Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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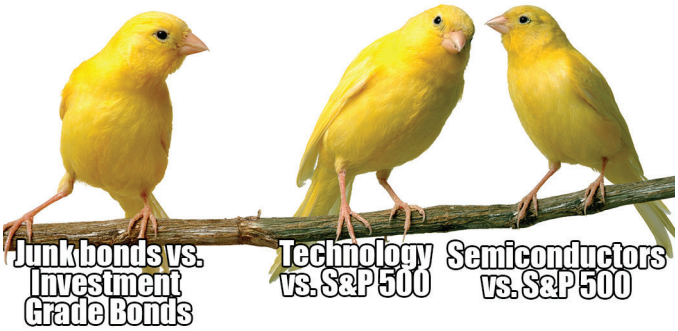
Market Update

The stock market has rallied recently, but investors should probably start considering becoming more defensive in the not-so-distant future. Currently, the stock market is on the threshold of transitioning into the six-month unfavorable period for stocks (May 6th to October 27th). As the S&P 500 tries to reach its all-time highs again, the global economy has been showing fairly consistent signs of slowing.

The US has been one of the exceptions, with a stronger than expected Manufacturing PMI and Nonfarm payroll reports. In addition, last quarter China flooded credit into the market and has recently shown signs of increasing manufacturing and exports. This has given investors hope, but the results have not been echoed in most other countries. Europe, including Germany, the industrial powerhouse of the continent, has shown consistently weak growth.

Investors should be cautious as the stock market transitions into the six-month unfavorable period. When will the stock market turn down? No one knows with certainty, but I am watching three "canaries" in the market for clues.

Canary watching!



S&P 500 - Technical Status

The S&P 500 managed to break above 2800 in March and trade above this level for most of March. This was a positive development. Currently, the S&P 500 is just shy of 2900 and the all-time closing high of 2930.75 set on September 20th, 2018. If the S&P 500 is able to trade above the previous all-time high, it is "blue sky" with no resistance levels above. Strong momentum could propel the stock market higher. Unfortunately, the rally has had a lack of volume confirmation (volume has been declining). If the S&P 500, does re-test the 2800 level and break below, the stock market will probably be in trouble. Given, that the stock market is on the verge of its six-month unfavorable period, investors should consider being cautious at this time.

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

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	19.9%
HXE	Horizons S&P Capped Energy ETF	11.2%
	United States Dollar Exposed Assets	
	Commodities	
UNG	US Natural Gas Fund LP	1.8%
	Equities	
HXS	Horizons S&P 500® Index ETF	46.0%
XLP	Consumer Staples Select Sector SPDR Fund	6.0%
IWD	iShares Russell 1000 Value ETF	6.0%
FHE	First Trust AlphaDex US Materials Sector Index ETF	5.1%
XLF	Financial Select Sector SPDR Fund	3.0%
	US Dollar Forwards (April 2019) - Currency Hedge **	0.0%
	Cash, Cash Equivalents, Margin & Other	1.0%
	Total (NAV $249,029,012)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 78.7% 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.

In my November newsletter, I called the technology sector a "canary in the coal mine." The sector had been leading the S&P 500 higher for over two years. When a major sector leads the stock market higher for an extended period of time, often when the sector's performance starts to deteriorate it is an ominous sign that the stock market is about to stumble. This is exactly what happened in late 2018. The declining technology sector brought the S&P 500 dramatically lower. The S&P 500 managed to put in a bottom on December 24th. It has rallied since, but it is possible that the same cycle could happen all over again.

Currently, I am watching three "canaries in the coal mine" to help determine when the stock market may start to turn down as it enters its six-month unfavorable period from May 6th to October 27th (the weaker six months of the year).

First Canary - Technology sector

The first "canary" is once again the technology sector's relative performance compared to the S&P 500. If the technology sector once again starts to underperform the S&P 500, it is a sign that the broad stock market could be in trouble. Currently, the technology sector is outperforming the S&P 500. This canary has not tweeted a warning yet, but keep watching.

