Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

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Market Update

Recession Party….is it ending?

The recent stock market rally has been largely predicated on the belief that the Federal Reserve will implement an aggressive rate cutting schedule. The Federal Reserve has been communicating its inclination to reduce its federal funds rate based upon weak global economic data and weaker than expected economic data in the US.

Many investors are cheering the stock market higher with each release of weak economic data. Investors are having a recession party. As more weak economic data is reported, the greater the chance that the Federal Reserve will cut interest rates. Right now, it does not matter if economy is inching closer to a recession, all that matters is that the Federal Reserve is cutting rates. Bad news is good news.

It is possible that this relationship could go on for an extended period of time, especially if the Federal Reserve is able to negotiate a path that does not lead to a recession.

On the other hand, if the economy deteriorates at a rapid

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S&P 500 - Technical Status

The S&P 500 has broken to new all-time highs. Technically, that is a good thing. The problem is that volume has been declining as the stock market has climbed higher. Declining volume means that investors lack conviction. The S&P 500 has been trying to break the psychologically important level of 3,000, after previously breaking above resistance at 2950. A break back below 2950 will have investors calling for a quadruple top. Currently, the S&P 500 is overbought according to RSI, but it has not shown any signs of turning down. It can remain overbought for an extended period. Nevertheless, investors need to be cautious at this time as we approach the two worst contiguous months of the year for the S&P 500: August and September.

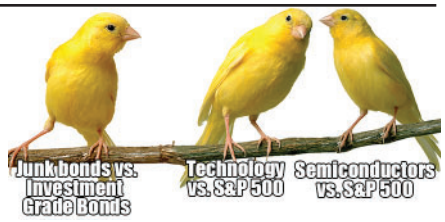
Horizons Seasonal Rotation ETF (HAC : TSX)
Portfolio Exposure as of **June 30th,** 2019

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
HCRE	Horizons Equal Weight Canada REIT Index ETF	7.8%
	Bond	
HFR	Horizons Active Floating Rate Bond ETF	17.6%
HBB	Horizons CDN Select Universe Bond ETF	3.9%
	Commodities	
HUG	Horizons Gold ETF	4.0%
	United States Dollar Exposed Assets	
	Short Term & Bond	
HTB	Horizons US 7-10 Year Treasury Bond ETF	24.5%
DLR	Horizons US Dollar Currency ETF	24.0%
HUF	Horizons Active US Floating Rate Bond (USD) ETF	1.1%
	Equities	
XLP	Consumer Staples Select Sector SPDR Fund	9.3%
IBB	iShares Nasdaq Biotechnology ETF	5.0%
	US Dollar Forwards (July 2019) - Currency Hedge **	1.0%
	Cash, Cash Equivalents, Margin & Other	1.9%
	Total (NAV $274,070,037)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 93.8% 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.

3 Canaries



Below is an update on the three canaries that I have written about in my past newsletters. There are many different indicators to measure investment sentiment. The three canaries provide a different insight and can help in determining when the market may turn lower.

Junk bonds vs. High Quality Corporate Bonds

Junk bonds have been underperforming high quality corporate bonds since last October. In other words, bond investors are not buying into the stock market rally. Junk bonds have been underperforming in some periods when the stock market has performed well, such as June. This trend can continue, but it is a concern. Over the long-term, bond investors are right more often than stock market investors...time will tell.

Technology - Leading the stock market higher for now

The stock market has been led by the technology sector over the last few years. When this sector cracks, the bull market is probably over. ❶ Technology led the S&P 500 lower. ❷ Technology led the S&P 500 higher ❸ Technology led the S&P 500 lower ❹ Technology led the S&P 500 higher. Watch for the relative strength line to break lower = market in trouble

Semiconductors - Early warning signal

The semiconductor sector is an early warning signal for a possible market turn down. ❶ Semiconductors started to underperform the S&P 500 before technology ❷ Semiconductors started to outperform the S&P 500 early compared to technology ❷ Semiconductors turned down at same time as technology (no early warning) ❹ Semiconductors started to outperform the S&P 500 early compared to technology.

pace, it will not matter if the Federal Reserve cuts rates or not. Investors will stop cheering the Federal Reserve cuts and realize that the economy is slipping into a recession. The consequences for stocks in all likelihood will be negative. At some point, investors will treat bad news as bad news. It is hard to tell when this will happen, but the consequences can be severe.

We live in surreal times. The economy is currently experiencing an extended period of expansion. The unemployment rate is at forty-nine year lows. And the Federal Reserve is seriously contemplating embarking on a rate cutting program.

