

Thackray Newsletter

— Know Your Buy & Sells a Month in Advance —

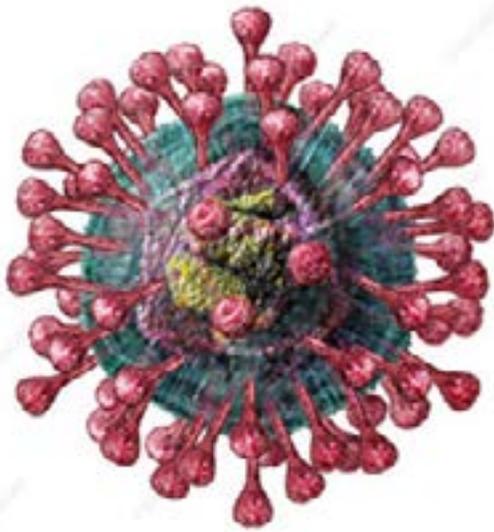
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Market Update

The stock market is not “immune” to a pullback in its favorable six-month period (October 28 to May 5). Pullbacks can happen at any time, but they have not happened as frequently in the favorable six-month period as they have in the other six-months of the year.



The stock market has been moving higher with mixed economic global economic signals. In this environment, typically a strong economic report will rally the stock market (unless it is perceived as causing the Federal Reserve to take action that does not favor the stock market). Recently, the stock market has been starting to show signs of reacting negatively to bullish news.

On Friday February 7th, the Nonfarm Payroll report came in at 225k, higher than the expected 160k, which should be bullish, but the stock market declined on the same day.

When the stock market declines on positive news, it is typically considered a sign of developing bearish sentiment. It is possible that investors are worried that the Federal Reserve may slow down their path of cutting their federal funds rate. Currently, investors have the odds at 82% that the Federal Reserve will cut its rate some time in 2020 (<https://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html>).

On the other hand, the stock market pulling back on positive news might be indicating that investors are starting to show concern over the spreading coronavirus.



S&P 500 Technical Status - All is good....but...

Recently, the S&P 500 has reached an all-time high. Technically, on a price pattern relationship, the S&P 500 is sound, as it is usually at all-time highs. Any serious trouble for the stock market could still be further out.

The “canary” sectors of the stock market: technology (XLK) and junk bonds (JNK) continue to perform well. The technology sector has received a boost from some “heavy weights” reporting better than expected earnings.

The one sector that could be signalling that the S&P 500 could stumble in the near future is the semiconductor sector (SMH). Recently, the sector has just broken below its upward trendline relative to the S&P 500. It may bounce back above the trend line, but this is a warning, watch for this sector to decline lower relative to the S&P 500, to indicate that the stock market is stumbling.

The technology sector (XLK) has been outperforming the S&P 500. When technology breaks below its trend line, it will probably indicate stock market trouble. When junk bonds break their upward trend line, it will probably be a sign that bond investors are turning negative on the economy, confirming a possible equity pull-back.

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

Symbol	Holdings	% of NAV
	Canadian Dollar Exposed Assets	
	Equities	
ZCN	BMO S&P/TSX Capped Composite Index ETF	15.8%
HXT	Horizons S&P/TSX 60™ Index ETF	15.2%
HEWB	Horizons Equal Weight Canada Banks Index ETF	9.2%
ZEB	BMO Equal Weight Banks Index ETF	3.9%
HXE	Horizons S&P/TSX Capped Energy Index ETF	2.5%
	Commodities	
HUZ	Horizons Silver ETF	2.0%
	United States Dollar Exposed Assets	
	Equities	
HXS	Horizons S&P 500® Index ETF	20.6%
VOO	Vanguard S&P 500 ETF	10.9%
IWM	iShares Russell 2000 ETF	6.2%
XLY	Consumer Discretionary Select Sector SPDR Fund	4.9%
FHD	First Trust AlphaDEX U.S. Consumer Discretionary Sector Index ETF	4.8%
XLE	Energy Select Sector SPDR Fund	2.3%
GDX	Vaneck Gold Miners ETF	2.1%
	US Dollar Forwards (Feb 2020) - Currency Hedge **	-0.7%
	Cash, Cash Equivalents, Margin & Other	0.4%
	Total (NAV \$341,627,649)	100.0%

** Reflects gain / loss on currency hedge (Notional exposure equals 85.9% 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.

Up until now, investors have largely remained unperturbed by the coronavirus with markets fairly complacent. The exception to has been some of the commodity prices including copper and oil, which have fallen in price. It is possible that investor sentiment is starting to shift and investors are becoming more nervous.