In the graph above (in the bottom panel), the technology sector continues its outperformance of the S&P 500. A break below the trend line would indicate that the sector is set to underperform S&P 500 and the overall stock market could head lower.

On an absolute basis, the previous for the technology sector was set in early October. Although this is considered support, the support level of approximately $71.50 is probably more helpful. A break below this level would indicate that the overall upward trend is broken and that the stock market could be set to stumble.

Second Canary - Semiconductor sector

The second canary is the semiconductor sector's relative performance to the S&P 500. The semiconductor sector has similar trends as the technology sector, but is more sensitive to trade issues and tends to be more volatile. Currently, the semiconductor sector has been strongly outperforming the S&P 500, despite weakening fundamentals. Semiconductor companies have been reporting weaker sales. Revenues for the sector declined 7.3% in February (WSTS). Companies have been issuing downward guidance, but the sector continues to perform well. There seems to be a belief that the weak fundamentals in this sector are temporary. I am not sure why. This sector of the stock market attracts a lot of "spec" money and if it starts to underperform the S&P 500, this canary could be tweeting trouble ahead for the overall stock market.

In the graph above, using the semiconductor sector ETF (SMH), the bottom panel shows the relative performance of the semiconductor sector compared to the S&P 500. A break below the upward trendline would be a good indication that the semiconductor is underperforming. This break would indicate that speculative investment in the stock market is fading and consequently the stock market's current rally could be in jeopardy.

On an absolute basis, support for SMH is approximately $107. If SMH were to pull back and break below this

level, this would be an indication that the sector's upward trend is broken, and consequently an indication that the stock market may stumble and head lower.

Third Canary - Junk bond performance relative to investment grade bonds

The third canary is the relative performance between the junk bond (high yield) sector compared to the investment grade corporate sector. The junk bond sector is more sensitive to deteriorating economic conditions as the sector has a higher probability of having defaults. When the junk bond sector is outperforming, it generally means that investors are bullish in the stock market (not always). The bond market is huge: it dwarfs the stock market in size. There is an adage that bond investors know best. Currently, junk bonds are underperforming investment grade bonds, which is an indication that bond investors believe that the economy is faltering. This canary is starting to "tweet," that there is trouble ahead and investors would be wise to pay attention.

Combining Canaries

Junk bonds have been underperforming investment grade bonds for some time. They have already issued their warning. Bond investors are not buying this rally. Using relative bond performance does not provide a timing indicator as divergence with the stock market can persist for quite some time. Best to consider this "canary" as a warning sign.

A break below key support levels for the semiconductor sector is important, but does not carry the same weight as the technology sector. The semiconductor sector's relative performance compared to the S&P 500 is a good warning indicator, but the relative performance of the technology sector is more prescient as it is a broader sector that includes many of the companies that have been leading the overall stock market higher.

Given that the stock market is set to transition into its six-month unfavorable period (May 6th to October 27th), paying attention to the "canaries" is more important as historically the stock market has on average been weak over the next six months. Any downturn in the stock market has the potential to be significant.

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Tracking Stock Market Sentiment with the 3 Canaries

Junk Bonds vs. Corporate Bonds & Technology & Semiconductors vs. S&P 500

Over the last 5 years, the S&P 500 has had 4 major market tops. The August 2015 top was the result of the stock market being spooked by China devaluing its currency after weak economic data. The second top in 2015 was the result of investors getting concerned about the impacts of the Fed raising rates. The first top in 2018 occurred when the stock market was overextended and volatility spiked. The second top in 2018 was the result of the Fed rasing rates.

Bond investors got both 2015 stock market tops correct. Junk bonds underperformed investment grade bonds ahead of the August 2015 correction and into 2016. Bond investors saw the early 2018 top as noise. Junk bonds started to underperform, at the same time the stock market rolled over in late 2018. The stock market has since recovered, but junk bonds continue to underperform investment grade bonds, signaling that bond investors are concerned about risk in the stock market and are not "buying" this rally.