Whatever rate cuts do happen in the future are still going to have a one to two-year delay before they impact the economy. With the economy still strong, the Federal Reserve has portrayed the next possible cut as an insurance cut, as they have indicated that they want to take action before significant damage is done to the economy.

Knowing when to leave the recession party is difficult as the party rolls on and the stock market moves higher. Investors should be cautious at this time as something might trigger a sentiment shift and everyone will try to leave the party together. It is always difficult to predict the event that could trigger investor's souring on the stock market.

From a seasonal perspective, the stock market is in its six-month unfavorable period (May 6th to October 27th) when there historically have been only a few large gains. Since 1950, the S&P 500 has only produced a return of 10% or greater, eight times (all coming off recessions or periods of extremely weak economic growth). We might be heading into a recession, but we are definitely not coming off a recession. By the way, the S&P 500, in the other six months of the year (favorable period, October 28th to May 5th), since 1950 has produced returns of 10% or greater, twenty-eight times.

In comparison, looking at losses instead of gains in the same yearly period, the S&P 500 has produced a loss of 10% or greater eight times in its unfavorable six-month period. This compares to the favorable period which has only produced a loss of 10% or greater twice.

Do the seasonal trends mean that the recession party will end within the next few months. No. But they do indicate that there is probably limited upside in the stock market at this time, despite the recession party. And if the party were to end, there is a higher likelihood that the stock market correction could be deep.

Investors should remember that the last two times that the Federal Reserve cuts interest rates (2001 and 2007) the stock market peaked (to be discussed in August newsletter).

It is easy to stay too long at a party. In the now famous words of Chuck Prince, CitiGroup CEO, July 2007, "as long as the music is playing, you've got to get up and dance. We're still dancing."

We all know what happened not too long after Chuck Prince's statement.

Right now, investors are dancing at a Recession Party, celebrating the possibility of a recession. The Recession party can end at any time. Be careful how long you dance.

What the HAC is going on?

In June, HAC was largely in fixed income. The fund continued to hold an equity position in consumer staples. Mid-month the fund entered into a position in gold bullion. Also, mid-month, the fund entered into a position in the biotech sector. By the end of June, the fund had increased its equity holdings, but was still largely in fixed income.

Seasonal Opportunities

Biotech – Consolidating

Biotech has a seasonal period from June 23rd to September 13th (Thackray's 2019 Investor's Guide).

In its strong seasonal period, since 1992, the biotech sector has performed well on an absolute basis and relative to the S&P 500. In its seasonal period from 1992 to 2017, the biotech sector has been positive 85% of the time, produced an average gain of 11.6% and outperformed the S&P 500, 88% of the time.

Currently, on an absolute basis, the biotech sector is at the mid-point in its trading range. It has a support level that is not too far below. It also has room to run with a gap to resistance above. What is more important on a technical basis is that biotech has been consolidating relative to the S&P 500 since April. A consolidation pattern is often a good basis for a positive move in a seasonal period. Currently, the trade is well setup from a seasonal basis. Nevertheless, if the consolidation trend breaks to the downside, consideration should be given to exiting the trade.

On average, over the long-term, the strongest month of the year for the biotech sector has been July, which is the sweet spot of the seasonal trade.

The biotech sector performed very well just before the start of its seasonal period, but more recently has been suffered as Trump has been pushing more transparency in drug prices, including forcing drug companies to show

drug prices on TV. He has also threatened to use executive action to push through changes. As a result, the sector in the last few days has been underperforming the S&P 500. At this point it has not had a technical breakdown.

My Call: The biotech sector will probably consolidate further relative to the S&P 500, but manage to outperform the broad index into August.

Gold Bullion – More shine left?

Gold bullion has a seasonal period of strength from July 12th to October 9th, with the sweet spot of the trade being in August and September (Thackray's 2019 Investor's Guide).

As central banks around the world have pledged to act "dovishly," gold has benefitted. As interest rates have fallen, the opportunity cost of owing gold has fallen, making it more attractive. When interest rates are low, investors are more inclined to own gold.

Gold has essentially gone nowhere over the last six years. It is the same price today as it was in 2013. Of course it did not flat-line over the last six years. From 2013, it worked its way lower, until 2016. Since that time, it has risen in fits and starts. Up until 2019, gold had a ceiling of$1360-$1380. When it reached this level, it turned down. The subsequent low was generally higher than the previous low. This technical pattern is called an ascending triangle and is considered a bullish pattern. In June 2019, gold broke above its resistance level and has so far managed to stay above this level. It would not be surprising to see gold once again test its previous resistance (now support). This often happens before a more sustained move higher.

