Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

Playing Chicken

Playing *Chicken* is the act of two parties on a collision course, if neither party swerves, both parties suffer demonstrable damage. If one party concedes by swerving, it is considered the loser. Currently, both the US and China are playing *Chicken*, hoping the other party will concede.

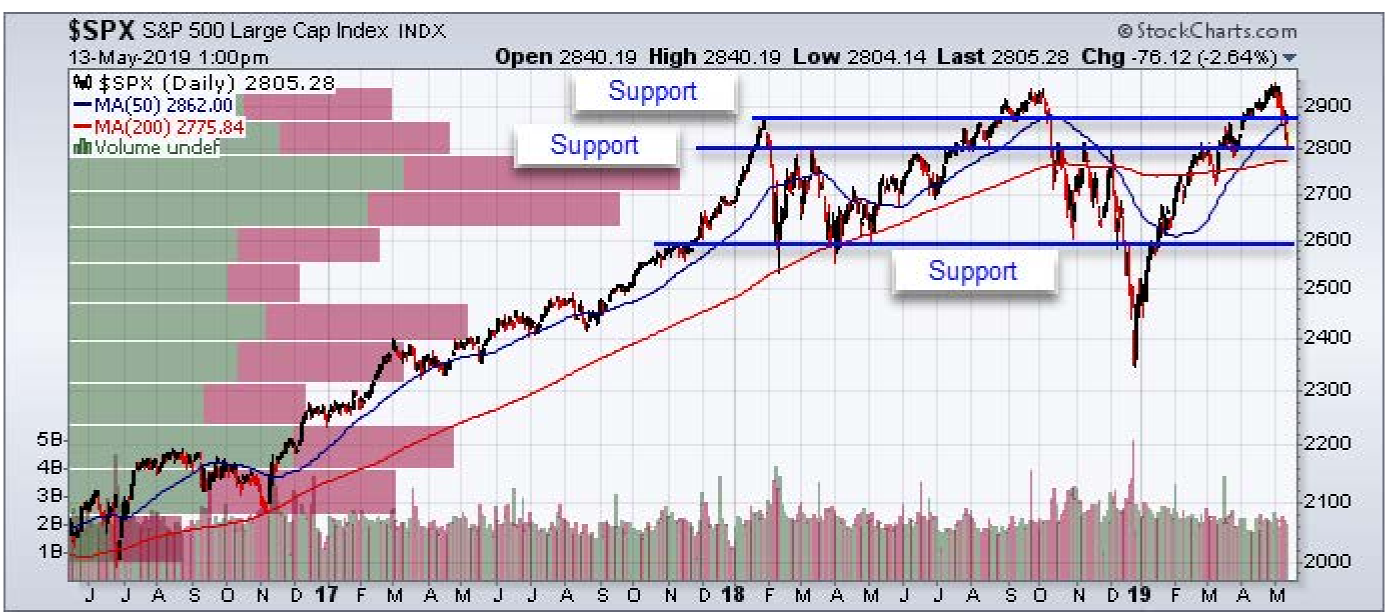
Update: The situation has changed very fast between the US and China in their trade war. Even as I was writing this market update the situation was changing. Nevertheless, the dynamics of the trade war have not changed.

It is not just Trump and Xi playing chicken in trade negotiations (as expected). Investors are also playing chicken with the stock markets, based upon possible outcomes of the trade negotiations. They are primarily betting that the trade negotiations will have a positive outcome. Common statements from investors and market pundits are: “Trump needs to finalize a deal before the elections,” “Trump is just looking for a superficial deal, even a minor win,” “China needs a deal to bolster its faltering economy,” and many other platitudes.

So far, investors have failed to fully account for the possibility of failed talks between the US and China. The S&P 500 has pulled back almost 5% from its closing high of 2,945.83 on April 30th. It really has not pulled back a

S&P 500 - Technical Status

The S&P 500 recently reached an all-time high, but has pulled back from this level in the last two weeks. The stock market has entered its six-month unfavorable period (May 6th to October 27th). The graph below shows three key levels of support. First, the old high in early 2018 (which the S&P 500 has now breached below). Second, 2800 which was previously a major level of resistance, as the S&P 500 failed multiple breach attempts in 2018. Third, 2600 which previously provided support in 2018. In 2018, a large number of shares traded between 2600 and 2800, as seen by the horizontal volume bars on the left of the graph. At this point, it would not be unreasonable to expect the S&P 500 to spend time in the 2600 to 2800 band over the next six months.



Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **April 30th,** 2019

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HXT	Horizons S&P/TSX 60™ Index ETF	4.4%
HXE	Horizons S&P Capped Energy ETF	11.1%
	Bond	
HFR	Horizons Active Floating Rate Bond ETF	9.9%
	United States Dollar Exposed Assets	
	Commodities	
UNG	US Natural Gas Fund LP	1.6%
	Equities	
HXS	Horizons S&P 500® Index ETF	53.3%
XLP	Consumer Staples Select Sector SPDR Fund	9.8%
	US Dollar Forwards (April 2019) - Currency Hedge **	-0.2%
	Cash, Cash Equivalents, Margin & Other	10.1%
	Total (NAV $265,166,608)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 83.4% 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.

lot compared to large corrections that have taken place in previous years. In other words, there may be more pain to come.

Betting on the trade talks- China has read Trump's book on negotiation

In my last newsletter I stated that when Trump said that trade talks were going well, they probably were going poorly and vice versa. Trying to bet on the trade talks is pointless. Really, no one knows when and if the trade talks are going to be resolved. The one thing that you can bet on is that the Chinese delegation has read Trump's book on negotiation. They know what to expect. They know how to position themselves and how to counter Trump's strategies. In the end, it makes for a volatile experience for everyone. Investors are starting to become more skeptical that the trade deal can be resolved satisfactorily for all parties. Initially, investors believed that Trump would settle for a superficial trade deal with a lot of self congratulations on his part. Investors expected the US-China negotiations to be a repeat of the NAFTA negotiations. But the old NAFTA deal and the current US-China trade relationship is totally different.

NAFTA was largely a "fair" deal that benefitted all parties and the new USMCA deal was by and large a "tweak" to the old deal. The current US-China trade relationship is totally biased towards China. In order to achieve a fair deal for the US, China has to give up a lot. It is doubtful that China will concede willingly. They may concede to terms that are time delayed (set to take effect after Trump leaves office). If a trade deal is signed, it is the fine print that it should be judged on.

In addition, the Chinese culture is very different than the Western culture. It is extremely important for the Chinese to "save face," even if they have to make concessions. Trump's negotiation style is not very conciliatory, and so far Trump has not made any plans to change his aggressive style.

Even if a trade deal is signed in the next few weeks, the market may only rise in the short-term. World wide growth is slowing down, earnings are weak and the stock market is entering its six-month unfavorable period. This is not a good back drop for the stock market to perform well over the next six months.

It is possible that somehow the US and China manage to bandage a trade deal together. If it happens it will probably be one that takes a few years before it is fully implemented. The stock market could have a short-term rally up to 3,000 and maybe higher. It is doubtful that the Chinese will be fully compliant with any trade deal. It is more likely that they will pay lip service, make some adjustments, and then drag their feet on the implementation. In other words, there is no "blue sky" ahead where a switch is flipped, everyone is happy and the stock market moves relentlessly higher.

Sell in May and Go Away – Is the stock market going to get a parking ticket?

Recently, the S&P 500 set all-time highs, but this year it could get a parking ticket in the six-month unfavorable period for stocks which lasts from May 6th to October 27th (Sell in May period). Why a parking ticket? Its all about odds. Most of us speed just a bit in our cars and seldom get caught. Parking is different. Park illegally and your chances of getting caught are fairly good, not 50/50, but the combined effect of a large fine and a good chance of getting caught deters most drivers.