The technology sector showed no signs of abating its strong performance compared to the S&P 500 in both 2015 stock market tops and in early 2018. In late 2018, the technology sector started to underperform the S&P 500, before the S&P 500 started to turn lower. Typically the technology sector performs well in October and November, and underperformance was an ominous sign. Currently, the technology sector is outperforming the S&P 500, If the sector starts to underperform.... another market top?

The semiconductor sector has a similar trend as the technology, relative to the S&P 500. The difference is that its relative performance to the S&P 500 turned down earlier in March of 2018. Like the technology sector, the semiconductor sector has been strongly outperforming the S&P 500 in 2019. If the semiconductor sector starts to underperform the S&P 500 this could be a sign that the S&P 500 is once again set to roll over.

What the HAC is going on?

In March, HAC was fully invested in the stock market. Early in the month, HAC exited the small-cap and mid-cap sectors, approximately when their seasonal period of strength finished. HAC also exited out of the retail sector and Canadian banks. The banking sector was hit hard when the US yield curve inverted and investors became concerned of decreasing profit margins for the banks. Canadian banks also had a negative pall cast over them as rhetoric from a prominent short seller in the US discussed increased risk for the sector. In addition, a well respected independent research house in Canada, Veritas, produced a report advising clients to sell all of the big six banks. The period of seasonal strength for the Canadian banking sector finished in mid-April.

During the month of March, HAC's position in natural gas declined. The seasonal sweet spot for this trade is April. During March, HAC increased its position in the energy sector, as oil producing companies have their seasonal sweet spot in April.

Towards the end of March, HAC entered into a long position of the Canadian dollar versus the US dollar as April tends to be the strongest month of the year for the Canadian dollar.

In March, HAC reallocated from the Canadian broad stock market to the US, as the US stock market showed increasing signs of strength.

Seasonal Opportunities

Oil (WTI) - Strong Q1 rally

The price of oil has risen sharply in Q1. Demand for oil has increased and supply has been curtailed by OPEC+ cuts to production. This has been positive for the price of oil, but investors are still concerned that a slowing global economy will decrease demand for oil. Although the price of oil may continue to increase in its seasonal period, there is probably limited upside ahead.

My Call: The price of oil will probably increase over the next few weeks, but then roll over slowly.

US Energy sector - In seasonal sweet spot

The energy sector (stocks) was positive in Q1, but did not appreciate at the same rate as the price of oil. Relative to the S&P 500, the energy sector has been consolidating.

April tends to be a strong month for the energy sector. So far, the energy sector has not had a strong rally relative to its historical seasonal trend and the increasing price of oil. At this point, the energy sector could rally over the next few weeks, but given that the its seasonal period ends shortly, it would be wise for seasonal investors to be cautious at this time. Investors should note that the energy sector is often weak in June.

My Call: The energy sector will probably outperform the stock market moderately over the next few weeks, into the beginning of May. The energy sector will probably start to turn down in late May.

Natural Gas - Cold weather not helping this trade

Natural gas has a seasonal period that lasts from mid-March until mid-June. This seasonal period is not as strong as the primary seasonal period (September 6th until December 21st). Nevertheless, historically the current seasonal period has on average been profitable.

In the short-term, the price of natural gas is often affected by the current weather. Recent weather patterns should have been supportive for natural gas, but the price of natural gas has been soft and declined.

Typically, April tends to be one of the stronger months of the year for natural gas prices. Essentially, natural gas prices have not responded favorably despite favorable concerns. At this time, investors should be cautious with natural gas and consideration should be given to exiting the sector if further weakness persists.

My Call: Natural gas prices will probably rise moderately over the next few weeks and probably not continue to rise for the duration of its seasonal period.

Canadian Banks - Seasonal period finished

The seasonal period of strength for the Canadian banking sector finished on April 12th. Recently, the Canadian banks have come under pressure as the yield curve in the US has flattened and Steve Eisman, a prominent short seller in the US, has made negative comments regarding the Canadian banks. Veritas, an independent research firm also published a bearish report on Canadian banks.