Many investors have seen the recent rally in gold and proclaimed that it has moved up too far too fast. It is important to remember that commodities are very different than the overall stock market. It is not too many years ago that the price of oil moved from $40 to $138.

The seasonal period for gold starts in early July and lasts until early October. Although gold is a worthwhile seasonal trade, commodity trades, including gold bullion tend to have a large dispersion of returns in their seasonal period. In other words, in the past, gold bullion has produced both large gains and losses in its seasonal period. Nevertheless, we are on the doorstep the of strong seasonal period for gold, which combined with favorable technicals could make for a good gold trade this year.

My Call: Gold bullion will probably consolidate over the next few weeks and then outperform in August and September.

Gold or Gold Miners?

The seasonal period for gold miners starts on July 27th and lasts until September 25th. The sweet spot for the trade is August and September (Thackray's 2019 Investor's Guide).

Gold or gold miners? It depends on the stock market. If gold is moving higher and the stock market is ripping higher, then gold miners are typically the preferred choice.

Gold miners get the most attention from investors, for the simple reason is that they are stocks. Despite their familiarity with stocks, investors should understand the different drivers affecting both gold bullion and gold miners. This is particularly important at this time of the year.

Gold miners are generally a leveraged play on gold bul-

lion, with the overall stock market strength an important influencer. The following diagram illustrates, in very general or approximate terms, the relationship between the stock market direction, gold bullion direction and gold miners. The bottom line is that consideration should be given gold bullion as a base and it is believed that the stock market is going to perform positively, then layering on gold stocks can be considered.

	S&P 500 Strong Rally	S&P 500 Weak Rally	S&P 500 Weak Correction	S&P 500 Strong Correction
Gold Rally				
Gold Miners	↑↑↑	↑↑	↑	↓
Gold Correction				
Gold Miners	↑	↓	↓↓	↓↓↓

↑↑↑Strong Rally ↑↑Moderate Rally ↑Weak Rally

↓↓↓Strong Correction ↓↓Moderate Correction ↓Weak Correction

The performance of gold miners is not too dissimilar to gold bullion over the last six years. Other than a blow-off top in 2016, gold miners are priced at the same level they were in 2013/14.

Energy – Possible trade coming up

The energy sector has a secondary seasonal period from July 24th to October 3rd. Although this trade is not as seasonally strong as the main energy trade that lasts from late February into early May, it is worth consideration, especially if the energy sector has corrected before the start of its seasonal period (Thackray's 2019 Investor's Guide).

Since May of last year (after a strong seasonal period from February 25th to May 9th) the energy sector has performed poorly, producing an absolute loss and has underperformed the S&P 500. The sector has continued to underperform the S&P 500 even in June when the price of oil was increasing. In July, the energy sector has continued its underperformance.

On a technical basis, this is a decent setup for the next seasonal period from July 24th to October 3rd. Although the energy sector is "looking good" coming into its seasonal period, there are two caveats. First, if the stock market has a major correction, the energy sector will probably suffer. Second, after the next seasonal period finishes, the sector typically performs poorly for most of October and into December.

My Call: The energy sector will probably moderately outperform the S&P 500 for most of its upcoming seasonal period, but start to correct in September.

US Government bonds - Still some more seasonal juice left !

US government bonds have a strong seasonal period from May 6th to October 3rd. The sweet spot for the seasonal trade is August and September. Canadian government bonds have a similar seasonal period (Thackray's 2019 Investor's Guide).

Government bonds have performed well since late 2018. They performed well in May when the stock market was preforming poorly and in June when the stock market was rallying. Bond investors have a pessimistic view of the economy and are looking for a further slowdown.

The question is, can bonds continue to perform well given

their substantial run. Yes. The sector may have some consolidation, but it is still possible for government bonds to perform well. The sweet spot (the best part) of the seasonal trade for government bonds is in August and September. It would not be surprising to see government bonds consolidate at this level, or even give back some of their gains.

My Call: US government bonds will probably consolidate over the next few weeks before moving higher in August and September.

Canadian REITS –

Canadian REITs have a strong seasonal period from May 20th to September 20th

Canadian REITs have performed relatively well so far in their seasonal period. Since April they have been forming a bullish ascending triangle pattern with higher lows.

On July 10, Poloz reaffirmed the BoC position to stay put on interest rates until further evidence of a deteriorating economy. In the short-term this could impact Canadian REITs negatively, but at the current time there is no evidence that the sector is breaking down.

My Call: Canadian REITs will probably consolidate at this point and then moderately outperform the TSX Composite in August and the first part of September.

Utilities - Still some spark left

The utilities sector has a strong seasonal period from July 17th to October 3rd (Thackray's 2019 Investor's Guide).