In the six-month unfavorable period for stocks (May 6th to October 27th), from 1950 to 2018, the S&P 500 has produced a geometric average loss of 0.2%. A lot of pundits have mistakenly assumed that because the S&P 500 has been positive for most of the "Sell in May" periods it is therefore a good time to be in the stock market. From 1950 to 2018, the S&P 500 has been positive in the six-month unfavorable period 63% of the time. By focusing just on the fact that the S&P 500 has been positive most of the time, they are ignoring the risk side of the equation. It is the risk of large losses that is the concern. Does it really matter if small gains are made more than half of the time and then a big loss occurs? Of course it does. All of your gains and then some can be wiped out.

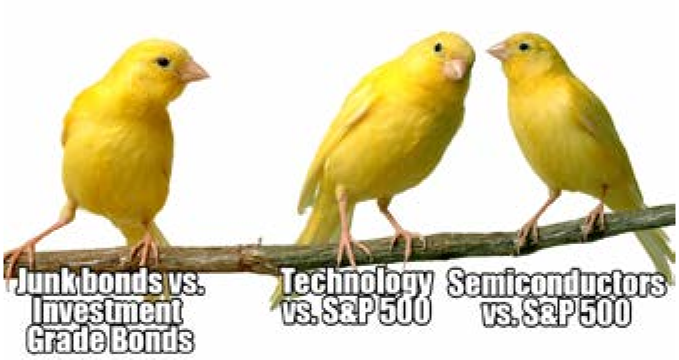
This is akin to parking illegally. Most of the time you can park your car illegally and not suffer any consequences, but periodically a large parking ticket will make you think twice about parking illegally in the future. Sometimes, drivers will try to ascertain the variability of the risk of getting a parking ticket. Although they have already calculated that overall the risk of parking ticket is too high to take a chance on average, they will occasionally make a decision to take the risk based upon the fact that the perceived risk is reduced because of specific circumstances. For example, fewer parking attendants working on weekends or the occurrence of rain making it less desirable for parking attendants to be outside. In the end, there might be some adjustment to risk levels, but usually it is still not worth parking illegally.

Although stock market pundits every year look for exceptions to the “Sell in May” phenomenon, and argue that “this time is different, this is probably not the year for an exception.”

The world economy is slowing. The recent parade of negative economic reports does not indicate world wide growth. The US and China, coincidently have both had some positive economic reports, but even positive economic reports in these two major countries is suspect. In the first quarter of the year, China substantially increased the liquidity in its financial system. This had a positive effect on the Chinese economy, but given the size of the increase, it would have been expected that the Chinese economy would have had a stronger positive reaction, like it did in the summer/autumn of 2015. China has also indicated that it is pulling back on its credit expansion. It is concerned that the shadow banking system will once again reassert itself.

The US has recently had strong GDP and Nonfarm Payroll reports. Investors should be careful reading too much into these reports. The Nonfarm Payroll figure had a very positive beat of 283,000 jobs created in April, which was higher than expectations. Nevertheless, do not read too much into the reports as the PMI numbers have generally been weaker than expected.

Checking in on the canaries



Last month I featured three canaries on the front page of my newsletter as early warning signals that the stock market might be in trouble. After a few comments from subscribers, I thought I would clear up the canary analogy. In times past, coal miners used to carry canaries into the coal mine with them in order to detect carbon monoxide which in high amounts is lethal to humans. If above normal amounts of carbon monoxide were present in the coal mine, the canaries because of their small size, rapid heart rate and higher metabolism would die before the coal miners succumbed (sorry animal activists, but that is the way it was). Coal miners would then know to vacate the coal mine before they were in jeopardy.

In my last newsletter, I used three canaries to help determine the health of the stock market: junk bond performance relative to the investment grade bonds, semiconductors relative to the stock market and the technology sector relative to the stock market. At the time, junk bonds were underperforming corporate investment grade bonds and the trend remains. Both the semiconductor and technology sectors were outperforming the S&P 500, which is in an indicator of positive stock market momentum, but circumstances have now changed.

Junk bond performance relative to Corporate Investment Grade Bonds - Canary #1

Currently, junk bonds are underperforming investment grade bonds. This is an indication that bond investors do not have a healthy outlook for the economy. When equity investors disagree with bond investors, it is usually bond investors that are correct. So far, the divergence is not huge. Nevertheless, this canary continues to tweet caution.