Although China was slow to acknowledge the coronavirus problem initially, they are taking very aggressive action and currently have over 45 million people in lock-down (<https://www.businessinsider.com/quarantine-history-following-china-wuhan-coronavirus-lockdowns-2020-1>). This is the largest quarantine in human history and is greater than the total population of Canada.

The fact that China is taking such aggressive action says something about how serious it considers the coronavirus. As of the time writing this report, 1,115 people have died from the coronavirus, more than from SARS in 2002-3. Currently, there are 45,131 confirmed cases of coronavirus. Researchers at John Hopkins University have produced an excellent website tracking the confirmed cases and deaths from coronavirus <https://gisanddata.maps.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd-40299423467b48e9ecf6>.

The problem is that reported numbers may be understated as many people may have been improperly diagnosed in an overly taxed medical situation. In addition, China has a reputation for not telling the truth in much of its official reporting to the outside world and could be understating the actual number of infections.

The end result, is that investors are now starting to consider the fact that the coronavirus could have more of an economic consequence than first expected. Many analysts are now starting to take a look at the effect of supply chains being impaired.

Up until now, people have been comfortable to model this virus using SARS as a proxy. Now that we have passed the SARS death total, the analysis of this modelling will become less relevant. The next possible bump in concern will be if a western country starts to see an acceleration in the number of confirmed cases. If the US reports 100 cases and acceleratingworry is going to increase.

No one knows how the coronavirus situation is going to play out. We do not even know the origins of the virus. There is speculation that it came from a variety of sources including bats, snakes, pangolins (scaly anteater) and other possible sources. It is possible that the virus will fade soon. And it is possible that it will continue on its destructive course. No one knows.

The coronavirus situation is occurring in the middle of the

favorable six-month period for the stock market (October 28 to May 5). Over the long-term this period has strongly outperformed the unfavorable six-month period (May 6 to October 27). This has been true for many decades, including the most recent decade after the Great Financial Crisis (GFC).

In recent years, we have seen two sharp corrections in the favorable period. One in early 2016 and the other in late 2018. Both resolved to the upside with the favorable period being positive in both occasions. On average, betting on a sustained pullback in the stock market in its favorable period has not been a profitable venture.

The strong performance of the stock market in its favorable period does not mean that there will not be corrections. Corrections in the favorable time period are resolved to the upside far more often than in the unfavorable period. Since 1950, there have only been two instances of the S&P 500 producing a loss of 10% or greater in its favorable period.

There are options to controlling risk in the six-month favorable period for stocks. It is possible to stay invested, but take on less risk, or beta, than otherwise. It is also possible to take on less exposure to sectors of the stock market that would be disproportionately affected by the coronavirus. If this is the best path, attention must be paid to the development or resolution of the coronavirus situation with appropriate adjustments made depending on the developing path.

What the HAC?

In January, HAC was fully invested in equities. Major changes in the fund included, exiting gold mid-month, exiting technology late in the month, exiting US financials mid-month, initiating a position in Canadian banks, increasing the allocation to the Canadian stock market late in the month. Towards the end of 2019, HAC initiated its first small position in the energy sector. In January, HAC increased its position with another small tranche.

In addition, HAC postponed entry into some of the cyclical sectors, such as materials and industrials as the sectors failed to show increasing relative strength compared to the broad stock market.

Seasonal Opportunities

Financials –

The financial sector has a strong seasonal period from December 15th to April 13th

The financial sector started to rally relative to the S&P 500 in September as the yield on the US Treasury 10year note started to increase. The increasing yield favors the financial sector as the yield curve steepens, helping the banks with their net interest margin. Just after the start of the favorable season for US financials, the yield on the 10year started to fall. Recently, the financial sector has been underperforming as the yield on the 10year has been falling. Currently, the yield is at 1.59%, just above the level that it bottomed in September.

Now that the earnings period for the US banks is long past (mid-January), investor focus will be on the steepness of the yield curve, which will drive the relative performance of the US banks.

The US financial sector could become a favored sector if the fears of the coronavirus subsides and expectations for global growth increase.



My Call: The financial sector will probably moderately outperform the S&P 500 over the next month and a half.

Small Caps – Not working as the yield on the US Treasury 10yr is falling

The small cap sector has a strong seasonal period from December 19th to March 7th.

