500 if a major market decline were to occur.

My Call: The value sector will probably start to outperform and continue to outperform into early May.

Industrials- hope is fading for a successful trade negotiation

Seasonal period - January 23rd to May 5th

The industrial sector has been performing well in its seasonal period, but is showing signs that it may be rolling over relative to the S&P 500.

The sector has been outperforming largely based upon trade negotiation optimism and also the very strong performance of Boeing which makes up 10% of the sector (graph below).

My Call: The industrial sector will probably start to underperform the S&P 500.

Transportation- forecasting tougher times ahead

Seasonal period - January 23rd to April 16th

The transportation sector started its seasonal period well compared to the S&P 500. Recently, the sector has pulled back significantly. The Dow Jones Transportation Index (not shown) is down for eleven days in a row. The fact that the sector appears to have ended its seasonal period early is not a good sign for the stock market. Many investors view the transportation sector as a leading sector of the broad market.

My Call: The transportation sector will probably continue to underperform the broad stock market over the next month.

Stocks Section

Chevron- so far so good

Seasonal period - February 1st to May 5th

Chevron is outperforming the S&P 500 in its seasonal period. Relative to the S&P 500, Chevron has broken out of its consolidation box. Although it has been turned back at a resistance level on an absolute basis, the technical profile still remains strong for Chevron.

My Call: Chevron will probably consolidate relative to the S&P 500, before outperforming in April.

Eastman Chemical- struggling

Seasonal period - January 28th to May 5th

Eastman Chemical has a strong seasonal profile. It tends to perform well from late January to early May. After outperforming the S&P 500 starting in December, Eastman Chemical has slightly underperformed.

My Call: Eastman Chemical will probably perform slightly better than the S&P 500 in the remainder of its seasonal period.

TJX-tentatively outperforming

Seasonal period - January 22nd to March 30th

TJX has been outperforming the S&P 500 since late last year. So far, the outperformance has not been particularly strong. Nevertheless, this stock has a strong track record of outperforming at this time of the year.

My Call: TJX will probably continue to outperform the S&P 500 in its seasonal period, which finishes at the end of March.

Currency Corner

Canadian dollar – Seasonal period weeks away

Seasonal period - April 1st to April 30th

The Canadian dollar is in an overall downward trend relative to the US dollar. Recently, after a run to the top of the trading channel, the Canadian dollar turned down. The Canadian dollar has a strong track record of outperforming the US dollar in April, as it has only underperformed once in the last thirteen years.

Given the strength of the seasonal trend, a long position in the Canadian dollar, in April is still a favorable proposition.

My Call: The Canadian dollar will probably start to outperform the US dollar in late March.

Brooke's Rant

Do NOT listen to MMT'ers - they are dead wrong. Period.

There is a growing movement of people, investors and economists supporting a "garbage" economic theory, Modern Monetary Theory. Without going into the intricacies of the theory, the basics state that a country like the US that funds its debts with its own currency can run large continuous deficits, generally without consequence.

This policy is so wrong, on so many different levels. Unchecked government deficits have an opportunity cost. Spending today, forgoes spending tomorrow. MMT'ers will say that this is not true as governments can spend into oblivion, but current and past spending incurs interest charges which could have been used for health care etc.

When interest rates are low, paying interest payments is relatively easy, but there is no guarantee that interest rates will remain low. Do you really want to put a country at risk with no buffer down the road if things go wrong and additional funds are needed to support an economy in a recession.

Printing money does not create wealth. Increased government deficits supported by an increased money supply does not increase wealth, it redistributes it from the private citizens to the government. Increased government spending crowds out private spending.

So why is MMT starting to be accepted into the mainstream? Today, people are heavily indebted, see nothing wrong with high levels of debt, and expect their governments to run deficits in order to spend for the greater good of its population. The general feeling is that if "we can personally run a large debt, why can the government not do the same?"

Ok, some of the MMT'ers do concede that running large government deficits could drive up inflation. Their solution: you might think that it would be to reduce government spending. Nope. The MMT solution is to raise taxes to slow the economy down. I am not joking. Their solution is to once again increase the government coffers at the expense of working people. MMT is really a platform for big government with big government debts and a reduced role of the free market. What could go wrong (sarcasm)?

Government spending needs to be kept on a short leash and accounted for at all times. If governments are given the ability to spend recklessly, a misallocation of resources will take place along with a lack of market investment in the economy. It does not matter what country you live in, we can all point to wasteful government spending. The more money you give the government, the more that they waste. I am not saying that taxes and government spending are bad. They are necessary for a properly functioning society. Too large of a government, running large deficits will lead to waste, decreased market incentive and a lack of economic growth. Don't be fooled by MMT, it does not make economic sense or common sense.