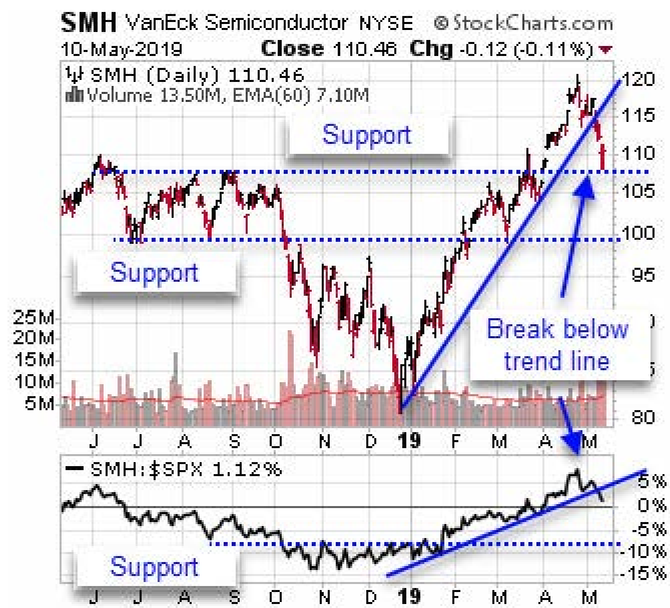
Technology vs. S&P 500 - Canary #2

The technology sector has led the stock market over the last two years. When it falters, investors should pay attention; it is likely a sign of stock market trouble ahead. When a market leader starts to underperform the broad market, it typically represents a shift in investor sentiment. We witnessed this phenomenon in October of 2018. After a two year long stretch of out performance relative to the S&P 500, the technology sector started to underperform the S&P 500 in October 2018. The stock market crashed shortly afterwards. I discussed this in my November newsletter. For details click [here: https://www.alphamountain.com/site/wp-content/uploads/2018/11/Thackray_Newsletter_2018_11_November.pdf](https://www.alphamountain.com/site/wp-content/uploads/2018/11/Thackray_Newsletter_2018_11_November.pdf)

Currently, the technology sector has started to show weakness on an absolute basis and has broken its upward trend line. On a relative basis, the technology sector has also broken its upward trend line, indicating underperformance. As such, once again, we can expect the stock market to stumble in the near future. At this time, investors should consider being more cautious. The technology sector has tweeted its warning.

Semiconductors vs. S&P 500- Canary #3

The semiconductor sector has similar performance compared to the technology sector, but there are some differences. The semiconductor sector started to outperform the S&P 500 early in the 2019. Despite weak guidance and less than stellar earnings, the sector managed to keep outperforming the S&P 500 into April. In late April, the sector started to correct and underperform the S&P 500. The semiconductor sector tends to attract a lot of speculative money, when it starts to underperform, it is a sign that the speculative investors are starting to leave the game. The semiconductor canary has tweeted its warning, confirming the warning signal from the technology sector: it would be wise to consider becoming more cautious at this time.



What the HAC is going on?

At the beginning of April, HAC was fully invested in equities. Towards the end of month, HAC started to reduce its equity exposure, but was still mostly invested in equities. Overall, equity holdings were skewed towards the US. The largest sector weight was the energy sector. Up until mid-April, the energy sector performed well. HAC started to exit its position in the energy sector in mid to late April as the sector started to show weakness.

Seasonal Opportunities

Consumer Staples - Starting to show relative strength

The consumer staples sector has a strong seasonal period from April 23rd to October 27th.

The consumer staples sector tends to be one of the better performing sectors over the six-month unfavorable period for stocks (from May 6th to October 27th). Nevertheless, investors should realize that if the stock market corrects sharply, the consumer staples sector will probably correct as well, but typically not to the same degree as the overall stock market.

After performing at market since late January, the consumer sector started to outperform in April. Investors are generally attracted to this sector in times of higher stock market volatility.

My Call: The consumer staples sector will probably outperform the S&P 500 over the next six months, with most of the outperformance occurring in October, when the sector tends to be one of the strongest sectors of the stock market.

Health Care - Recovering

The health care sector has a strong seasonal period from May 1st to August 2rd.