Typically, US dollar strength helps to support the small cap sector, as small cap companies generate most of their revenues domestically. This has not been the case recently– small caps are underperforming, as the US dollar has

been strengthening. Why?

The relative performance of the small cap sector compared to the S&P 500 is currently being driven by the yield on the US Treasury 10yr, or more accurately, by investor perceptions of future growth. The yield on the 10yr has been falling as investors have been anticipating slower global growth. Small caps are generally not as well capitalized as large caps and have overall lower credit ratings. When economic growth becomes a concern, small caps generally underperform.



My Call: The small cap sector will probably perform at market over the next month. If the yield on the US Treasury 10year trends lower, the small cap sector will probably continue to perform poorly and end its seasonal period early.

Consumer Discretionary –

The consumer discretionary sector has a strong seasonal period from October 28th to April 22nd

The coronavirus is ultimately not favorable for the stock market. The exception could be segments of the health care sector. Consumer spending has been stretched, but has remained strong. Retail has suffered as the bricks and

mortar stores have become disenfranchised. The hotels, restaurant and leisure sub-sector represents approximately 20% of the consumer discretionary sector and is vulnerable to the development of the coronavirus.

Up until now, the sector has largely been driven by the relative performance of Amazon. In October, the relative performance of the sector compared to the S&P 500 dropped as Amazon's results disappointed. In January, the sector received a lift as Amazon beat expectations.

Upcoming, the hotel, restaurant and leisure sub-sector may be the main driver of the sector, as it is at the whim of the virility of the coronavirus.



My Call: The consumer discretionary sector will probably perform moderately above market over the next two months.

Transportation –

The transportation sector has a strong seasonal period from January 23rd to April 16th

The transportation sector has been underperforming the S&P 500 since late 2017. Many investors have used the poor performance of this sector as a indicator of a possible economic slow down. So far, this has not played out as expected. Given, the poor performance of this sector, it is often best to wait for the sector to start to show strength before taking a position.



My Call: The transportation sector will probably moderately underperform the S&P 500.

Retail–

The retail sector has a strong seasonal period from October 28th to November 29th and then a second seasonal period from January 21st to April 12th



The retail sector has been underperforming the S&P 500 since last October. Typically, the retail sector preforms well in February and March. The sector performs well at this time, as it usually is good value after a weak January. On average, the sector is favored as expectations for positive economic conditions develop at the beginning of the year. So far, this has not happened this year and the sector

is underperforming as results from some retail operations have been worse than expected.

My Call: The retail sector will probably perform at market over the next month and a half.

Oil (West Texas Crude) –

West Texas Crude Oil has fallen from the top of its trading range at the beginning of the year. It is now at the bottom of its trading range. China consumes approximately 13% of the world’s oil. Recently, because of the coronavirus, China has reduced its consumption of oil by 20%, which has had a material impact on the price of oil.

The seasonal period for the oil starts in late February. It is possible that oil may bounce if the release of any positive economic news coincides with the beginning of its seasonal period.



My Call: The price of oil will probably get traction over the next month unless the coronavirus continues to have a material impact on economic growth.

Energy US–

The energy sector has a seasonal period from February 25th to May 9th. Like oil, it can start its seasonal rally earlier, especially if the sector been strongly underperforming.

The energy sector, has followed the price of oil lower in 2020. Like oil, the energy sector could bounce upon any positive economic news.



My Call: Like oil, the energy sector will probably find traction over the next two months.

Energy Canada –

The Canadian energy sector has a strong seasonal period from February 25th to May 9th. Like the US energy sector, the rally can start before the beginning of its seasonal period with positive economic news.



The Canadian energy sector has fallen on the drop in the price of oil in 2020. The good news from a technical stand point is that the sector has been forming a pattern of rising bottoms, which tends to be bullish. At this point, the sector needs to show some strength and bounce off its trend line.

My Call: The Canadian energy sector will probably find traction over the next two months and possibly outperform the TSX Composite.

Natural Gas –

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

The price of natural gas has been falling sharply since last December. It has broken support at \$2.00. A warmer than expected winter has pushed the price lower. The good news is that natural gas has a period of seasonal strength from March 22nd to June 19th, which is approaching. The current correction could lead to an ideal setup for natural gas in its next seasonal period.



My Call: Natural gas will probably stabilize at the current price or slightly lower before performing well starting in late February or early-March.