The utilities sector has performed well since late 2018. Its major period of outperformance was in the fourth quarter of 2018, when the stock market was performing poorly. As interest rates have decreased, bond proxies, including utilities have performed well.

My Call: The utilities sector will probably moderately outperform the S&P 500 in August and September.

Technology - Not seasonal but worth a comment

Live by the sword, die by the sword...live by technology, die by technology...investors will remain in the technology sector until the end

The technology sector has been the leader of this bull market; when the sector starts to underperform the stock

market it will be a good indication that this stage of the bull market is in jeopardy. A lot of investment pundits proclaim that when technology fades, another sector of the market will takes its place, such as value, and the market can continue to trudge higher. This is highly unlikely. Sure, after the next correction, or even in the next correction, value may be preferred part of the stock market. But if investors truly believe the stock market is moving higher, they will rush back into the technology sector, where they have made their money.

The absolute performance of the technology sector is good to watch for signs of market weakness, but relative performance to the stock market is better. The level that would demonstrate that investors are losing faith in the stock market is the line connecting the tops of the relative strength of XLK (technology) vs the S&P 500, from June 2018 to October 2018 and also the June low of this year. If this level is broken, there will probably a serious risk of the stock market rolling over. I have also included the relative strength line at the next level lower, which was low point at the beginning of this year. If this line is broken, then it will be a very strong indication that investors have lost faith in the technology sector and hence the stock market.

Short Sells for Pair Trades

Small Caps

Small caps have a seasonal weak period from July 1st to August 13th. Seasonal strength can extend into October.

Small Caps have been underperforming large caps since July of last year. It is interesting to note that in this downtrend period, the sector was positive and outperformed the large cap sector in its seasonal period of strength from mid-December to early March.

It is also interesting to note that the small cap sector has been underperforming the large cap sector while the US

dollar has been rising in value relative to world currencies. Typically, a stronger dollar favors the small cap sector as small companies generate much more of their earnings domestically. This is a positive for a short sell of the small cap sector because if the US dollar does start to drop in value, this would put further pressure on the small cap sector.

Technically, the sector is at the top of its trading channel. It has not been able to break this level twice this year. If the broad stock market turns down, it is likely that the small cap sector will turn lower and underperform large caps. On a price momentum basis, the RSI is neutral, but the full stochastic oscillator has turned down from being overbought. Overall, the sector looks to be losing momentum just as it has hit resistance at the top of its trading channel.

Transportation- Driving off the road

The transportation sector has a weak seasonal period from August 1st to October 9th (Thackray's 2019 Investor's Guide).

The transportation sector has a similar chart to the small cap sector. One difference is that on an absolute basis, the sector is a bit lower in its trading channel. The sector has been underperforming the S&P 500 since last October.

At this time it looks like the transportation sector is set to fall further (particularly if there is a short-term bounce in the sector). If it breaks the bottom of its trading channel, it is possible to see the sector go back to its levels at the beginning of the year. Given the persistent underperformance relative to the S&P 500, if the broad market rallies strongly, then the transportation sector could bounce strongly.

Industrials - Underperforming

The industrial sector has a weak seasonal period from June until late October.

The industrial sector underperformed the S&P 500 in 2018. This was largely the result of the US-China trade war that was developing. A brief rally of outperformance occurred as the stock market rallied at the beginning of 2019. Since March, the industrial sector has once again been underperforming. On an absolute basis, the sector is at the top end of its trading channel. From a price mo-

mentum perspective, the sector is losing momentum and is close to oversold.

Overall, the sector is still on the decline and seasonals point to continued weaker performance. The risk to the trade is if positive progress is made between the US and China on their trade war. Given that there has not been any announcements from the US since the G20 meeting and China is openly stating that the trade war is not on the verge of being resolved, the risk of a positive trade war development affecting a short sell of the industrial sector is diminishing.

Materials - Weak for an extended period of time

The materials sector has a weak seasonal period from May to September.

The materials sector has a similar technical profile as the industrials sector. The big difference is that the materials sector has underperformed the S&P 500 by a larger amount compared to the industrials sector.

On an absolute basis, the sector is just below its resistance level. The materials sector has been underperforming the S&P 500 since early 2018. In 2019, the underperformance has been at a more gradual pace, but sector has underperformed. Price momentum has been fading with the full stochastic oscillator registering an almost oversold level.

Homebuilders- Strong in weak seasonal period

Homebuilders have a primary weak seasonal period that last from April 27th to June 13th (Thackray's 2019 Investor's Guide).