Similar to the consumer staples sector, the health care sector will typically correct if the stock market corrects sharply, but not by as much. Although the health care sector is considered a defensive sector, it can be driven by political sensitivities, particularly around elections.

After strongly outperforming the S&P 500 for most of the 2018, the health care sector started to underperform the in 2019. The sector's underperformance was exasperated by some vocal left-wing politicians making headlines with their claims that everyone should have free health care.

My Call: The health care sector will probably outperform the S&P 500 over the next two months.

Biotech - Upcoming seasonal trade

The biotech sector has a strong seasonal period from June 23rd to September 13th, with the sweet spot of the seasonal trade occurring in July.

Currently, it is too early for the biotech seasonal trade. It is one of my favorite trades with a high success rate. This trade should be monitored for the possibility of an early entry. I will write about this trade more in my next newsletter.

US Government bonds - Opportunity ahead?

US government bonds have a strong seasonal period from May 6th to October 3rd. The seasonal sweet spot is in August and September. On an absolute basis, US government bonds have performed well in 2019. Relative to the S&P 500 they have lagged. Nevertheless, they represent a good opportunity for a seasonal position at this time. Although they have broken their steep upwards trend line, US government bonds could still move higher from this point, especially given the increased volatility in the US stock market.

On the margin, investors tend to seek positions with less risk in the six-month unfavorable period for stocks which lasts from May 6th to October 27th. US government bonds tend to perform well for most of this period as they benefit from the shift to less risky investments.

US Government bonds were one of my top picks recently on BNN Bloomberg Market Call on Thursday May 9th. For details, click [here: https://www.bnnbloomberg.ca/brooke-thackray-s-top-picks-may-9-2019-1.1256477](https://www.bnnbloomberg.ca/brooke-thackray-s-top-picks-may-9-2019-1.1256477)

My Call: US government bonds will probably rise in June, pause in July and then once again perform well in August and September.

REITs - Starting to show strength

REITs have a strong seasonal period for May 20th to September 20th.

REITs tend to perform relatively well in a slow growth environment and with interest rates range-bound or declining. The current North American economy is well suited for REITs. If the stock market corrects sharply, REITs will probably be dragged down with the rest of the market, particularly if there are concerns about a dramatically slowing economy.

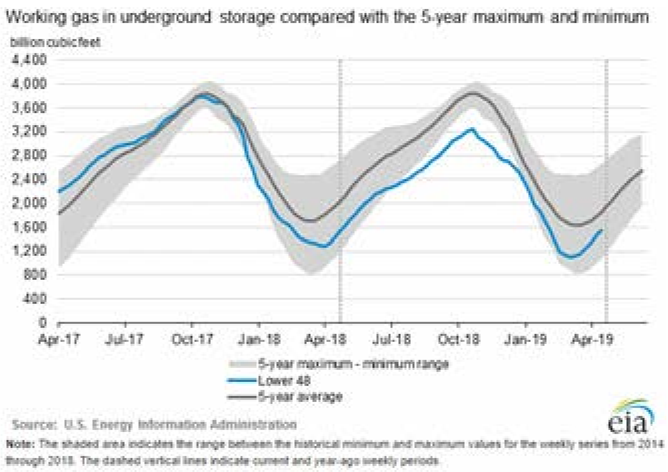
Currently, REITs are showing strength on an absolute basis. On a relative basis, REITs have been performing at market since the beginning of the year, but since late April, the sector has shown relative strength as the overall market has stumbled.

The Canadian REIT sector was one of my top picks recently on BNN Bloomberg Market Call on Thursday May 9th. For details, click [here: https://www.bnnbloomberg.ca/brooke-thackray-s-top-picks-may-9-2019-1.1256477](https://www.bnnbloomberg.ca/brooke-thackray-s-top-picks-may-9-2019-1.1256477)

My Call: Over the next few months REITs will probably provide positive returns as stock market volatility increases.