Technically, Canadian banks are consolidating in their trading range, but relative to the Canadian stock market, Canadian banks have broken down.

My Call: Despite, attractive valuations compared to historical norms, Canadian banks will probably underperform the Canadian stock market in the near future.

US Financials - Seasonal period finished

Since early 2018, the US financial sector has been underperforming the S&P 500. In its seasonal period that started in late January and finished recently, the financial sector started out by underperforming the S&P 500. When the US yield curve inverted, the financial stocks performance deteriorated further relative to the broad market. Recently, the sector bounced relative to the stock market, but overall is still in its downtrend on both an absolute basis and relative to the S&P 500.

My Call: The financial sector underperformed in its seasonal period and will probably continue to underperform.

Consumer Discretionary- Seasonal period ending soon

Starting in the summer of 2018, the consumer discretionary has been performing at market, except for its recent tick higher, with a breakout on both an absolute and relative basis compared to the S&P 500. Investors should be cautious with this positive signal as the consumer discretionary sector's seasonal period ends in late April.

My Call: The consumer discretionary sector will probably perform at market until the stock market starts to roll over.

Materials- Possible last bounce

The materials sector has been consolidating relative to the S&P 500 since last autumn. In April, the sector has had a bounce relative to the S&P 500 as it has been perceived that the US-China trade talks have shown positive developments. The seasonal period ends shortly.

My Call: The materials sector will probably outperform the S&P 500 over the next few weeks in its seasonal period.

Industrials- Boeing Bump

At the beginning of this year, the industrial sector started to outperform the S&P 500, largely as the result of strong performance from Boeing. On a technical basis, the sector broke above its downtrend channel. It is ironic, that after two of Boeing's 737 Max planes crashed, it was Boeing that was largely responsible for bringing Boeing back to its trend channel relative to the S&P 500.

My Call: The industrial sector will probably perform at market for the duration of its seasonal period which ends on May 5th. After the seasonal period ends, the industrial sector will probably underperform the S&P 500.

Transportation - One last bounce?

The transportation sector has a seasonal period that ends on April 16th. Recently, the sector has bounced both on an absolute basis and relative to the S&P 500. The sector has now reached the top of its trading channel on a relative basis compared to the S&P 500. Given that the transportation sector is finishing its seasonal period, seasonal investors should be cautious in this sector at this time.

My Call: The transportation sector will probably start to underperform the S&P 500 in the near future.

Consumer Staples- Boring but relevant

In 2018, as investors focused on growth sectors, such as the technology sector, the consumer staples sector underperformed the S&P 500. The underperformance lasted until October. When the stock market corrected, the consumer staples sector outperformed. In 2019, the consumer staples sector has performed approximately at market.

The consumer staples sector starts its seasonal period in mid-April. If the growth sectors of the stock market start to correct, it would be expected that the consumer staples sector would start to outperform the stock market.

My Call: The consumer staples sector will probably outperform the broad market over the next six months.

US Government bonds- Recent rally may delay entry point

On an absolute basis, US government bonds have performed well since October. In 2019, government bonds have been positive, but have underperformed the stock market. Government bonds start their seasonal period on May 6th. Given the recent rally in the bond market, it is possible that the sector may start its seasonal period late. The current support level for the government bond market, using the US government bond ETF (IEF), is approximately $104.50.

My Call: Government bonds will probably consolidate over the next month and then resume their upward trend.