Homebuilders have been outperforming the S&P 500 since last October. Typically, the homebuilders sector performs well from October into March. But the sector has continued to perform well in a period when it tends to underperform the S&P 500 from late April to mid-June. The main reason for its strong performance has been declining rates, reducing the cost of mortgages and benefitting the overall homebuilders sector. When the homebuilders sector starts to underperform the S&P 500, it will be a good indication that investors perceive that lower interest rates will have an increasing benefit to the economy.

Currency Corner

CADUSD - Showing strength ahead of seasonal period

The Canadian dollar has a secondary seasonal period from August 20th to September 25th. This trades has historically not been as strong as the April seasonal period, but it is still worth consideration (Thackray's 2019 Investor's Guide).

Although the Canadian dollar is in a multi-year downtrend (not shown in graph), the Canadian dollar has just broken its two year downtrend. It is also on the doorstep of breaking out of a double bottom pattern. A break above 0.77 would indicate a double bottom breakout. The Canadian dollar is currently setting up well for its August 20th to September 25th seasonal period. There is still some time before the trade takes place, but the trade needs monitoring.

Investors should not get too excited, as the US dollar has a seasonal period of strength from late September until mid-December.

My Call: The Canadian dollar will probably moderately outperform the US dollar over the next two months.

Brooke's Rant

To "0" and Beyond!

You can't make this stuff up. On Monday July 8, 2019, fourteen "junk" bonds (yes, junk) in the Eurozone traded into negative territory (Bloomberg). This is crazy. Investors are buying a bond from a company that has a more than a remote chance of going bankrupt in the future, and the kicker is if the investor holds the junk bond to maturity and the company does not go bankrupt, they will get back less money than they invested. Yes, they will lose money. Why are investors buying junk bonds with a negative yield? They believe that the ECB will buy private corporate junk bonds, as part of a quantitative easing program, as it has done in the past and drive rates even lower.

Why do investors believe that the ECB will take such an action? Because on Monday July 8th, 2019, ECB Executive Board member Benoit Coeure, said that "policy makers could "hypothetically" restart net asset purchases if circumstances make it necessary."

European investors were primed for such a statement when a couple of weeks previous, the outgoing President of the ECB, Dhragi, announced to almost everyone's surprise, that the ECB is thinking of embarking on another quantitative easing program. Dhragi is set to leave his office on October 31st of this year. He famously established his position as a dove in 2012 when he announced that the ECB would do "whatever it takes," to support the Eurozone. He does not want to leave the ECB with investors thinking of him as a hawk.

To put investors in even a greater mood to anticipate more dovish action by the ECB, Christine Lagarde the Chief of the IMF was recently nominated to take over from Dhragi on October 31st of this year.

Lagarde's first public words after her nomination clearly laid out her position. She stated that "negative interest rates in Europe and Japan are "net positives" for the global economy." Although she did state that the side effects of the policies should be closely monitored.

No one is arguing that the first round or two of QE was not needed, but there is a good argument that central banks got carried away with too many rounds of QE. Lagarde's statement is really disingenuous, as there has been significant collateral damage from negative interest rates.

To focus on just one example: Zombie Companies, which are increasing in numbers in the current low interest rate environment. Zombie companies can only pay their inter-

est expense and are not capable paying the principal on their debt. Negative yields and artificially low yields help these companies stay in business.

Badly managed companies should be allowed to go out of business. Period. To keep them alive is misallocation of resources in which everyone losses. When companies go out of business, their assets get redistributed, better management takes over and society benefits.

Trump does not want to be left out of the fun and has openly tweeted about his desire for lower interest rates, openly criticized Powell for not lowering rates, investigated whether he could dismiss Powell before the end of his term and has nominated dovish individuals for the Federal Reserve governor positions that have openly supported lower rates.

The world economy is slowing and central banks are ready to do "whatever it takes" to make sure that the economy keeps ticking along and hopefully avoid a recession. Governments will do their share of digging the hole deeper by increasing their debts with reckless spending. No politician wants to be the one that cuts spending in order to save for the future. That is someone else's problem. No central banker wants to be the one that stifled the economy with high interest rates or lack of money printing.

One way or another, central bankers are intent on helping the economy stay alive, and out of a recession. The preferred tool that is being increasingly referenced is "negative interest" rates. In the future, you will probably hear a lot more about NIRP (Negative Interest Rate Policy).

It is possible that the economy may be slipping into a recession. The economy may end up in a recession despite the Federal Reserve's "planned" interest rate cuts. Many parts of Europe are already slowing significantly, including Germany. If the US does enter into a recession, expect the Federal Reserve to take aggressive action. One way or another we are probably going to "0," and beyond... negative.