US REITs –

US REITs have a strong seasonal period from March 8th to September 20th

US REITs are driven primarily by two factors, economic conditions and interest rates. The REIT sector has a unique profile in that it tends to continue to perform relatively well as the stock market turns down on weaker economic growth expectations. Relative to other economically sensitive sectors, the REIT sector's weak performance is delayed. This is because the yield on the sector helps to dampen the sector's propensity to decline in weaker economic times.

If expectations of an economic decline continue to occur, then the sector can suffer. If expectations for economic growth contract substantially....watch out, the sector can play catch up on the downside.

In addition, the REITs tends to start to perform well relative to the S&P 500, ahead of the strong seasonal period for bonds, which have a strong seasonal period that starts in May. The REIT seasonal period starts in March, as the sector benefits on average from the expectations for stronger economic growth at time of the year.

In the graph below, REITs outperformed the S&P 500 in Q4 of 2018, as bond yields fell ❶. In 2019, REITs performed at market, as bonds yield continue to fall ❷. This would be expected as stock market was rallying strongly. In strong market rallies, REITs have difficulty keeping up, despite falling interest rates. In Q4 of 2019, REITs underperformed the S&P 500, as bond yields increased, as would be expected ❸. More recently, REITs are once again showing signs of outperformance as bond yields have been falling.



My Call: The US REIT sector will probably start to outperform the S&P 500 in mid-to-late-March.

Value – Can't get no respect

The value sector has a strong seasonal period from November 29th to January 6th and then another strong seasonal period from February 26th to April 19th

The value sector has been underperforming the S&P 500 for a long time (years). There have been brief periods of outperformance, but the sector underperformed in 2019 and more recently in 2020, has underperformed sharply.

The financial sector is the largest weight in the value segment of the stock market. If we do see a pickup in the 10yr bond yield, then the financial sector would be expected to outperform, which would help the value sector. In addition, the value sector has a relatively large weighting in the resource sector. If the resource sector starts to pick up this would help to boost the relative performance of the value sector.



My Call: The value sector will probably outperform starting in late February or early March, and continue to perform well until the end of April.

Industrials –

The industrial sector has a strong seasonal period from January 23rd to May 5th

The industrial sector has been underperforming the S&P 500 since late October. It is still in a downtrend. If expectations of economic growth become more positive, expect this sector to perform particularly well.

When a sector underperforms for an extended period of time before the start of a seasonal period, it typically becomes sensitive to any positive news. In this case, if the news stream becomes positive, it would be expected that the industrial sector would break its downtrend relative to the S&P 500 and start to perform well.



My Call: The industrial sector will probably start to outperform in early March.

Materials –

The materials sector has a strong seasonal period from January 23rd to May 5th



The materials sector has suffered a similar relative drop compared to the S&P 500, as the industrials sector and dropped sharply at the end of 2019. Once again, if a scenario of positive economic news develops, it would be expected that the materials sector would outperform. The materials sector has historically been one of the top performing sectors in the month of February since 1990.

My Call: The materials sector will probably gain traction at this point and moderately outperform the S&P 500 into April.

Gold

The seasonal period for gold is from December 27th to January 26th and can extend into late February with strong momentum. Gold's primary seasonal period is from July 12th to October 9th. The discussion below focusses on the current seasonal period.

Gold has recently finished its seasonal period. It was positive in its seasonal period and managed to outperform the S&P 500. It is possible that gold could provide somewhat of a hedge against the coronavirus becoming a pandemic, particularly if central banks are forced to lower interest rates. Nevertheless, it has finished its seasonal period. The next few months (up until July), tend to be weak for gold. Sure, gold can perform well, but it is no longer in its seasonal period.



Gold Miners –

Gold miners have two seasonal periods. The main seasonal period is from July 27th to September 25th and a secondary seasonal period from December 23rd to February 14th.

The gold miners sector is finishing its seasonal period this week. The sector has not been performing particularly well. It is possible, like gold, it could receive a boost if interest rates fall. Nevertheless, the sector is finishing its seasonal period at a time when its relative performance is faltering. Consideration should be given to exiting the sector in the near future.



My Call: The gold miners sector will probably start to underperform in the near future.

Silver –

Silver has a strong seasonal period from December 27th to February 22nd



On an absolute basis, silver has been on a downtrend and has been underperforming the S&P 500 since the beginning of the year. On a relative basis compared to the S&P 500, silver has been performing at market since last November. Given that it is almost at the end of its seasonal period, consideration should be given to exiting the sector in the near future.

My Call: Silver will probably underperform in near future.