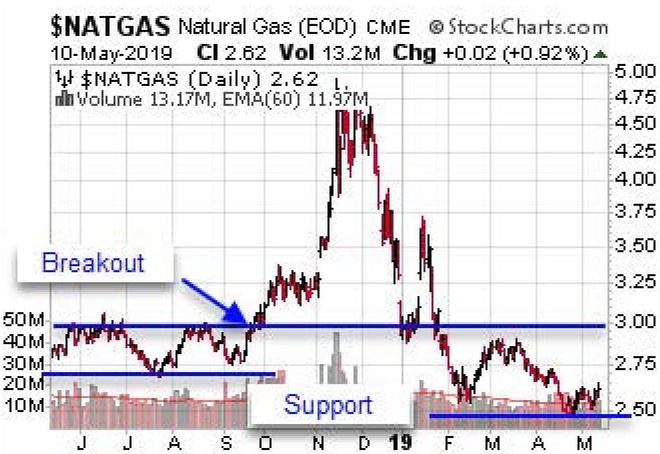
Natural Gas - Fading or Re-igniting?

Natural gas has a strong seasonal period from March 22nd to June 19th.



After having a very good seasonal period from early September to December, natural gas has so far stalled in its current seasonal period form March 22nd to June 19th. The trade is well supported by low inventory levels of natural gas in the US, which are currently below the five year average (see graph above).

The large supply of natural gas coming onto the market has curtailed the price of natural gas from moving higher.



My Call: Natural gas currently looks to be bouncing off a base at $2.50 and could rally to $2.75 spot price over the next few weeks. Natural gas gains within its seasonal period are probably limited at this point.

Gold - Seasonal period not here yet

I have included gold in this report as it is making the headlines with the current geopolitical situation and the US-China trade deal negotiations. Gold might be tempting, but it is not in its seasonal period.

After performing well on an absolute basis at the beginning of the year into February, gold has pulled back with lower highs and formed a descending bearish triangle.

The next seasonal period starts in July. Although it is possible for geopolitical tensions to push gold higher, seasonal trends support a better entry at a later point in time, closer to the start of the seasonal period for gold.

My Call: Gold will probably break lower before representing a good buying opportunity in July.

Energy - Seasonal period over

The energy sector has a primary strong seasonal period- from February 25th to May 9th, which has now finished. The next seasonal period for the energy sector is from July 24th to October 3rd. Although this seasonal period is not as strong as the primary seasonal period, very often if the sector has had a multi-month period of underperformance coming into this seasonal period, the sector can set up for a good seasonal trade. Something to watch out for in the future as the July seasonal period approaches.

Currency Corner

The Canadian dollar is in a longer term down trend relative to the US dollar. April is usually a strong month for the Canadian dollar, but this year the Canadian dollar was slightly negative in April. The Canadian dollar not performing well in its seasonal period, could be an indication that further weakness is ahead. On Friday May 10th, it was reported that the Canadian economy produced 106K jobs in April. Investors should be careful in using this number to judge the strength of the Canadian economy. It is often very "lumpy," and can reverse direction the following month.

Currently, the seasonal trend favors the US dollar as May is one of the stronger months of the year for the US dollar. The Canadian dollar is in a downtrend relative to the US dollar with a trading channel that started in late 2017.

Brooke's Rant

Beyond Greed

I may not be a burger coinsurer, but I cannot figure out how in the world, Beyond Meat which just went public is worth over 40x sales. To put this in perspective, Amazon has a price to sales ratio of less than 4. And for another more direct comparison, Tyson Foods has a price to sales ratio of less than 1. Why does Beyond Meat deserve a 40 multiple on sales, it doesn't make sense? This "anomaly" is difficult to take advantage of as it is very expensive to short the stock. Last week there were reports that some investors were being charged 100% p.a. to short sell the stock.

Sure, there are some differences between veggie burgers, but in the end they are a commodity, a food product. There is currently competition and there will be more competition in the future. Burger King plans to launch its "Impossible Burger" shortly. I love how the dramatic names make the burgers seem so special. I also love how pundits state that the market will grow and Beyond Meat will be able to get the lion's share of the market – good luck. In a few years there will be a large number of veggie burgers in the grocery stores and the price to sales ratio of the veggie burger companies will be relatively close to one another....but not at 40x.

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