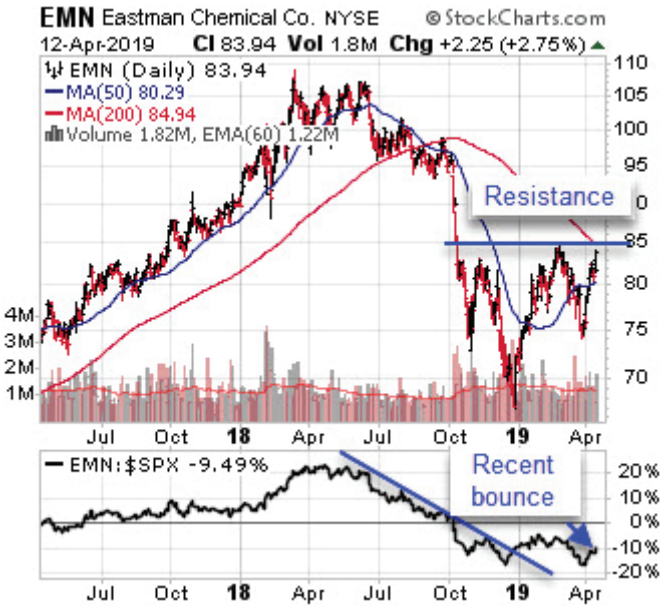
Stocks Section

Chevron- The Anadarko Effect

Chevron was outperforming the S&P 500 in its seasonal period (February 1st to May 5th), but once it bid $33 billion for Anadarko the stock dropped dramatically. Although seasonal trends are beneficial, when unexpected event occurs, it can affect the price of a security, regardless of seasonal trends.

Eastman Chemical-

Eastman Chemical has underperformed in its seasonal period. Recently, Eastman has bounced and could manage to outperform by the end of its seasonal period. Nevertheless, seasonal investors should be cautious as the seasonal period ends in a few weeks (May 5th).



My Call: Eastman Chemical will probably perform at market for the remainder of its seasonal period.

TJX- Outperformed in its seasonal period (once again)

TJX outperformed in its seasonal period once again. The trade has finished and seasonal investors should probably wait until next January before considering the trade once again.

Currency Corner

Canadian dollar – Seasonal period finishes at the end of April

Historically, the strongest month of the year for the Canadian dollar is April. Currently, the Canadian dollar is outperforming the US dollar in the first half of April.

Despite the Canadian dollar being in a short-term seasonal period, it is still in a longer-term downtrend versus the US dollar. Investors should note that the US dollar has a strong seasonal period versus the Canadian dollar in May.

My Call: The Canadian dollar will probably moderately outperform the US dollar in the remainder of April and then start to underperform in May.

Brooke's Rant

Liar Liar

This rant is not in support or against Trump. It is a commentary on the strategy that the White House has chosen to take in trade negotiations.

It used to be in politics that the lies were more subtle and meant to slowly deceive populations. Announcements were more diplomatic.

The White House has chosen a strategy of constantly lying about the progress of the US-China trade talks. It appears that China has countered by doing the same. Trump and his administration team have decided that they want to include the US population in the negotiating strategy. By making extreme statements to the public, they are sending messages to the Chinese negotiating team, hoping to get an edge in the negotiations. One week, the Trump administration claims that the trade negotiations are going well and in the next week, the public is told that the trade negotiations are going poorly.

Trump lives in the land of opposites. When Trump says the trade talks are going well, they are probably going poorly. When he says trade talks are going poorly, they are probably going well.

I get it. It's a strategy. Unfortunately, the US population is collateral damage. Being purposely misled has hurt the American trust. Recently, the stock market has been performing well largely on the basis that it is believed that the US-China trade negotiations are proceeding well. Investors have largely shrugged off the announcements made by the White House administration, as they have heard it all before. They have now reached a point of saturation. Investors seem to be paying attention to the activity level of the trade "Sherpas" (negotiators). More meetings in the US and China, represent an increasing chance that the trade negotiations are proceeding well.

One day, a trade deal between China and the US will probably be signed. The White House will declare it the best trade deal ever (even better than the USMCA). Although there may be an initial stock market rally, investors will probably become skeptical of any signed deal. Will it get implemented? What is the timing? Will it ever be enforced?

Although lying to the public "may" be a good strategy to advance negotiations, in the end it may backfire as the public questions the veracity of any possible agreement.