Emerging Markets (Hedged) –

Emerging markets have a seasonal period that lasts from November 24th to April 18th

Emerging markets have underperformed the S&P 500 in 2019 and continue to underperform in 2020. I have written about this previously, but it is still worth noting that the emerging markets managed to outperform the S&P 500, when the S&P 500 was losing ground in Q4 of last year. In the graph below, I have used the hedged ETF, HEEM to take out the effect of the US dollar on the emerging market performance trend.

Given that more than one-third of the fund is invested in China, the emerging markets sector is not expected to pick up relative to the S&P 500 until investors anticipate better economic conditions ahead for China. This could happen in the near future, or be delayed, depending on the progress made against the coronavirus.



Stocks

TJX –

TJX Companies has a seasonal period from January 22nd to March 30th

The seasonal period for TJX has just started. TJX has been underperforming the S&P 500 since last October, but has recently just started to show some strength as its seasonal period started. Many apparel retail companies have been producing weaker than expected results in the current earnings season. This does not necessarily mean that TJX will be brought down by the trend. So far, this has not impacted TJX.



My Call: TJX will probably moderately outperform the S&P 500 in February and March.

Eastman Chemical –

Eastman Chemicals has a seasonal period from January 28th to May 5th

After underperforming the S&P 500 since last November, the seasonal period for Eastman Chemical has just started recently and Eastman Chemical has started to outperform.

From 1994 to 2018, Eastman Chemical has produced an average 12.7% gain and has been positive 88% of the time.

So far, in the current seasonal period, Eastman Chemical has been outperforming the S&P 500.



My Call: Eastman Chemical will probably outperform the S&P 500 over the next two months and finish its strong seasonal period early.

Currencies

Canadian dollar or US dollar –

The US dollar, has been outperforming the Canadian dollar since the beginning of the year. This lines up with the strong seasonal period for the US dollar which lasts from early January to mid-March.



The Canadian dollar has a strong seasonal period in the month of April, which has historically been the Canadian dollar's strongest month of the year.

Currently, the Canadian dollar is oversold and at support of \$0.75.

My Call: The Canadian dollar will probably bottom out somewhere between \$0.74 and \$0.75, and out perform the US dollar starting in the near future.

Brooke's Rant

The end of the boom bust cycle... Bob Prince

Recently, at Davos 2020, Bridgewater Co-CIO Bob Prince proclaimed that the boom-bust cycle was over. Unbelievably, he was not kidding (https://www.youtube.com/watch?v=Gg_rOQF9Y4Q).



I am going to add this statement to the my wall of “Crazy Statements” in my office. Every so often, central bankers and other key members of the financial elite say something that is absolutely ridiculous.

It is true that we are still in a record long expansion, but that does not mean that we will not have another bust again. The economic expansion from 2009 has been mediocre. Typically, coming off a recession the economy has multiple years of 4-5% GDP growth. That has not been the case this time around.

So, what has happened. The Federal Reserve and other central banks have decided that it is more important to stave off an economic slowdown at the cost of burdening society in the future. The costs have been huge, including costs to savers, pension plans, productivity in the economy and misallocation of resources.

As the economy stumbles in the future, the Federal Reserve and other central banks will continue with their modus operandi of lowering rates and quantitative easing. This will probably continue to buy their respective economies time, but it will not postpone the inevitable of a major recession– forever.

Central banks will probably receive help from their governments in delaying a major correction in the economy. Around the world, governments are already mobilizing their resources to dramatically increase fiscal spending. Of course this will help in the short-term. In fact, that is part of the problem. Society will view the temporary boost in the economy as a good thing and will want more. The governments will oblige and spend even more money. Government spending does not create long-term wealth, but it sure feels good in the short-term. The long-term consequences are a misallocation of resources, lower productivity, stagnation in the economy and the possibility of inflation.

The bottom line is that central banks and society have opted not to allow small forest fires take place over time and thus have opted for a large forest fire down the road. In the investment world, investors, such as Bob Prince, believe that central banks and governments will always have their backs and prop up the economy and markets at the first sign of trouble. The result is corporations borrowing too much money for non-productive uses and investors taking on too much risk. At some point, the actions of the central banks and governments will be ineffectual– they will be pushing on a string. It will not matter what they do, their actions will not work. Period. They will have run out of ammunition, or investors will have lost faith, or both. The result will be a major contraction in the economy and a major correction in the stock market.

The next major downturn may not take place for five or even ten years or longer, but there will be a bust in the economy. Guaranteed.

So, Bob Prince you are wrong. I am right. Put that on your wall Bob!

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